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UNITED STATES BANKRUPTCY COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

In re:

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*,
Debtors and Debtors In Possession.

☒ Affects all Debtors.

☐ **Affects Verity Health System of California,**
☐ **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. 18-20151

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-20171-ER
Chapter 11 Cases

Hon. Judge Ernest M. Robles
DATE: July 2, 2020
TIME: 10:00 a.m.
LOCATION: Courtroom 1568
255 E. Temple St., Los Angeles, CA.

WITHDRAWAL OF OBJECTION TO APPROVAL OF DISCLOSURE STATEMENT

WITHDRAWAL OF OBJECTION TO APPROVAL OF DISCLOSURE STATEMENT

The Medical Staff of Seton Medical Center hereby withdraws its Objection to the approval of the Debtor's Disclosure Statement Describing Debtors' Chapter 11 Plan of Liquidation (the "Disclosure Statement"); Dkt #4939.

DATED: June 30, 2020

Respectfully submitted,

ST. JAMES LAW, P.C.

By: /s/ *Michael St. James* .
Michael St. James
Counsel for the Medical Staff of Seton Medical Center

MEMORANDUM OF POINTS AND AUTHORITIES

I. SUMMARY OF RELIEF SOUGHT

The Seton Medical Center Foundation ("Philanthropic Seton") is a solvent charitable foundation with a net worth (as of the Petition Date) of approximately $5.2 million, consisting almost exclusively of cash. All of that cash was donated to Philanthropic Seton to advance its charitable purposes; that is, the provision of medical services *at the Seton Medical Center*.

Through "deemed substantive consolidation," Verity Health Systems of California, Inc. ("VHS" or the "Debtor") apparently proposes to re-purpose some portion of Philanthropic Seton's net worth from those intended charitable purposes to the general purposes of the Debtor's estate or at least to non-Seton charitable purposes.[1] This Objector believes that deemed substantive consolidation renders the Plan of Liquidation unconfirmable as regards Philanthropic Seton and the other Philanthropic Foundations but accepts that the Court may defer that legal issue to the confirmation hearing.

The Disclosure Statement, however, can be approved only if it provides "adequate information," and to be "adequate" the information must at least be accurate. The discussion of "deemed substantive consolidation" in the Disclosure Statement is at least misleading – and more than arguably false – with respect to the Philanthropic Foundations. The Disclosure Statement should be revised so as to provide "adequate information" – *accurate* information – about both the justification for and the consequences of "deemed substantive consolidation" with regard to the Philanthropic Foundations.

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[1] VHS asserts that the funds will be put to some charitable purpose. That is not what the language of the Plan actually says. In any event, the funds were not given for "some charitable purpose:" they were given to support medical care *at Seton.*

II. FACTS

A. Philanthropic Seton

The Debtor described the Philanthropic Foundations as follows:

> each Debtor Hospital is the sole member of the Debtor nonprofit public benefit corporation that handles its fundraising and grant-making programs: St. Francis Medical Center Foundation, St. Vincent Foundation, Seton Medical Center Foundation, Saint Louise Regional Hospital Foundation, and O'Connor Hospital Foundation (collectively, the "Philanthropic Foundations").

Adcock Declaration; Dkt #8; ⁋112.

Philanthropic Seton is one of these "Philanthropic Foundations," described by the Debtor as follows:

> **Seton Foundation.** Seton Foundation, governed by a Board of Trustees, raises funds through grants, special events and individual donors. Charitable donations and endowments raised by Seton Foundation help fund the acquisition of new equipment and the expansion of facilities at the Seton Medical Center and Seton Coastside. Seton is the sole corporate member of the Seton Foundation. As of May 31, 2018, Seton Foundation had a balance of $2,693,778.66 million in temporary restricted assets and a balance of $2,717,591 million in permanently restricted assets for the purpose of funding programs such as oncology, the San Francisco Heart & Vascular Institute, and women and delivery services.

Adcock Declaration; Dkt #8; ⁋41.

The Schedules of Assets and Liabilities for Philanthropic Seton; Case No. 18-20175, Dkt #10; reflect assets consisting of cash in three bank accounts aggregating $6,224,259.50; Schedule A/B, p.1; accounts receivables principally consisting of "pledges" of $54,233.00; Schedule A/B, p. 3; and a "limited edition serigraph" valued at $56,800.00; Schedule A/B, p. 7.

The Schedules of Assets and Liabilities for Philanthropic Seton; Case No. 18-20175, Dkt #10; reflect liabilities consisting of two unsecured debts aggregating $1,002,545.00, held in roughly equal amounts by VHS and Seton Medical Center.

Assuming the validity of the two unsecured inter-company debts, Philanthropic Seton had a net worth of $5,221,714.50, consisting almost exclusively of cash which had been donated to it to advance its charitable "public benefit" goals *at Seton*.

B. Effect of Deemed Substantive Consolidation

The Debtor explains that "[s]ubstantive consolidation refers to the consolidation of the assets and liabilities of different legal entities 'so that the assets and liabilities are dealt with as if the assets were held by, and the liabilities were owed by, a single legal entity.'" Disclosure Statement, 118:10-12. On its face, this would suggest that the entire $5.2 million net worth would be consolidated with the Debtor and would contribute to paying its liabilities.

