SAMUEL R. MAIZEL (Bar No. 189301)
samuel.maizel@dentons.com
SONIA MARTIN (State Bar No. 191148)
sonia.martin@dentons.com
TANIA M. MOYRON (Bar No. 235736)
tania.moyron@dentons.com
NICHOLAS A. KOFFROTH (Bar No. 287854)
nick.koffroth@dentons.com
DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
Tel: (213) 623-9300 / Fax: (213) 623-9924

Counsel to Plaintiffs and Chapter 11
Debtors and Debtors In Possession

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION - LOS ANGELES

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

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a California nonprofit public benefit corporation, ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation, ST. VINCENT DIALYSIS CENTER, INC., a California nonprofit public benefit corporation, and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, SETON MEDICAL CENTER, a California nonprofit public benefit corporation, and VERITY HOLDINGS, LLC, a California limited liability company,

Plaintiffs,

v.

KALI P. CHAUDHURI, M.D., an individual, STRATEGIC GLOBAL MANAGEMENT, INC., a California corporation, KPC HEALTHCARE HOLDINGS, INC. a California Corporation KPC HEALTH PLAN HOLDINGS, INC. a California Corporation, KPC HEALTHCARE, INC. a Nevada Corporation, KPC GLOBAL MANAGEMENT, LLC, a California

Case No. 2:20-cv-00613-DSF

Hon. Dale S. Fischer

PLAINTIFFS' MOTION TO DISMISS DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S AMENDED COUNTERCLAIMS, OR IN THE ALTERNATIVE, TO STRIKE PORTIONS OF DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S AMENDED COUNTERCLAIMS

Date: October 5, 2020
Time: 1:30 p.m.
Place: Courtroom 7D
350 West 1st Street
Los Angeles, CA 90012

Limited Liability Company, and DOES 1 through 500, Defendants.
STRATEGIC GLOBAL MANAGEMENT, INC., a California corporation, Counter-Plaintiff, v. VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a California nonprofit public benefit corporation, ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation, ST. VINCENT DIALYSIS CENTER, INC., a California nonprofit public benefit corporation, and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, SETON MEDICAL CENTER, a California nonprofit public benefit corporation, and VERITY HOLDINGS, LLC, a California limited liability company, Counter-Defendants.

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

NOTICE OF MOTION AND MOTION

TO DEFENDANTS, COUNTER-CLAIMANTS AND THEIR COUNSEL AND TO THE CLERK OF THE COURT:

PLEASE TAKE NOTICE that on October 5, 2020 at 1:30 p.m. or as soon thereafter as counsel may be heard in the United States District Court for the Central District of California, located at First Street Courthouse, 350 W. 1st Street, Courtroom 7D, Los Angeles, California, Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, Verity Holdings, LLC, and the above-captioned debtors will and hereby do move to dismiss (in whole or in part) each count of Defendant Strategic Global Management, Inc.'s Amended Counterclaims (the "Counterclaim"), pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a cognizable claim for relief. Specifically, Plaintiffs seek dismissal of all counts or alternatively dismissal of each claim that the Asset Purchase Agreement requires Plaintiffs to refund SGM's $30 million deposit, as well as each

claim for breach of contract, breach of the implied covenant of good faith and fair dealing, and tortious breach of contract. Counterclaim, ¶¶ 58-59, 64, 67-68.

In addition, and in the alternative, Plaintiffs move pursuant to Rule 12(f) of the Federal Rules of Civil Procedure to strike the portions of SGM's Amended Counterclaim that seeks refund of the Deposit, including: page 20, lns. 21-23; page 21, lns. 13-14; page 22, lns 3-4 and ln. 8; page 30, lns. 7-21, lns. 22-24; page 31, lns. 1-8, line 28; page 32, lns. 1-3; page 39, lns. 4-13, lns. 24-27; page 40, ln. 27; page 41, lns. 1-2, lns. 7-9; page 42, ln. 13, lns. 17-18; page 43, lns. 9-11, lns. 26-28; page 44, line 24.

This motion is based upon this Notice, the following Memorandum of Points and Authorities, the concurrently-filed Request for Judicial Notice, all pleadings, records and documents on file herein, and such additional evidence and argument as may be properly introduced in support of the Motion.

This motion is made following the conference of counsel pursuant to L.R.7-3, which took place on August 26, 2020.

Respectfully submitted,

Dated: September 3, 2020

DENTONS US LLP
SAMUEL R. MAIZEL
SONIA R. MARTIN
TANIA M. MOYRON
NICHOLAS A. KOFFROTH

By */s/ Sonia Martin*
Sonia Martin

Attorneys for Verity Health Systems of California, Inc., *et al.*

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

TABLE OF CONTENTS

Page

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

TABLE OF AUTHORITIES

Page(s)

Cases

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

Statutes

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

Rules and Regulations

Other Authorities

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

This case arises from an asset purchase agreement (the "APA") for the sale of four hospitals to Defendant Strategic Global Management, Inc. ("SGM") under the auspices of a Bankruptcy Court order. Ultimately, SGM did not close the sale, and Plaintiffs terminated the APA. The cornerstone of SGM's Counterclaim is the claim that the APA requires Plaintiffs to refund SGM's $30 million deposit (the "Deposit"), and that Plaintiffs have wrongfully retained the Deposit. On the basis of that claim, SGM asserts counts for breach of contract, breach of the implied covenant of good faith and fair dealing, and for tortious breaches of contract and the implied covenant. SGM's theory, however, fails as a matter of law.

First, pursuant to the express terms of Section 1.2 of the APA, the Deposit was "non-refundable." The APA provides that SGM is entitled to a refund of the Deposit under only four triggering circumstances, *none* of which SGM alleges. SGM fails to allege that any of those circumstances occurred, and it fails to allege any basis for recovering the Deposit under the APA or any legal theory.

Second, Plaintiffs *are under court order* not to release the Deposit. Specifically, the Bankruptcy Court's May 2, 2019 order approving the SGM Sale ordered that sale proceeds shall not be used for any purpose "except as provided in this Order, the DIP Credit Agreements or the Final DIP Order without further order of this Court." Plaintiffs' RJN, Ex. B. Declining to violate a court order does not breach the APA or its implied covenant of good faith and fair dealing, tortiously or otherwise.

Third, SGM cannot base its claims on the smattering of other alleged APA breaches that are referenced in the Counterclaim because SGM fails to allege facts demonstrating that such alleged conduct breached a specific provision of the APA, and fails to allege that it would have closed the sale transaction if such alleged breaches had not occurred. This is no coincidence, given that SGM never intended

to close the transaction pursuant to the APA's terms. As a result, SGM's other breach claims fail.

