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**UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

In re

VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., *et al.*,

Debtors and Debtors In
Possession.

- ☒ Affects All Debtors
☐ Affects Verity Health System of
California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital
Foundation
☐ Affects St. Francis Medical Center of
Lynwood Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center,
Inc.
☐ Affects Seton Medical Center
Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose
Dialysis, LLC

Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

Jointly Administered With:

Case No. 2:18-bk-20162-ER
Case No. 2:18-bk-20163-ER
Case No. 2:18-bk-20164-ER
Case No. 2:18-bk-20165-ER
Case No. 2:18-bk-20167-ER
Case No. 2:18-bk-20168-ER
Case No. 2:18-bk-20169-ER
Case No. 2:18-bk-20171-ER
Case No. 2:18-bk-20172-ER
Case No. 2:18-bk-20173-ER
Case No. 2:18-bk-20175-ER
Case No. 2:18-bk-20176-ER
Case No. 2:18-bk-20178-ER
Case No. 2:18-bk-20179-ER
Case No. 2:18-bk-20180-ER
Case No. 2:18-bk-20181-ER

Chapter 11 Cases

Hon. Ernest M. Robles

**LIMITED OBJECTION TO ASSUMPTION
AND ASSIGNMENT OF EXECUTORY
CONTRACTS**

**[RELATES TO DOCKET NOS. 4069 and
4267]**

Date: April 9, 2020

Time: 10:00 a.m.

Place: Courtroom 1568, 255 E. Temple St.
Los Angeles, California 90012



1820151200401000000000004

AppleCare Medical Group, Inc. (“ACMG”), AppleCare Medical Group, St. Francis Inc. (“ACMGSF”), and AppleCare Medical Management, LLC (“ACMM” and together with ACMG and ACMGSF, “AppleCare”) hereby object to (i) the cure amounts set forth in the Notice to Counterparties to Executory Contracts and Unexpired Leases of the Debtors That May Be Assumed and Assigned, [Docket No. 4267] (the “Cure Notice”); and (ii) assignment of the Agreements (defined below) without the provision of information to AppleCare that provides adequate assurance that any prevailing bidder can perform under the Agreements.

In support of its objection, AppleCare states as follows:

I. BACKGROUND

1. ACMG and ACMGSF are independent physician associations that contract with health plans to serve their members through employed and contracted physicians (“Group Risk Agreements”). (Declaration of Trish Baesemann [Docket No. 2144] (hereinafter, the “Baesemann Decl.”) ¶ 4.) Under the Group Risk Agreements, the health plans pay ACMG and ACMGSF per member capitated rates, which are intended to cover the health care of the plan’s members for non-hospital related services. (*Id.*)

2. The Debtor, St. Francis Medical Center (“SFMC”), has similarly entered into agreements with health plans for it to provide certain hospital services to their members, in exchange for per member capitated rates (“Hospital Risk Agreements” and with the Group Risk Agreements, the “Risk Agreements”). (*Id.* ¶ 5.)

3. Under the Risk Agreements, there are joint financial and clinical obligations that require SFMC, on the one hand, and ACMG or ACMGSF, on the other hand, to coordinate their activities to provide appropriate hospital, ancillary, and professional health care to the

1 health plans' members in an efficient and high quality manner. (*Id.* ¶ 6.) Further, under the
2 Risk Agreements, the health plans have delegated to SFMC the responsibility to establish and
3 administer risk sharing agreements with ACMG and ACMGSF. (*Id.*)
4

5 4. In accordance therewith, ACMG and SFMC entered into that certain Healthcare
6 Services Risk Sharing Agreement effective June 1, 2007, as amended from time to time (the
7 "ACMG Risk Sharing Agreement"). (*Id.* ¶ 7.) In addition, SFMC and ACMGSF entered into
8 that certain Healthcare Services Risk Sharing Agreement effective January 1, 2004, as
9 amended from time to time (the "ACMGSF Risk Sharing Agreement," and together with the
10 ACMG Risk Sharing Agreement, the "Risk Sharing Agreements").¹ (*Id.*)
11

