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Verity Health System of California, Inc., *et al*.

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION - LOS ANGELES

In re: VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*,[1] Debtors and Debtors In Possession.	District Court Case No.: 2:18-cv-10675-RGK Bankruptcy Court Lead Case No.: 2:18-bk-20151-ER
OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF VERITY HEALTH SYSTEMS OF CALIFORNIA, INC., *et al.* Appellant. v. VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.* Appellees.	**BRIEF OF APPELLEES VERITY HEALTH SYSTEM OF CALIFORNIA, INC. *ET AL*.**

[1] The other Debtors in the chapter 11 cases, being jointly administered under Lead Case No. 2:18-bk-20151-ER, are O'Connor Hospital 2:18-bk-20168-ER, Saint Louise Regional Hospital 2:18-bk-20162-ER, St. Francis Medical Center 2:18-cv-20165-ER, St. Vincent Medical Center 2:18-bk-20164-ER, Seton Medical Center 2:18-cv-20167-ER, O'Connor Hospital Foundation 2:18-bk-20179-ER, Saint Louise Regional Hospital Foundation 2:18-cv-20172-ER, St. Francis Medical Center of Lynwood Foundation 2:18-cv-20178-ER, St. Vincent Foundation 2:18-cv-20180-ER, St. Vincent Dialysis Center, Inc. 2:18-cv-20171- ER Seton Medical Center Foundation 12:8-cv-20175-ER, Verity Business Services 2:18-cv-20173-ER, Verity Medical Foundation 2:18-cv-20169-ER, Verity Holdings, LLC 2:18-cv-20163-ER, DePaul Ventures, LLC 2:18-cv-20176-ER, and DePaul Ventures - San Jose Dialysis, LLC 2:18-cv-20181-ER.

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 8012 of the Federal Rules of Bankruptcy Procedure, Appellee Verity Health System of California, Inc., as debtor and debtor in possession in the above captioned jointly administrated chapter 11 cases, hereby discloses that it is a nonprofit public benefit corporation organized under the laws of the State of California and that it has no parent corporation and has no shareholders, and therefore no entity owns or controls ten percent or more of its shares.

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Verity Health System of California, Inc. ("VHS"), and the above-referenced affiliated debtors and debtors-in-possession (the "Debtors") in the above-captioned chapter 11 cases (the "Chapter 11 Cases") pending in the United States Bankruptcy Court for the Central District of California (the "Bankruptcy Court") and the appellees herein, hereby submit their opening brief in response to the opening brief [ECF No. 22] (the "Committee's Brief") filed by the Official Committee of Unsecured Creditors of Verity Health System of California, Inc., et al. (the "Committee" or the "Appellant"), and respectfully request the Court affirm the Bankruptcy Court's *Final Order (A) Authorizing the Debtors to Obtain Postpetition Financing; (B) Authorizing the Debtors to Use Cash Collateral; and (C) Granting Adequate Protection to Prepetition Secured Creditors Pursuant to 11 U.S.C. §§105, 363, 364, 1107 and 1108*[2], entered October 4, 2018, [Committee's App.[3] No. 34] as subsequently modified by the Bankruptcy Court on February 4, 2019 [Debtors' App.[4] No. 1] following the Rule 7052 Motion (defined below) and the execution of the Swinerton Stipulation (defined below) (ECF Nos. 409 and 1457 are collectively the "Final DIP Order").

I. BASIS OF APPELLATE JURISDICTION

This Court has jurisdiction over this appeal, pursuant to 28 U.S.C. §158(a)(1), following a timely filed notice of appeal by the Committee and the Debtors' *Statement of Election to Transfer Appeal to the United States District*

[2] All references to "sections" or "§" herein are to sections of the Bankruptcy Code, 11 U.S.C. §§101, *et seq.* unless otherwise noted. All references to Rules are to the Federal Rules of Bankruptcy Procedure.

[3] Citations to "Committee's App." refer to *Appendix in Support of the Official Committee of Unsecured Creditors' Appellant's Brief*, filed at ECF No. 23.

[4] Citations to "Debtors' App." refer to the *Appendix in Support of the Brief of Appellees Verity Health System of California, Inc. et al.*, filed concurrently herewith.

Court for the Central District of California and as provided for by Rule 8005(a)(1). ECF No. 3.