Finally, SGM has failed to plead its Count III for alleged tortious breach of the APA and its implied covenant of good faith and fair dealing, for manifold reasons. SGM did not plead an independent tort and failed to properly allege the elements of a fraud claim under California law, and has merely challenged alleged "misrepresentations" that are subject to the litigation privilege and also accurately described undisputed court orders. Accordingly, Count III is barred by the economic loss rule.

For the reasons fully described below, Plaintiffs respectfully request that the Court dismiss Counterclaims I [First Cause of Action - Breach of Contract] ("**Count I**") and II [Second Cause of Action - Breach of the Implied Covenant of Good Faith and Fair Dealing] ("**Count II**"), to the extent they are premised on purported breach of the APA for failure to refund SGM's $30 million deposit, and strike any allegations seeking the refund of the Deposit. In addition, Plaintiffs respectfully request that the Court dismiss the remainder of Counts I and II, and also SGM's Counterclaim III [Third Cause of Action - Tortious Breach of Contract] ("**Count III**").

II. FACTUAL BACKGROUND

A. The Bankruptcy And The Hospital Sale

On August 31, 2018, Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center (together with St. Francis and St. Vincent, the "Plaintiff Hospitals"), and Verity Holdings, LLC, and the above-captioned debtors (collectively, the "Debtors" or "Plaintiffs") each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code, which are currently administered before the Bankruptcy Court. *See* Counterclaim, Docket No. 58, at ¶ 16. The Debtors' bankruptcy cases are the second largest hospital bankruptcies in U.S. history.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

In January 2019, SGM executed an agreement to buy the Hospitals and their assets in exchange for (among other things) a cash payment of $610 million. *See* Counterclaim, ¶ 2. On January 8, 2019, SGM executed the APA, which is attached as an exhibit to the Plaintiffs' First Amended Complaint ("FAC"). *See* FAC, Ex. A; Counterclaim, ¶¶ 2, 17.

B. The Deposit And The Limited Circumstances For Its Refund

Pursuant to APA Section 1.2, SGM wired the $30 million Deposit into VHS's bank account. *See* Counterclaim, ¶ 18. APA section 1.2 expressly provides that the Deposit is nonrefundable, except for four enumerated instances:

> The Deposit shall be *non-refundable in all events*, except as provided in Section 6.1(b) or Section 6.2, or in the event [SGM] *has terminated this Agreement* pursuant to Section 9.1 (other than Section 9.1(b)) or as set forth in Section 9.2, in which case [Plaintiffs] shall immediately return the Deposit to [SGM] with all interest earned thereon.
>
> FAC, Ex. A (emphasis added).

First, Section 6.1(b)(2) of the APA requires the refund of the Deposit in the event the Hospitals were sold to an "overbidder" other than SGM, which SGM does not allege and undisputedly did not occur:

> [I]n the event that an overbidder (and not the Purchaser) is the successful bidder for the purchase of the Assets (the '**Alternate Transaction**') and the Alternative Transaction is approved by the Bankruptcy Court, (a) the Deposit, and any interest earned thereon, shall be returned to Purchaser immediately upon the entry of such sale order[.]
>
> FAC, Ex. A.

Second, Section 6.2 requires refund of the Deposit in the event the Bankruptcy Court's "Sale Order" approving the APA was appealed and a stay was imposed:

> In the event a stay is issued by any appellate court, including the United States District Court, which prevents the sale from closing, as scheduled, Purchaser shall have the right to terminate this Agreement if such stay is not vacated on or before 45 days from the date of the stay is issued, and Purchaser shall be entitled to the prompt return of the Deposit and any interest earned thereon.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

FAC, Ex. A.

Third, Section 9.1 of the APA delineates the following grounds on which the APA could be terminated, permitting a refund of the Deposit:

> 9.1 Termination. This Agreement may be terminated at any time prior to Closing:
>
> (a) by the mutual written consent of the parties;
>
> (b) by Sellers if a material breach of this Agreement has been committed by Purchaser and such breach has not been (i) waived in writing by Sellers or (ii) cured by Purchaser to the reasonable satisfaction of Sellers within fifteen (15) business days after service by Sellers upon Purchaser of a written notice which describes the nature of such breach;
>
> (c) by Purchaser if, in its sole and absolute discretion, it is not satisfied with either (i) the results of its due diligence examination of the Hospitals, or (ii) the contents of any schedule or exhibit that was not completed and attached to this Agreement, but which has been provided to Purchaser after the Signing Date, and Purchaser has notified Seller of its election to terminate the Agreement under this Section 9.1(c) on or prior to January 8, 2019 […];
>
> (d) by Purchaser if a material breach of this Agreement has been committed by Sellers and such breach has not been (i) waived in writing by Purchaser or (ii) cured by Sellers to the reasonable satisfaction of Purchaser within fifteen (15) business days after service by Purchaser upon Sellers of a written notice which describes the nature of such breach;
>
> (e) by Purchaser if satisfaction of any of the conditions in ARTICLE 8 has not occurred by December 31, 2019 or becomes impossible […].
>
> (f) by Sellers if satisfaction of any of the conditions in ARTICLE 7 has not occurred by December 31, 2019 or becomes impossible […];
>
> (g) by either Purchaser or Sellers if the Bankruptcy Court enters an order dismissing the Bankruptcy Cases or fails to approve the Sales Procedures Motion by the date specified in Section 6.1(b);
>
> (h) by Sellers if, in connection with the Bankruptcy Cases, any Seller accepts an Alternate Transaction and pays the Break-Up Fee;

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

> (i) by either Purchaser or Sellers if the Closing has not occurred (other than through the failure of any party seeking to terminate this Agreement to comply fully with its obligations under this Agreement) on or before December 31, 2019; or
>
> (j) by Purchaser if a force majeure event […].
>
> FAC, Ex. A.

Finally, Section 9.2 of the APA states that the Deposit must be refunded if the APA is terminated for any of the above reasons other than the Purchaser's default under Section 9.1(b):

> 9.2 Termination Consequences. If this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1: (a) all further obligations of the parties under this Agreement shall terminate (other than Purchaser's right to receive the Break-Up Fee if applicable), provided that the provisions of ARTICLE 12, shall survive; and (b) each party shall pay only its own costs and expenses incurred by it in connection with this Agreement; provided, in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof. In addition, *if this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 (other than Section 9.1(b)), Seller shall immediately return the Deposit to Purchaser with all interest earned thereon.* Each Party acknowledges that the agreements contained in this Section 9.2 are an integral part of the transactions contemplated by this Agreement, that without these agreements such Party would not have entered into this Agreement.
>
> FAC, Ex. A (emphasis added).