In fact, the Debtor has imported a theory about "properly donor-restricted funds" which would protect some unidentified portion of that net worth from being transferred to the Debtor to pay liabilities. See, Plan, §1.18 (definition of "assets" includes "cash of the [Philanthropic] Foundations that is not properly donor-restricted"); and §§ 5.3, 5.4 (proceeds of dissolution of Philanthropic Foundations will go to an undisclosed purpose the Attorney General approves). The Debtor's theory apparently arises out of *In re Winsted Mem'l Hospital* 249 B.R. 588 (Bankr. D. Conn. 2000) and its progeny, which attempt to identify the property excluded from a debtor's estate pursuant to Section 541(d). St. James Dec., Dkt #3079; Exhibit A. In those cases, the funds in dispute are held by the debtor directly, and so the question there was exclusion from the debtor's estate as property in which the estate has no equitable interest.

That rationale is inapposite where the debtor is solvent, as the Philanthropic Foundations are. Whether the Philanthropic Foundation received the funds under a restriction requiring it to spend them on a cancer ward ("properly donor-restricted") or was given the money at a fund-raising dinner to support its general charitable activities at Seton (presumably, not "properly donor-restricted"), the funds are a part of the net worth of a charitable non-profit entity which was dedicated to advancing medical care at Seton and, absent a legal basis for substantive consolidation, cannot be taken from that charitable entity to be used to pay the Debtor's debts. The Debtor's "properly donor-restricted funds" theory is a red herring.

Other factual matters will be discussed in connection with the argument, below.

III. ARGUMENT

A. The "Third Factor" Should be Stricken From the Disclosure Statement

The Disclosure Statement's assertion about a "third factor," reproduced below, is incorrect, misleading and should be stricken.

> The Ninth Circuit's case-by-case substantive consolidation analysis focuses on two, independent factors... Additionally, bankruptcy courts have identified a third, un-enumerated factor that goes to the heart of the substantive consolidation analysis — whether the equities of the case demonstrate that substantive consolidation is reasonable under the circumstances. See, e.g., *In re Bashas' Inc.*, 437 B.R. 874 (Bankr. D. Ariz. 2010).

Disclosure Statement, 119:16-24.

The *dictum* of *Basha's* has no application here, and it is misleading when quoted in this Disclosure Statement. *Basha's* involved a 100% Plan, affirmatively accepted by *all* unsecured creditors. No one was prejudiced by consolidation ("The court perceives no practical nor legal prejudice" to anyone. 437 B.R. at 928.) Rather, "the consolidation request is purely for convenience." 437 B.R. at 929. In *Basha's*, the absence "of potential or actual *harm* drove the decision." Id. *Basha's* is s*ui generis*, and *nothing* about *Basha's* circumstances is consonant with the instant case.

Suggesting, as the Disclosure Statement does, that "deemed" substantive consolidation can be imposed whenever it is "reasonable" under "the equities of the case" is simply misleading, if not explicitly incorrect. It is inconsistent with applicable Ninth Circuit law; compare, *In re Bonham*, 229 F.3d. 750 (9th Cir. 2000); and should be stricken from the Disclosure Statement.

B. There Should be Clarification Respecting the Factual Basis for Deemed Substantive Consolidation of the Philanthropic Foundations

Much of the discussion and analysis in the Disclosure Statement is not, in fact, applicable to the Philanthropic Foundations. In order to prevent the Disclosure Statement from being misleading, that fact should be made explicit.

To that end, the following should be inserted into the Disclosure Statement:

1. At the end of "The Debtors Obtained Secured Financing as a Single Economic Unit;" at 120:25, insert:

The Philanthropic Foundations were not liable on any of the secured financing, so this factor is not applicable to them.

2. At the end of "The Debtors Negotiated Major Contracts and Agreements as a Single Economic Unit;" at 122:5-6, insert:

The Philanthropic Foundations were not parties to any of the major contracts or agreements, so this factor is not applicable to them.

3. At the end of "The Debtors' Affairs Are So Entangled That Consolidation will Benefit Creditors;" at 123:1-2, insert:

The Philanthropic Foundations maintained completely separate and distinct bank accounts, books and records and financial transactions, so this factor is not applicable to them.

The foregoing is simply a correct statement of the relevant facts as regards the Philanthropic Foundations. It also demonstrates that substantive consolidation, whether "deemed" or not, is entirely inappropriate with respect to the Philanthropic Foundations.

C. Disclose What is at Stake

The net worths of the Philanthropic Foundations all differ, and their net worths as of the petition date may say little about their current net worths. In addition, the Debtor acknowledges that some portion of those net worths are "off the table" – the "properly donor-restricted funds" – but none of that is disclosed.

The Disclosure Statement should disclose what is at stake for each Philanthropic Foundation: how much of the funds which it accumulated as charitable contributions are to be re-purposed for creditor payments.

Likewise, even if dedicated to charitable purposes, the Debtor should disclose whether the funds will be dedicated to the intended charitable purposes, and if not, why not. The funds held by Philanthropic Seton were contributed to support medical services *at Seton*. If the Debtor intends to repurpose those funds to charitable purposes in Los Angeles or the greater Bay Area, it should disclose that, and explain why it should be permitted to do so.

If the funds of solvent Philanthropic Seton at issue *could* be retained to advance the medical care at Seton – as the donors intended – why should they be moved elsewhere? Clearly, there is no bankruptcy purpose to be served by thwarting the donors' intent.

IV. CONCLUSION

This Objector does not believe that "deemed substantive consolidation" is legally permissible with respect to the Philanthropic Foundations but acknowledges that is an issue for the Confirmation Hearing.

For the present, the question is whether the Disclosure Statement provides "adequate information." With respect to the application of "deemed substantive consolidation" to the Philanthropic Foundations, the Disclosure Statement is incorrect, misleading and entirely inadequate. The Court should require the Debtor to revise its Disclosure Statement as described above.

DATED: June 23, 2020

Respectfully submitted,

ST. JAMES LAW, P.C.

By: /s/ *Michael St. James* .
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