12 5. Under the Risk Sharing Agreements, SFMC is generally responsible for
13 establishing and administering a risk pool into which certain capitation payments are made by
14 the health plans, and out of which are paid the costs of providing hospital and other ancillary
15 services to members, including certain administrative expenses. (*Id.* ¶ 8.) In addition, SFMC
16 is responsible for accumulating and transmitting encounter data for AppleCare members to
17 whom it renders services, and for various other reporting obligations. (*Id.*) ACMG and
18 ACMGSF are generally responsible, under the Risk Sharing Agreements, to provide services
19 related to, among other things, (i) utilization management, (ii) discharge planning, (iii)
20 authorizations and referrals, (iv) case management, (v) claim appeals and denials, and (iv) pre-
21 admission certification, admission management, and transfer management.
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25 ¹ The Risk Sharing Agreements contain ACMG and ACMGSF's highly confidential and
26 sensitive commercial information. Accordingly, the parties agreed that the Risk Sharing
27 Agreements will remain confidential. While the Debtors should have copies of the foregoing,
28 other parties in interest may request such copies by written request to the undersigned counsel
and upon the entry into either an acceptable confidentiality agreement or the entry of an
appropriate protective order. If requested by the Court, ACMG and ACMGSF will provide
the Risk Sharing Agreements to it for *in camera* review.

1 6. ACMG and ACMGSF are compensated under the Risk Sharing Agreements
2 through a share of the surplus of the risk pool, which is measured annually, as well as a
3 percentage of the CMS Risk Adjustment. ACMG and ACMGSF's share of the risk pool is
4 paid, in part, through interim settlements throughout the course of the current year with a final
5 settlement to occur approximately eighteen months following the close of such year. For
6 example, the final settlement for 2019, will occur during the first half of 2021.
7

8 7. Additionally, AppleCare and SFMC are parties to that certain Ancillary Service
9 Agreement effective February 1, 2000, as amended from time to time (the "Services
10 Agreement").² (*Id.* ¶ 9.) Under the Services Agreement, SFMC provides certain covered
11 services to the AppleCare members (the "Covered Services"), in exchange for certain fees.
12 (*Id.*) Pursuant to the Services Agreement, SFMC agreed to be appropriately licensed and
13 accredited to provide the Covered Services; to appropriately keep and provide access to
14 medical records; and to participate in and comply with applicable utilization management,
15 quality assurance, and risk management programs. (*Id.*)
16
17

18 8. To assist it with administering the pools under the Risk Sharing Agreements,
19 SFMC entered into that certain Capitation Management Agreement with ACMM effective
20 August 1, 2010, as amended from time to time (the "Management Agreement" and together
21 with the Risk Sharing Agreements, and the Services Agreement, the "Agreements").³ Under
22
23

24 ² The Services Agreement contains SFMC's proprietary information. Accordingly, AppleCare
25 agreed to maintain the confidentiality of the Services Agreement. While the Debtors should
26 have a copy of the Services Agreement, other parties in interest may request such copies by
27 written request to undersigned counsel and upon entry into either an acceptable confidentiality
28 agreement or the entry of an appropriate protective order. If requested by the Court, AppleCare
will provide the Services Agreement to it for *in camera* review.

³ The Management Agreement contains ACMM's highly confidential and sensitive
commercial information. Accordingly, the parties agreed that the Management Agreement
will remain confidential. While the Debtors should have a copy of the Management
Agreement, other parties in interest may request such copies by written request to the

1 the Management Agreement, ACMM performs a number of services for SFMC related to,
2 among other things, the following: eligibility, claims adjudication, accounting, and
3 information technology. In exchange for these services, SFMC pays ACMM a percentage of
4 its monthly capitation revenue and reimburses ACMM for certain costs and expenses.
5

6 9. On August 31, 2018 (the “Petition Date”), the Debtors filed voluntary petitions
7 in this Court under Chapter 11.
8

9 10. On February 10, 2020, the Debtors filed their Motion for the Entry of (I) An
10 Order (1) Approving Form of Asset Purchase Agreement; (2) Approving Auction Sale Format
11 and Bidding Procedures, (3) Approving Process for Discretionary Selection of Stalking Horse
12 Bidder and Bid Protections; (4) Approving Form of Notice to be Provided to Interested Parties;
13 (5) Scheduling a Court Hearing to Consider Approval of the Sale to the Highest and Best
14 Bidder; and (6) Approving Procedures Related to the Assumption of Certain Executory
15 Contracts and Unexpired Leases; and (II) An Order Authorizing the Sale of Property Free and
16 Clear of All Claims, Liens and Encumbrances [Docket No. 4069] (the “Sale Motion”),
17 pursuant to which they sought to sell substantially all of SFMC’s assets.
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20 11. On February 26, 2020, the Court entered its Order (1) Approving Auction Sale
21 Format And Bidding Procedures, (2) Approving Process For Discretionary Selection Of
22 Stalking Horse Bidder And Bid Protections; (3) Approving Form Of Notice To Be Provided
23 To Interested Parties; (4) Scheduling A Court Hearing To Consider Approval Of The Sale To
24 The Highest And Best Bidder; And (5) Approving Procedures Related To The Assumption Of
25
26

27 _____
28 undersigned counsel and upon the entry into either an acceptable confidentiality agreement or
the entry of an appropriate protective order. If requested by the Court, AppleCare will provide
the Management Agreement to it for *in camera* review.