C. The Bankruptcy Court Orders Effectuating The Sale And Preventing Release Of The Deposit

On January 17, 2019, the Debtors filed a motion to approve, among other things, the form APA and related "stalking horse" protections and bidding procedures for the sale of the Hospitals, which the Court approved. *See* Plaintiffs' Request for Judicial Notice In Support of Motion to Dismiss SGM's Amended Counterclaims ("Plaintiffs' RJN"), Ex. A. On May 2, 2019, the Court entered an order approving the sale to SGM (the "Sale Order"). *See* Plaintiffs' RJN, Ex. B. SGM filed a brief in support of entry of the Sale Order. *See* Plaintiffs' RJN, Ex. M. ("SGM respectfully

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

requests that the Court grant the Sale/Bid Procedures Motion as submitted by the Debtor.")

The Sale Order required that all sale proceeds (including the SGM deposit) be held in Escrow Deposit Accounts, pursuant to the terms and restrictions set forth in the order authorizing postpetition financing, use of cash collateral, liens, adequate protection, and other relief (the "Final DIP Order"), which were expressly incorporated into the Sale Order. *See* Plaintiffs' RJN, Ex. C. Pursuant to the Final DIP Order, the subsequent cash collateral orders entered in the bankruptcy proceedings, and the Sale Order, the Debtors cannot use sale proceeds held in Escrow Deposit Accounts without the consent of the Prepetition Secured Creditors or an order of the Court. *See* Plaintiffs' RJN, Exs. D-H.

Specifically, the Final DIP Order required the Debtors to place "all proceeds of any sale or other disposition of the Debtors' property" in "Escrow Deposit Accounts" subject to deposit account control agreements. Plaintiffs' RJN, Ex. C. Paragraph 4 of the Final DIP Order restricts the Debtors' authority to use or transfer funds held in the Escrow Deposit Accounts:

> [T]he Debtors shall not be permitted to use Cash Collateral of any of the Prepetition Secured Creditors held in any Escrow Deposit Account for any purpose without first obtaining the consent of the applicable Prepetition Secured Creditor or obtaining an order of the Court pursuant to Section 363 of the Bankruptcy Code after notice and a hearing. *Id.*

In addition, the DIP Agent was granted a first priority lien on the Escrow Deposit Account and all Sale Proceeds:

> As provided by the Interim Order, this Final Order and the DIP Credit Agreement, the DIP Liens *shall attach as first priority liens and security interests*, pursuant to section 364(d) of the Bankruptcy Code and the DIP Financing Agreements, to all proceeds of any sale or other disposition of the Debtors' property, including, without limitation, the Healthcare Facilities (as defined in the DIP Credit Agreement) and any other DIP Collateral (as defined below) (the "***Sale Proceeds***"). The Sale Proceeds shall be held in escrow in one or more deposit accounts subject to a deposit account control agreement in favor of

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

> the DIP Agent (the "***Escrow Deposit Account***"). Any funds held in the Escrow Deposit Account shall not be commingled with any other funds of the selling Debtor, the Sale Proceeds of any other Debtor or otherwise.
>
> Plaintiffs' RJN, Ex. C. (emphasis in italics added)

The terms of the Final DIP Order were expressly incorporated into the Sale Order, which likewise provides that Sale Proceeds shall not be used for any purpose "except as provided in this Order, the DIP Credit Agreements or the Final DIP Order *without further order of this Court*":

> 13. The terms and conditions of the Final DIP Order shall apply with respect to the Sale Proceeds and Escrow Deposit Accounts (defined herein). Without limiting the foregoing, the Debtors shall comply with paragraph 4 of the Final DIP Order in the following manner:
>
> (a) the Debtors shall direct SGM, pursuant to the terms of the APA, to remit all Sale Proceeds to the separate accounts opened in the name of each Debtor for the Sale Proceeds (each such hereafter referred to as "Escrow Deposit Account");
>
> [. . .]
>
> (c) without limitation of the rights of the DIP Agent and DIP Lender under the DIP Financing Agreements and the Final DIP Order, *no funds held in any Escrow Deposit Account shall be* (i) commingled with any other funds of the applicable Debtor or any of the other Debtors or (ii) *used by the Debtors for any purpose, except as provided in this Order, the DIP Credit Agreements or the Final DIP Order without further order of this Court,* after reasonable notice under the circumstances to the DIP Agent, the Prepetition Secured Creditors and the Committee; and
>
> (d) each Escrow Deposit Account shall be subject to a deposit account control agreement in favor of the DIP Agent and DIP Lender, and subject to, without limitation of the rights of the DIP Agent and DIP Lender under the DIP Financing Agreements and the Final DIP Order with respect to the Sale Proceeds and Escrow Deposit Account, including, without limitation, following the occurrence of an Event of Default or the Revolving Loan Termination Date (as defined in the DIP Credit Agreement), the Debtors shall not be permitted to use the funds held in any Escrow Deposit Account for any purpose, except as provided in paragraph 14, 15, 16, and 17 of this Order [concerning payment of cure amounts for assigned contracts], and to fund any Purchase Price adjustment in favor of the Purchaser, without first obtaining the consent

> of the DIP Agent, DIP Lender and the Prepetition Secured Creditors or obtaining an order of the Court pursuant to §§ 363 or 1129 after reasonable notice under the circumstances to the DIP Agent, the DIP Lender, the Prepetition Secured Creditors and the Committee and, if necessary, a hearing thereon[.]

Plaintiffs' RJN, Ex. B (Sale Order ¶ 13) (emphasis added).

After the bankruptcy court entered the Sale Order, the Debtors obtained authority for the consensual use of cash collateral pursuant to a Supplemental Cash Collateral Order and subsequent amendments to the Supplemental Cash Collateral Order. *See* Plaintiffs' RJN, Exs. D-H. Each order explicitly incorporates the limitations of the Final DIP Order.

In addition, per SGM's request, the Debtors, and the other proponents of the plan of liquidation, agreed to include certain language in the disclosure statement describing the plan, the plan, and the order confirming the plan, concerning the parties' respective rights to the Deposit:

> The Liquidating Trust shall not distribute the Deposit to creditors in accordance with the Plan or take any other action which would reduce or dissipate the Deposit, unless permitted by a judgment or an order entered by the District Court having jurisdiction over the Adversary Proceeding, and such judgment or order has not been stayed.

See Plaintiffs' RJN, Ex. N (Omnibus Reply at 6-7); RJN, Ex. O (Disclosure Statement at 43). This original language to which the parties agreed is substantively included in the June 29, 2020 omnibus reply in support of approval of the July 2, 2020 disclosure statement, and was incorporated into the disclosure statement itself. *Id.* SGM's request that the Court amend the word "Nonrefundable" from the descriptor "Nonrefundable Deposit," used in substantively similar language incorporated in the plan and confirmation order, was granted on September 3, 2020. *See* Plaintiffs' RJN, Ex. S ("The Confirmation Order and Plan shall be deemed amended such that the term 'Nonrefundable Deposit' is replaced with the term 'Deposit.'"); *id.*, Ex. R. Furthermore, it "does not appear to the Court that use of the term 'Nonrefundable Deposit,' instead of 'Deposit,' could have any effect upon the

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Plan's provisions pertaining to the deposit, or could in any way prejudice SGM's rights in the SGM Action." Plaintiffs' RJN, Ex. Q (Order on SGM Limited Objection).

D. SGM Fails To Close And Never Terminates The APA

The background regarding Plaintiffs' efforts to close the Sale with SGM are detailed in the First Amended Complaint, and incorporated by reference. *See* 2:20-cv-00613-DSF, Docket No. 29. Specifically, on behalf of Plaintiffs, Plaintiffs' counsel of record sent a November 20, 2019 letter to SGM that summarized the Bankruptcy Court's November 18, 2019 Order ordering SGM to close the sale:

> As the Court correctly noted in its memorandum of decision, dated November 18, 2019 [Docket No. 3632], Section 8.6 of the APA has been satisfied. Section 8.6 provides that SGM "shall consummate the Sale" if "the Supplemental Sale Order becomes a final, non-appealable order prior to the expiration of the Evaluation Period . . . and all other conditions to closing have been satisfied." Yesterday, as we notified you, the Debtors reached a settlement agreement with the United States, on behalf of Department of Health and Human Services and the Centers for Medicare and Medicaid Services, allowing for the transfer of the Medicare Provider Agreement without successor liability. Consequently, SGM must close this transaction promptly, but no later than ten (10) business days from yesterday, or December 5, 2019, because all conditions to closing are satisfied. See APA § 1.3.
>
> Failure to promptly close will result in, at a minimum, SGM's (i) loss of the $30 million non-refundable deposit under Section 1.2 of the APA, (ii) liability for a further $60 million in damages under Section 11.1 of the APA, and (iii) responsibility for the Debtors' prevailing party attorneys' fees under Section 12.12 of the APA. The Debtors' expressly reserve all rights to bring any and all other appropriate claims that may exist in law or equity against SGM or its principals.

See Counterclaim, ¶¶ 45-47. But SGM did not close the sale on December 5, 2019 or on any subsequent date, despite having ample opportunity. *See* Counterclaim, ¶¶ 53-55. Instead, it sent the Debtors a letter on December 5, 2019, demanding the refund of its $30 million deposit. *See* Counterclaim, ¶ 54.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

On December 6, 2019, the Debtors filed an emergency motion for issuance of an order to show cause why SGM failed to close the sale by December 5, 2019. *See* Plaintiffs' RJN, Ex. I. On December 9, 2019, the Bankruptcy Court denied the motion and ruled that "[a]ny efforts undertaken by the Debtors with respect to the alternative disposition of the Hospitals" would not violate the APA. Plaintiffs' RJN, Ex. J, at 2. The Bankruptcy Court recognized that:

> By failing to close, SGM risks the loss of its $30 million good-faith deposit as well as the possibility of damages for breach of contract in an amount of up to $60 million. [. . .] In the future, the Debtors will have an opportunity to litigate the issues of whether SGM has breached the APA and whether the Debtors are entitled to retain SGM's good-faith deposit.
>
> Plaintiffs' RJN, Ex. K at 2.

By letter dated December 10, 2019, Plaintiffs confirmed they remained prepared to close, stating "[t]he Debtors were prepared to close on December 5, and remain able and willing to do so today. SGM, however, has intentionally frustrated the Debtors' efforts, and has never proposed any alternative closing date[.]" FAC, ¶¶ 103-104; Answer to First Amended Complaint ("SGM Answer"), Docket No. 41, ¶¶ 103-104. On December 17, 2019, Debtors sent SGM a letter advising that the APA would terminate effective December 27, 2019. *See* Plaintiffs' RJN, Ex. L; Counterclaim, ¶ 54. SGM never terminated the APA—only the Debtors did.

E. <u>The Adversary Proceeding Against SGM and Its Alter Egos</u>

Plaintiffs filed their original Complaint in this proceeding on January 3, 2020. On March 11, 2020, Plaintiffs filed the FAC. *See* Docket No. 29.

On July 10, 2020, SGM answered the FAC and filed its Counterclaim, asserting four counts. In response, Plaintiffs filed a Motion to Dismiss. *See* Docket No. 39. On August 10, 2020, SGM filed its Amended Counterclaim, asserting three counts. *See* Docket No. 58. Count I and Count II allege Plaintiffs breached the APA and the implied covenant of good faith and fair dealing. Count III alleges that such breaches were tortious.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Each of SGM's claims is premised on the allegation that the APA requires Plaintiffs to refund the Deposit. *See* Counterclaim, ¶¶ 58, 60, 64-65, 68, and Prayer for Relief ¶ 2. As explained below, that is incorrect.

III. LEGAL STANDARD

A motion to dismiss a counterclaim is subject to the same standard as a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure (the "Civil Rules"). *E.g.*, *Eagle Eyes Traffic Indus. USA Holding v. AJP Distributors Inc.*, No. 218CV01583SJOAS, 2018 WL 4859260, at *2 (C.D. Cal. June 22, 2018) (citing *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003)). "Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Id.* (quoting *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1988)). Civil "Rule 12(b)(6) must be read in conjunction with Civil Rule 8(a), which requires 'a short and plain statement of the claim showing that the pleader is entitled to relief.'" *Id.* (quoting Fed. R. Civ. P. 8(a)(2)). Thus, the Court may not accept as true mere legal conclusions in the counterclaim, and the legal "framework" of the counterclaim "must be supported by factual allegations." *Id.* (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009)).

A motion to dismiss under Civil Rule 12(b)(6) is also the proper way to challenge an improper request for relief contained within a count that also alleges other claims. *E.g.*, *Whittlestone, Inc. v. Handi-Craft Co.*, 618 F.3d 970, 974 (9th Cir. 2010) (Civil Rule 12(b)(6), not Civil Rule 12(f), allows litigants "a means to dismiss some or all of a pleading"); *see Yeiser Research & Dev. LLC v. Teknor Apex Co.*, 281 F. Supp. 3d 1021, 1057 (S.D. Cal. 2017) (dismissing some but not all breach of contract claims raised in one count); *Williams & Cochrane, LLP v. Quechan Tribe of Fort Yuma Indian Reservation*, No. 317CV01436GPCMDD, 2018 WL 2734946, at *7 (S.D. Cal. June 7, 2018) (dismissing one breach of contract claim, pleaded in a single count with other unchallenged breach of contract claims, "[t]o the extent that Count One is premised on a violation of Section 5" of the contract).