1 Certain Executory Contracts And Unexpired Leases [Docket No. 4165] (the “Bidding
2 Procedures Order”).

3
4 12. On March 13, 2020, the Debtors filed and served the Cure Notice [Docket No.
5 4267] ,which identifies contracts that could potentially be assumed and assigned pursuant to
6 the Bidding Procedures Order (the “Potential Assumed Contracts”), and the amounts, if any,
7 that the Debtors believe are owed to each counterparty to such Potential Assumed Contracts
8 due to any defaults that exist under such contracts.
9

10 13. The Potential Assumed Contracts included the following contracts with
11 AppleCare: the ACMG Risk Sharing Agreement, the ACMGSF Risk Sharing Agreement, and
12 the Management Agreement, all with a cure amount of “TBD.” The Cure Notice failed to list
13 the Ancillary Services Agreement.⁴
14

15 14. As more particularly set forth on Exhibit A hereto, the current amounts owed to
16 AppleCare under the Risk Sharing Agreements and the Management Agreement are as
17 follows:
18

Contract	2018 Pool ⁵
ACMG Risk Sharing Agreement	\$10,689,632
ACMGSF Risk Sharing Agreement	\$3,593,978
Management Agreement	\$269,854

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27 ⁴ AppleCare reserves it rights with regard to any cure that may be owed under the Services
28 Agreement upon the Debtor listing such agreement as a Potential Assumed Contracts in
accordance with the Bid Procedures Order.

⁵ The below amounts are calculated based on the fact that pre-petition party pool expenses
due to third parties have not been paid due to the bankruptcy filing.

1 15. With regard to the amounts owed under the Risk Sharing Agreements and
2 Management Agreement for 2018, these amounts are final.

3 **II. OBJECTION**

4 **A. Cure Objection**

5
6 16. AppleCare objects to the Cure Amounts listed in the Cure Notice.
7 Sections 365(b) and 365(f) of the Bankruptcy Code require that the Debtors cure, or provide
8 adequate assurance that they will promptly cure, all defaults under any executory contracts
9 that they seek to assume and assign to the prevailing bidder.
10

11 17. The Cure Notice does not set forth any amounts, estimate or otherwise, that may
12 be due and owing under the Agreements. Instead, the Debtors have stated that any amounts
13 due and owing under the Agreements are “TBD”.

14 18. The below amounts are currently due and owing under the Risk Sharing
15 Agreements and Management Agreement, and must be paid if they are going to be assumed
16 and assigned under § 365:
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18

Contract	2018 Pool
ACMG Risk Sharing Agreement	\$10,689,632
ACMGSF Risk Sharing Agreement	\$3,593,978
Management Agreement	\$269,854

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23 19. Although SFMC has paid the interim settlement amount currently owing under
24 the Risk Sharing Agreements and the Management Agreement for 2019, the final settlement
25 of the 2019 pools will not occur until 2021. Accordingly, AppleCare reserves its rights to
26 collect those amounts due and owing under the Risk Sharing Agreements and the Management
27
28

1 Agreement for 2019 that will be determined as a result of the final settlement of the 2019
2 pools.

3
4 20. Because SFMC has continued to operate under the Agreements during 2020,
5 AppleCare also reserves the right to seek as a cure any and all amounts that may become due
6 and owing for 2020 under the Agreements through the closing of any sale transaction.

7
8 21. In the ordinary course of business, AppleCare has provided to the Debtors
9 substantially all of the back-up data for the amounts outstanding under the Agreements as set
10 forth on Exhibit A on both a monthly basis and in aggregate form.⁶ AppleCare has been and
11 will continue to work in good faith with the Debtors to attempt to resolve the cure amounts.

12 **B. Adequate Assurance Objection**

13
14 22. AppleCare further objects to the Sale Motion because the Debtors have not
15 provided AppleCare with adequate assurance of future performance that the ultimate purchaser
16 of the assets, whether it be a “Qualified Bidder” or a “Qualified Bidder” that has been
17 designated as the “Stalking Horse Bidder,” can perform the core, material obligations of the
18 Agreements. While AppleCare acknowledges that bids are not due until April 3, 2020 and the
19 auction, if any, will be held on April 7, 2020, AppleCare raises this objection now because
20 there are only two days between the commencement of the auction and the sale hearing. Thus,
21 it is of paramount importance that the Debtors be apprised of the scope and nature of the
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26 ⁶ The back-up data contains the confidential and proprietary information of AppleCare (and
27 possibly the Debtors), as well as potentially confidential protected health information under
28 the Health Insurance Portability and Accountability Act (“HIPAA”). Upon request to the
undersigned counsel and entry of an appropriate protective order, such back-up data may be
made available to a party in interest. If requested, AppleCare can make the back-up data
available to Court for an *in camera* review.