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

IV. ARGUMENT

A. SGM Cannot Recover The Deposit Because It Was Non-Refundable Under The Express Terms Of The APA

Each of SGM's claims in Counts I-III fail, at least in part, because the express terms of the APA do not entitle SGM to recover the Deposit, and a series of Court orders preclude the release of the Deposit. *See Gosha v. Bank of New York Mellon Corp.*, 707 F. App'x 484 (9th Cir. 2017) (affirming dismissal of claims based on parties' written agreements, because "absent ambiguity, the court construes the words of a contract as a matter of law" (quotation omitted)).

1. The Deposit Is Non-Refundable Because None Of The Exceptions Under Section 1.2 Are Applicable.

SGM admits it paid the Deposit to VHS "[p]ursuant to APA Section 1.2." Counterclaim, ¶ 18. As noted, Section 1.2 provides that the Deposit is refundable in only four enumerated instances. APA Section 1.2 states:

> The Deposit *shall be non-refundable in all events*, except as provided in Section 6.1(b) or Section 6.2, or in the event [SGM] *has terminated this Agreement* pursuant to Section 9.1 (other than Section 9.1(b)) or as set forth in Section 9.2, in which case [Plaintiffs] shall immediately return the Deposit to [SGM] with all interest earned thereon.
>
> FAC, Ex. A (emphasis added).

The Counterclaim, however, does not seek a refund under *any* of these four enumerated instances, *none* of which would entitle SGM to a refund of the Deposit in any event.

First, APA Section 6.1(b) would have been triggered only in the event that an "Overbidder" successfully bid to purchase the Hospitals in an "Alternate Transaction." *See* FAC, Ex. A, § 6.1(b). There is no dispute this did not occur, as is clear from the First Amended Complaint and the Counterclaim.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Second, APA Section 6.2 is likewise inapplicable on its face, because there was no appellate court stay of the Sale Order preventing a closing and SGM did not terminate the APA. *See* FAC, Ex. A, § 6.2.

Third, APA Section 9.1 (other than Section 9.1(b)) would only require a refund of the Deposit in the event "[SGM] has terminated this Agreement." FAC, Ex. A, § 1.2. As the Counterclaim confirms, however, this did not occur. Despite its baseless allegations that Plaintiffs breached the APA, SGM never purported to terminate the APA for any of the reasons unilaterally available to Purchaser as enumerated in Section 9.1, *e.g.* § 9.1(c) [due diligence dissatisfaction before January 8, 2019], §9.1(d) [Sellers' material covenant breach], § 9.1(e) [Article 8 conditions unsatisfied by December 31, 2019], 9.1(g) [dismissal of the chapter 11 cases], or §9.1(i) [failure to close without fault of Purchaser]. Instead, it simply refused to close the transaction and demanded the return of its Deposit in one letter, while seeking to keep Plaintiffs locked in the APA, incurring estimated daily losses of $450,000 and being prevented from selling the Hospitals to another buyer. SGM newly alleges in its Counterclaim that it "would always be entitled to a return of its deposit if it did not breach an obligation to close" under § 9.1(i). Counterclaim, ¶¶ 29, 31. But this allegation is meaningless, as SGM still does not argue it is actually entitled to the Deposit under § 9.1(i), nor can it. Again, it is undisputed that SGM did not terminate the APA, under any subsection of § 9.1, or otherwise.

Fourth, APA Section 9.2 also does not entitle SGM to a refund of the Deposit. That section provides:

> 9.2 Termination Consequences. If this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1: (a) all further obligations of the parties under this Agreement shall terminate (other than Purchaser's right to receive the Break-Up Fee if applicable), provided that the provisions of ARTICLE 12, shall survive; and (b) each party shall pay only its own costs and expenses incurred by it in connection with this Agreement; provided, in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof. In addition, *if this*

> *Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 (other than Section 9.1(b)), Seller shall immediately return the Deposit to Purchaser with all interest earned thereon.* Each Party acknowledges that the agreements contained in this Section 9.2 are an integral part of the transactions contemplated by this Agreement, that without these agreements such Party would not have entered into this Agreement.
>
> FAC, Ex. A (emphasis added).

Here, the APA was not terminated pursuant to Sections 6.1(b), 6.2, or 9.2. Rather, *Plaintiffs* terminated the APA, pursuant to Section 9.1(b). *See* FAC ¶¶ 88, 91, 93, 100, 107; SGM Answer ¶¶ 93, 107. Section 9.2 expressly provides that the Deposit will not be refunded in the event of a termination pursuant to Section 9.1(b). *See* FAC, Ex. A, APA, § 9.2 ("In addition, if this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 *(other than Section 9.1(b)),* Seller shall immediately return the Deposit to Purchaser with all interest earned thereon." (emphasis added)). Because none of the circumstances delineated in Section 1.2 occurred, the Deposit remains "*non-refundable*" according to the APA's express terms.

Consequently, SGM is not entitled to a refund of the Deposit.

2. Section 11.2 Does Not Entitle SGM To A Refund of the Deposit.

To avoid the express terms of Section 1.2, SGM stretches Section 11.2 of the APA past the breaking point. Contrary to SGM's assertions, APA Section 11.2 did not expand the limited set of circumstances in which the Deposit was refundable, or otherwise create a new right to a refund of the Deposit. Rather, any right to any refund of the Deposit under Section 11.2 remains subject to Section 1.2.

As its placement in the contract suggests, Section 11.2 merely outlines the remedies available in the event of a termination under Section 9.1(b) or (d). *See* FAC, Ex. A, § 9.2 ("in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof"). In contrast, Section 1.2 appears in the first section of the contract, sets forth the definition of "Deposit," and expressly states the Deposit is

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

"non-refundable in all events," except for the four instances set forth in Sections 6.1(b), 6.2, 9.1, and 9.2. FAC, Ex. A; *see In re Keller's Estate,* 134 Cal. App. 2d 232, 236 (1955) ("We are convinced that consideration should first be given to the order in which the provisions appear, for, unless some contrary design is apparent, what could be more logical in applying rules of interpretation than to say that each subsequent provision in a will must be considered in the light of that which has gone before.").

"The starting point for the interpretation of any contract is the plain language of the agreement." *EduMoz, LLC v. Republic of Mozambique*, No. CV1302309MMMCWX, 2014 WL 12802921, at *7 (C.D. Cal. July 21, 2014) (citing *Klamath Water Users Protective Ass'n v. Patterson*, 204 F.3d 1206, 1210 (9th Cir. 1999)). "If the language of the contract is clear, the intent of the parties should be determined from the contract itself." *Id.* (citing Cal. Civ. Code § 1639 (for written contracts, "the intention of the parties is to be ascertained from the writing alone, if possible")). "The contract language, therefore, governs interpretation of the agreement 'if the language is clear and explicit.'" *Id.* (quoting Cal. Civ. Code § 1638)).

Indeed, the "fundamental rule of contract interpretation" is that "a contract should be interpreted so as to give meaning to each of its provisions" without rendering any of them "meaningless." *Brinderson–Newberg Joint Venture v. Pac. Erectors, Inc.*, 971 F.2d 272, 278–79 (9th Cir.1992) (citing Restatement of Contracts (2d) § 203(a) cmt. b (1979)). To supplement those four limited instances with a new section that was not referenced would eviscerate the "non-refundable in all events" language of Section 1.2. *See Hints v. Am. Family Life Assurance Co. of Columbus*, No. 4:19-CV-03764-YGR, 2020 WL 2512234, at *3 (N.D. Cal. May 15, 2020) ("A court cannot rewrite the contract – a court must enforce the explicit language of the contract.") (citing *Gilliam v. Nevada Power Co.*, 488 F.3d 1189, 1194 (9th Cir. 2007)). SGM's proposed interpretation of Section 11.2 is also inconsistent with

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Sections 9.1 and 9.2, which list the specific circumstances entitling SGM to a refund in the event Plaintiffs did not fulfill their obligations under the APA and SGM terminated the APA. In other words, even if Plaintiffs breached the APA (which they did not), SGM could only recover its Deposit if SGM itself terminated the APA (which it did not).

For these reasons, SGM cannot recover the Deposit under the plain terms of the APA. Accordingly, the Court should dismiss each of SGM's Counts to the extent they are based on such a theory, or alternatively strike any allegations to this effect.

B. <u>Plaintiffs Are Prohibited By Court Order From Releasing The Deposit.</u>

In addition, each claim asserted by SGM fails because orders issued by the Bankruptcy Court preclude Plaintiffs from disbursing the Deposit. Specifically, as explained above, the Sale Order incorporates the provisions of the Final DIP Order, which requires that all sale proceeds, including deposits, be held in a segregated Escrow Deposit Account, and precludes the Debtors from disbursing those funds absent the consent of the Debtors' Prepetition Secured Creditors or an order of the Court. *See* Plaintiffs' RJN, Ex. B (Sale Order at ¶ 13); Plaintiffs' RJN, Ex. C (Final DIP Order at ¶ 4). The Counterclaim does not allege that such consent has been given or that such an order has been issued.

In the face of these arguments, SGM has incorrectly asserted that the Bankruptcy Court's orders are contrary to the express terms of the APA. However, the Sale Order provides that, "[u]nless otherwise provided in this Sale Order, to the extent any inconsistency exists between the provisions of the APA and this Sale Order, the provisions contained in this Sale Order shall govern." Plaintiffs' RJN, Ex. B (Sale Order at ¶ 26). Accordingly, the more restrictive terms of the Sale Order limiting disbursements of sale proceeds govern over any contrary language in the APA.

DENTONS US LLP
One Market, Spear Street Tower, 24th Floor
San Francisco, California 94105
(415) 267-4000

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Plaintiffs cannot be liable under any legal or equitable theory for refusing to engage in conduct that would violate a court order, particularly one that takes precedence over any inconsistent provisions contained in the APA. *See Singh v. Baidwan*, 651 F. App'x 616, 617-19 (9th Cir. 2016) ("the public importance of discouraging [illegal] transactions outweighs equitable considerations of possible injustice between the parties") (internal quotes omitted). This is particularly underscored by the parties' undisputed, agreed-upon language in the plan and disclosure statement (approved by the Bankruptcy Court) explicitly restricting any party's ability to "distribute" or otherwise "take any action" regarding the Deposit without a judgment or court order, discussed above. *See* Plaintiffs' RJN, Ex. B (Omnibus Reply at 6-7); *id.*, Ex. O (Disclosure Statement at 43); *id.*, Ex. P (SGM Limited Objection at 1-2); *id.*, Ex. Q (Order on SGM Limited Objection at 4).

In short, Plaintiffs are obligated to hold the Deposit pursuant to the Bankruptcy Court's orders, and they have not breached the APA by acting in conformance with those orders designed to protect the interests of parties other than Plaintiffs. Accordingly, Counts I, II, and III should be dismissed to the extent they are premised on this theory. In the alternative, the Court should strike all allegations that seek to impose liability for allegedly failing to remit the Deposit to SGM, as specified in the above Notice of Motion.

C. SGM Has Failed to Allege Claims For Other Alleged Breaches Of Contract And The Implied Covenant

SGM's three counts also assert a random collection of purported other breaches of the APA and the implied covenant, separate from SGM's incorrect contention that it is entitled to a return of the Deposit under the APA. For example, SGM accuses Plaintiffs of demanding that SGM close the transaction without satisfying certain closing conditions, failing "to comply with legal requirements" and obtain an approval for operation of Hospitals, failing to respond to "building and safety code violations," violating "other specifically enumerated regulatory issues as

set forth in the parties' correspondence," "allowing" revenue to deteriorate, failing to "reserve for its accrued obligations," and "incurring post-petition liability" (collectively, the "Other Alleged Breaches"). *See, e.g.*, Counterclaim, ¶¶ 58-59, 64, 67-68.

Despite such allegations, however, SGM fails to link the Other Alleged Breaches to any specific provisions in the APA prohibiting such alleged conduct. This is perhaps not surprising, given the APA's broad provision that the sale transaction was expressly "AS IS, WHERE IS AND WITH ALL FAULTS AND NONCOMPLIANCE WITH LAWS":

> (a) THE ASSETS TRANSFERRED TO PURCHASER WILL BE SOLD BY SELLERS AND PURCHASED BY PURCHASER IN THEIR PHYSICAL CONDITION AT THE EFFECTIVE TIME, "AS IS, WHERE IS AND WITH ALL FAULTS AND NONCOMPLIANCE WITH LAWS" WITH NO WARRANTIES, INCLUDING, WITHOUT LIMITATION, THE WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, SUITABILITY, USAGE, WORKMANSHIP, QUALITY, PHYSICAL CONDITION, OR VALUE, AND ANY AND ALL SUCH OTHER REPRESENTATIONS AND WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED, AND WITH RESPECT TO THE LEASED REAL PROPERTY WITH NO WARRANTY OF HABITABILITY OR FITNESS FOR HABITATION, INCLUDING, WITHOUT LIMITATION, THE LAND, THE BUILDINGS AND THE IMPROVEMENTS. ALL OF THE PROPERTIES, ASSETS, RIGHTS, LICENSES, PERMITS, PRIVILEGES, LIABILITIES, AND OBLIGATIONS OF SELLERS INCLUDED IN THE ASSETS AND THE ASSUMED OBLIGATIONS ARE BEING ACQUIRED OR ASSUMED "AS IS, WHERE IS" ON THE CLOSING DATE AND IN THEIR PRESENT CONDITION, WITH ALL FAULTS. ALL OF THE TANGIBLE ASSETS SHALL BE FURTHER SUBJECT TO NORMAL WEAR AND TEAR AND NORMAL AND CUSTOMARY USE OF THE INVENTORY AND SUPPLIES IN THE ORDINARY COURSE OF BUSINESS UP TO THE EFFECTIVE TIME.
>
> FAC, Ex. A.