1 information necessary to provide the requisite adequate assurance under Section 365(f) of the
2 Bankruptcy Code.

3
4 23. Section 365(f) of the Bankruptcy Code provides that a trustee may assign an
5 executory contract, provided that the trustee assumes the contract and that adequate assurance
6 of future performance by the assignee is provided, whether or not the contract is in default.
7 *See* 11 U.S.C. § 365(f)(2)(B). Such adequate assurance of future performance is appropriate
8 “in light of section 365(k), which provides that assignment relieves the trustee and the estate
9 from any liability for breaches occurring after assignment.” 3 *Collier on Bankruptcy* ¶
10 365.09[1] (Richard Levin & Henry J. Sommer eds., 16th ed. 2018).

11
12 24. “The assignee need not provide adequate assurance of all details of the contract
13 or lease, only of material and economically significant contract terms. A contract term is
14 material if it was integral to the bargained-for exchange and is economically significant if
15 performance is required to give the contract counterparty the full benefit of its bargain.” *Id.* at
16 ¶ 365.09[2]; *see In re Fleming Cos.*, 499 F.3d 300, 304-08 (3d Cir. 2007) (denying assignment
17 of grocery supply contract because essential term of contract, supply from specified location,
18 could not be fulfilled by potential assignee).

19
20
21 25. A court will look at several factors in determining adequate assurance of future
22 performance: “the financial ability to perform the contract; the general economic climate; the
23 existence of a guarantee; the reputation of the party seeking to assume responsibility for the
24 contract; and past dealings between the parties.” *In re Res. Tech. Corp.*, 624 F.3d 376, 383
25 (7th Cir. 2010) (citations omitted). *In Resource Technology*, the court explained that, as used
26 in Section 365(f)(2)(B) of the Bankruptcy Code, “‘adequate’ is a term of art and simply means
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28

1 assurances that are commercially reasonable under the particular circumstances of the case.
2 This is a commonsense, case-specific inquiry, and § 365(f)(2)(B) is given a practical,
3 pragmatic construction.” *Id.* (citation and quotation marks omitted.)
4

5 26. Here, despite the April 3, 2020 due date for bids, no information concerning the
6 qualifications of any potential bidder to perform under the Agreements has been provided to
7 AppleCare. When AppleCare is provided with this information, it should include the bidder’s
8 financial wherewithal and operational systems to administer the risk pools, capture and
9 transmit the member encounter data, and provide the other core reporting functions required
10 under the Risk Sharing Agreements. In particular, due to the sensitive financial and clinical
11 functions that SFMC performs under the Risk Sharing Agreements, AppleCare requires that
12 any prevailing bidder provide it with the due diligence information listed in Exhibit B (the
13 “Diligence Items”) to allow AppleCare to assess the bidder’s ability to perform under the Risk
14 Sharing Agreements and provide it with the requisite assurances that it can meet the
15 obligations under the Risk Sharing Agreements.
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18 27. Assuming the Services Agreement may be designated for assumption and
19 assignment, information should be provided concerning the bidder’s ability to perform the
20 Covered Services, its accreditation and licensing, and its administrative and operational
21 capabilities to maintain medical records and to comply with the applicable utilization
22 management, quality assurance, and risk management programs.
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25 28. Unless and until the foregoing information is provided to AppleCare, and it is
26 established that such information provides AppleCare with adequate assurance of future
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performance, this Court should deny the assignment of the Agreements to the prevailing bidder.

D. Reservation of Rights

29. AppleCare reserves its rights to supplement or modify this objection.

III. CONCLUSION

WHEREFORE, AppleCare respectfully requests that the Court enter an order (i) requiring the payment of the appropriate cure amount for the Agreements as set forth herein; (ii) denying the assignment of the Capitation Agreement under § 365, unless and until, (a) the Debtor provides AppleCare with the Financial Diligence and Delegation Diligence as described above and in Exhibit B (including the on-site inspection), and (b) such diligence materials demonstrate that the Winning Bidder will be able to perform under the Capitation Agreement; (iii) denying the sale of the accounts receivable owed under the FPAs as being free and clear of AppleCare's right of recoupment; and (iv) granting such further relief as the Court deems appropriate