The Counterclaim fails to allege how the conduct alleged in Counts 1-3 with respect to the Other Alleged Breaches could have actually breached specific

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

provisions of the APA, given the broad "AS IS WHERE IS" provision. Such conclusory claims fail to comply with Rule 8. *See e.g.*, *Smith v. Barrett, Daffin, Frappier, Treder & Weiss, LLP*, No. 18-CV-06098-RS, 2019 WL 2525185, at *9 (N.D. Cal. June 19, 2019) ("Smith's damages allegations are conclusory, listing a laundry list of harms without defining what it is that Smith has suffered in response to Defendants' averred conduct. Smith must plead specific allegations to allow for the reasonable inference, not the sheer possibility, of harm."); *Architectural Res. Grp., Inc. v. HKS, Inc.*, No. C 12-5787 SI, 2013 WL 568921, at *3 (N.D. Cal. Feb. 13, 2013) (same, dismissing breach of contract counterclaim).

In addition, SGM fails to allege that it would have closed the transaction absent the Other Alleged Breaches. As a result, SGM fails to allege that it sustained damages caused by the allegedly unmet conditions. *See, e.g.*, *DCR Mktg., Inc. v. U.S. All. Grp., Inc.*, No. SACV1901897JVSDFMX, 2020 WL 3883276, at *3 (C.D. Cal. June 26, 2020) (quotation omitted) (resulting damages are essential element of contract claim); *Hellenic Petroleum LLC v. Elbow River Mktg. LTD.*, No. 119CV00483LJOSKO, 2019 WL 6114892, at *4 (E.D. Cal. Nov. 18, 2019) (finding failure to plead breach of contract claim where plaintiff failed to allege it would have performed and/or any damages that could have resulted if plaintiff had not performed) (quoting *In re Nat'l Football League's Sunday Ticket Antitrust Litig.*, 933 F.3d 1136, 1149 (9th Cir. 2019) ("[C]onclusory allegations of law and unwarranted inferences are insufficient to avoid a Rule 12(b)(6) dismissal.")).

Accordingly, the remainder of SGM's claims for breach of contract and the implied covenant in Counts I, II, and III should be dismissed for this added deficiency.

D. Count III Fails On Additional Grounds.

Finally, Count III, for Tortious Breach Of Contract, fails on additional grounds. "[O]utside the insurance context, a tortious breach of contract may be found when (1) the breach is accompanied by a traditional common law tort, such as fraud

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

or conversion; (2) the means used to breach the contract are tortious, involving deceit or undue coercion or; (3) one party intentionally breaches the contract intending or knowing that such a breach will cause severe, unmitigable harm in the form of mental anguish, personal hardship, or substantial damages." *Underwriters at Lloyd's v. Abaxis, Inc.*, No. 19-CV-02945-PJH, 2020 WL 1677341, at *3 (N.D. Cal. Apr. 6, 2020) (quoting *Robinson Helicopter Co. v. Dana Corp.*, 34 Cal. 4th 979, 990 (2004)). Here, SGM has failed to plead (and cannot plead) any of these elements.

The Counterclaim does not allege any separate tort, and instead only asserts contract theories in Counts I, II and III. SGM previously asserted a tort claim in its Counterclaim (conversion), but then dropped it in the amended pleading. Indeed, as explained in Plaintiffs' prior Motion to Dismiss, no conversion claim could possibly stand because SGM was not entitled to the Deposit for the same reasons and the economic loss rule barred the claim.

Further, to the extent SGM is attempting to allege fraud, it has failed to do so. "Under California law, the elements of fraud are: (1) misrepresentation (false representation, concealment, or nondisclosure); (2) knowledge of falsity (or 'scienter'); (3) intent to defraud, i.e., to induce reliance; (4) justifiable reliance; and (5) resulting damage." *Westport Ins. Corp. v. Vasquez, Estrada & Conway LLP*, No. 15-CV-05789-JST, 2016 WL 1394360, at *5 (N.D. Cal. Apr. 8, 2016) (citing *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1126 (9th Cir. 2009)). Here, the Amended Counterclaim fails to show any of the elements, and certainly fails to do so with the required specificity under Federal Rule of Civil Procedure 9(b).

The only alleged "misrepresentations" identified in the Counterclaim were purportedly contained in a November 20, 2019 letter sent to Defendants' counsel by Plaintiffs' counsel pursuant to the underlying bankruptcy case. *See* Counterclaim, ¶¶ 46-47. That letter was protected by the litigation privilege, which applies to statements: "(1) made in judicial or quasi-judicial proceedings; (2) by litigants or other participants authorized by law; (3) to achieve the objects of the litigation; and

(4) that have some connection or logical relation to the action." *McNair v. City & County of San Francisco*, 5 Cal. App. 5th, 1154 at 1162 (citing *Silberg v. Anderson*, 50 Cal. 3d 205, 212 (1990)); *see also Rothman v. Jackson*, 49 Cal. App. 4th 1134, 1146 (1996).

As SGM admits, the November 20, 2019 letter is a communication between counsel of record for parties to the bankruptcy proceeding (SGM had become a party in interest to the underlying bankruptcy proceeding as of November 20, 2019 per 11 U.S.C. § 1109(b)). That letter extensively references orders issued by the Bankruptcy Court, and recited that the Bankruptcy Court had ruled that APA § 8.6 was satisfied, that the parties were obligated by court order to notify the Bankruptcy Court of the status of the sale, that SGM was thereby obligated to close the sale under the court-approved and court-enforced APA, and that SGM's failure to do so would cause it to incur liability for damages to Plaintiffs. Accordingly, the letter is a classic example of a communication between counsel of record, made in judicial proceedings, by litigants, to achieve the very object of the bankruptcy litigation. *See I & U, Inc. v. Publishers Sols. Int'l*, 652 F. App'x 558, 559 (9th Cir. 2016) (demand letter protected by litigation privilege); *Hedayati v. Perry Law Firm, APLC*, No. SACV1701411DOCDFMX, 2018 WL 3155186, at *5 (C.D. Cal. May 16, 2018), *report and recommendation adopted*, No. SACV171411DOCDFM, 2018 WL 3129803 (C.D. Cal. June 25, 2018) (same); *Sandoval v. Law Office of John Bouzane*, No. 15-764, 2016 WL 7383535, *4 (C.D. Cal. Jan. 5, 2016) (same); *Taylor v. Quall*, 458 F. Supp. 2d 1065, 1067 (C.D. Cal. 2006) (same). As a matter of law, it does not amount to fraud.

In any event, the November 20 letter could not have contained any false statements at the time it was sent, as a matter of law, because its language tracked nearly verbatim the Bankruptcy Court's November 18, 2019 Order, quoted above. Again, as discussed above, Plaintiffs cannot be liable under any legal or equitable theory for accurately describing a court order. *See Singh*, 651 F. App'x at 617-19.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Further, SGM has failed to specifically allege facts demonstrating that such statements were knowingly false, and made with the intent to defraud, as required under Rule 9(b).

Nor has SGM alleged the other essential elements of fraud. The word "reliance" does not appear in the Counterclaim, let alone allege specific facts demonstrating actual and justifiable reliance. *See generally*, Docket No. 58. To the contrary, SGM alleges that it *did not rely* on the November 20, 2019 letter, and instead sent its own November 22 letter disagreeing with the assertions in Plaintiffs' demand letter and refusing to close the sale. *Id.* at ¶¶ 48-49. Likewise, SGM does not allege specific facts showing that it suffered damages based on the statements in the letter, with which it disagreed.

Because SGM fails to allege a separate and independent basis for tort recovery, it fails to allege the elements of the third count, and its "recovery, therefore, is limited to contractual damages," and Count III must be dismissed. *See Westport Ins. Corp.*, 2016 WL 1394360, at *3, *5 ("[c]onduct amounting to a breach of contract becomes tortious only when it also violates a duty independent of the contract arising from principles of tort law") (quoting *Robinson Helicopter*, 34 Cal. 4th at 988); *Vigdor v. Super Lucky Casino, Inc.*, No. 16-CV-05326-HSG, 2017 WL 2720218, at *6 (N.D. Cal. June 23, 2017) (dismissing under *Robinson Helicopter*, finding that "the economic loss rule requires that Plaintiffs plead a *separate* tort to be entitled to tort remedies" and "Plaintiffs cannot simply retitle the same conduct 'fraud.'"); *Innovative Bus. Partnerships, Inc. v. Inland Cty. Reg'l Ctr., Inc.*, 194 Cal. App. 4th 623, 631–32 (2011) ("A cause of action for tortious breach of the covenant of good faith and fair dealing requires the existence and breach of an enforceable contract as well as an independent tort.").

V. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court grant Plaintiffs' Motion to Dismiss the Amended Counterclaim.

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

Respectfully submitted,

Dated: September 3, 2020

DENTONS US LLP
SAMUEL R. MAIZEL
SONIA R. MARTIN
TANIA M. MOYRON
NICHOLAS A. KOFFROTH

By */s/ Sonia Martin*
Sonia Martin

Attorneys for Verity Health Systems of California, Inc., *et al.*

DENTONS US LLP
ONE MARKET, SPEAR STREET TOWER, 24TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
(415) 267-4000

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION - LOS ANGELES

In re VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al*.	Case No. 2:20-cv-00613-DSF Hon. Dale S. Fischer
VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a California nonprofit public benefit corporation, ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation, ST. VINCENT DIALYSIS CENTER, INC., a California nonprofit public benefit corporation, and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, SETON MEDICAL CENTER, a California nonprofit public benefit corporation, and VERITY HOLDINGS, LLC, a California limited liability company, Plaintiffs, v. KALI P. CHAUDHURI, M.D., an individual, STRATEGIC GLOBAL MANAGEMENT, INC., a California corporation, KPC HEALTHCARE HOLDINGS, INC. a California Corporation KPC HEALTH PLAN HOLDINGS, INC. a California Corporation, KPC HEALTHCARE, INC. a Nevada Corporation, KPC GLOBAL MANAGEMENT, LLC, a California Limited Liability Company, and DOES 1 through 500, Defendants.	**[PROPOSED] ORDER GRANTING PLAINTIFFS' MOTION TO DISMISS DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S AMENDED COUNTERCLAIMS, OR IN THE ALTERNATIVE, TO STRIKE PORTIONS OF DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S AMENDED COUNTERCLAIMS** Date: October 5, 2020 Time: 1:30 p.m. Place: Courtroom 7D 350 West 1st Street Los Angeles, CA 90012
STRATEGIC GLOBAL MANAGEMENT, INC., a California corporation, Counter-Plaintiff, v. VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a California nonprofit public benefit corporation, ST. VINCENT MEDICAL CENTER, a	

California nonprofit public benefit corporation, ST. VINCENT DIALYSIS CENTER, INC., a California nonprofit public benefit corporation, and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, SETON MEDICAL CENTER, a California nonprofit public benefit corporation, and VERITY HOLDINGS, LLC, a California limited liability company,

Counter-Defendants.

DENTONS US LLP
601 South Figueroa Street, Suite 2500
Los Angeles, California 90017-5704
(213) 623-9300

The Court, having considered Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, Verity Holdings, LLC, and the above-captioned debtors ("Plaintiffs") Motion to Dismiss Defendant Strategic Global Management's Amended Counterclaims pursuant to Fed. R. Civ. P. 12(b)(6) and to strike portions of Strategic Global Management's Amended Counterclaims pursuant to Fed. R. Civ. P. 12(f) ("Motion"), and finding good cause therefore, **GRANTS** the Motion.

ACCORDINGLY, IT IS HEREBY ORDERED that:

1. Plaintiffs' Motion is **GRANTED** and Defendant Strategic Global Management's Amended Counterclaims are dismissed with prejudice for failure to state a cognizable claim for relief;
2. Plaintiffs' Request for Judicial Notice filed in support of its Motion is **GRANTED**;
3. Additionally, and in the alternative, the Court strikes the following portions of Strategic Global Management's Amended Counterclaims:
    a. page 20, lns. 21-23; page 21, lns. 13-14; page 22, lns 3-4 and ln. 8; page 30, lns. 7-21, lns. 22-24; page 31, lns. 1-8, line 28; page 32, lns. 1-3; page 39, lns. 4-13, lns. 24-27; page 40, ln. 27; page 41, lns. 1-2, lns. 7-9; page 42, ln. 13, lns. 17-18; page 43, lns. 9-11, lns. 26-28; page 44, line 24.

Dated: September __ 2020

Hon. Dale S. Fischer
UNITED STATES DISTRICT JUDGE