DATED: April 1, 2020

LAW OFFICE OF SUSAN I. MONTGOMERY

By /s/ Susan I. Montgomery
SUSAN I. MONTGOMERY

-and-

By /s/ Eric S. Goldstein
ERIC S. GOLDSTEIN (admitted *pro hac vice*)

Attorneys for AppleCare Medical Group, Inc.
AppleCare Medical Group, St. Francis Inc.
AppleCare Medical Management LLC

Exhibit A

Exhibit A

SFMC Bankruptcy Claims Summary

Unpaid Invoices (1)

Description	ACMGSF	ACMG	ACMM	Amount Due
2017 Settlement (Trued-up)	20,538	1,808,395		1,828,933
2018 Risk Pool Draw - June 18	130,680	341,640		472,320
Indigent Claims Processing - July 2018			1,500	1,500
Case Management - July 18	8,333			8,333
2018 Risk Pool Draw - August 18	133,590	345,456		479,046
Cap Management - August 18			268,354	268,354
Case Management - August 18	8,333			8,333
ACMS Risk Adj Sweep - November 18	354,733	647,460		1,002,193
2018 CMS Final Risk Adj Sweep	161,010	287,263		448,273
Total	817,217	3,430,214	269,854	4,517,285

2018 Final Settlement Adjustments (2)

Description	ACMGSF	ACMG	ACMM	Amount Due
2018 Final Settlement Balance-Estimated	534,235	2,070,889		2,605,124
Additional 2018 Settlement Adjustments	22,085	85,608		107,693
Total	556,320	2,156,497	-	2,712,817
Subtotal (1) + (2)	1,373,537	5,586,711	269,854	7,230,102

2018 Impact of Unpaid BK Liabilities to Pool Results

Description	ACMGSF	ACMG	ACMM	Amount Due
Pre-BK Adjudicated & Unfunded Claims	1,958,026	4,611,875		6,569,901
Pre-BK Third Party Admin Fees - Unpaid	54,801	102,569		157,370
2018 CMS Risk Adj Sweep - Unpaid	207,614	388,476		596,090
Total	2,220,441	5,102,921	-	7,323,361

Grand Total	3,593,978	10,689,632	269,854	14,553,463
Updated through 3/9/20				

Exhibit B

Exhibit B

EXHIBIT B

Provide the following performance metrics across their hospital system, by hospital, and identify any Disproportionate Share Facilities.

- Joint Commission status
- Centers of Excellence/Clinical program offerings
- H-CAHPS survey results
- Hospital mortality rates
- Core measure performance (sepsis, pneumonia, CHF, MI, surgical infections)
- Patient satisfaction results
- Length of stay by payor
- Hospital payer mix, including % managed care
- % hospital discharges before noon
- Readmission rates across products
- % of time at hospital capacity
- ER throughput time
- % of time on ER diversion
- % of admissions through the ER
- % of on-time OR starts
- Surgical complications, and sentinel events
- Turnaround time on radiology studies
- Specialized clinical designations (stroke center, STEMI center, etc) and associated performance criteria
- C-section rates
- Outpatient observation vs. inpatient rates
- Nosocomial infection and complication rates
- Closed services (i.e. closed ICU)
- Differentiation of services between weekdays and weekends
- Specialty services available (colorectal surgery, hepatobiliary surgery, neurosurgery, CT surgery, TAVR, endoscopic ultrasound)
- Number and specialty of employed physicians

Audited financial statements by hospital, if available, and otherwise audited financial statements at the system level.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:
1925 Century Park East, Suite 2000, Los Angeles, CA 90067

A true and correct copy of the foregoing document entitled (*specify*): LIMITED OBJECTION TO ASSUMPTION AND
ASSIGNMENT OF EXECUTORY CONTRACTS

will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On (*date*) April 1, 2020, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

See Attached List.

☒ Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:

On (*date*) April 1, 2020, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

☐ Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (*state method for each person or entity served*): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on (*date*) April 1, 2020, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

See Attached List

☒ Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

4/1/2020
Date

Susan I. Montgomery
Printed Name

/s/ Susan I. Montgomery
Signature

SERVICE LIST

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I. CERTIFICATE OF SERVICE

I hereby certify that on April 1, 2020, a copy of the foregoing was filed electronically and served by mail on anyone unable to accept electronic filing. Notice of this filing will be sent by email to all parties by operation of the Court's electronic filing system or by U.S. mail, postage prepaid, to anyone unable to accept electronic filing as indicated on the Notice of Electronic Filing. Parties may access this filing through the Court's CM/ECF system.

I hereby further certify that on April 1, 2020, the foregoing was served by email on the below listed notice parties.

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