II. ISSUES PRESENTED ON APPEAL

1. The Committee's three stated issues on appeal can be synthesized into a single question: whether the Bankruptcy Court's findings of fact were supported by substantial evidence in the record sufficient for the exercise of its discretion to conclude that the Debtors' offer to grant the Prepetition Secured Creditors (defined below) an Adequate Protection Package (defined below) that included the challenged Waivers (defined below) was legally permissible and appropriate under the circumstances of this case.

2. Whether the Committee's appeal has been rendered equitably moot or statutorily moot under §364(e) as a result of (a) the DIP Lenders' reliance on the DIP Final Order and the Prepetition Secured Creditors' consents therein contained to extend a revolving line of credit, (b) the execution of the DIP Lender Stipulation (defined below) [Debtors' App. No. 2], and (c) the Debtors' consensual use of the Prepetition Secured Creditors' cash collateral to continually repay borrowings utilized to fund operations under the DIP Credit Agreement (as defined below).

III. STANDARD OF REVIEW

The bankruptcy court's decision is reviewed under an abuse of discretion standard. *In re Lee*, 2018 WL 7501124 *7 (C.D. Cal. 2018) (holding a choice of equitable remedies was to be reviewed on an abuse of discretion standard). That proposition is entirely consistent with the appropriate standard of review for review of equitable remedies chosen by federal trial courts generally. *See Labor/Community Strategy Center v. Los Angeles County Metropolitan Transp. Authority,* 263 F.3d 1041, 1048 (9th Cir. 2001) (citing *Stone v. City and County of San Francisco*, 968 F.2d 850, 861 (9th Cir. 1992)) (citing *Swann v. Charlotte-Mecklenburg Bd. Of Educ.*, 402 U.S. 1, 15 (1971)). When reviewing a bankruptcy court's exercise of discretion, this Court reviews its conclusions of law *de novo* and

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its findings of fact for clear error. *In re Lee,* 2018 WL 7501124 *7 (citing *In re Sunnymead Shopping Center Co.,* 178 B.R. 809, 814 (B.A. P. 9th Cir. 1995)) and *In re Pecan Groves of Arizona*, 951 F.2d 242, 244 (9th Cir. 1991)). A*ccord*, *In re Roussos,* 2017 U.S. Dist. LEXIS 79117 (C.D. Cal. 2017), *app. dismissed*, *Roussos v. Ehrenberg*, 2018 U.S. App. LEXIS 5756 (9th Cir. Feb. 28, 2018) and *Levernier v. Educ. Credit Mgmt. Corp. (In re Levernier),* 307 B.R. 684 (C.D. Cal. 2004).

A bankruptcy court necessarily abuses its discretion if it bases its decision on an erroneous view of the law or clearly erroneous factual findings. *United States v. Hinkson,* 585 F.3d 1247, 1261 (9th Cir. 2009) (*en banc*) (citing *Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405 (1990) (partially superseded by rule on other grounds, FRCP 11)). "Under [the abuse of discretion] standard, a 'reviewing court cannot reverse unless it has a definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors.'" *In re Sunnymead Shopping Center Co.,* 178 B.R. at 814 (quoting *In re Goldberg*, 168 B.R. 382, 384 (B.A.P. 9th Cir. 1994)).

IV. STATEMENT OF THE CASE

A. Introduction

In pursuing this appeal, the Committee challenges the Bankruptcy Court's exercise of its broad equitable power to designate permissible forms of negotiated adequate protection and to use its discretion to permit the Debtors' good faith exercise of its business judgment to be implemented, after notice and a hearing, accompanied by unchallenged declarations of relevant facts.

Specifically, the Committee attempts to appeal from isolated parts of the Bankruptcy Court's Final DIP Order, which authorized seventeen affiliated not-for-profit corporate Debtors to enter into a $185 million Debtor in Possession Senior Secured Revolving Credit Facility (the "DIP Facility") with Ally Bank N.A. (the "DIP Lender"), pursuant to that certain Debtor in Possession Revolving Credit Agreement (the "DIP Credit Agreement"). But notably, the Committee does not

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ask this Court to reverse the Final DIP Order in full. Instead, the Committee only asks that this Court reverse the Final DIP Order to the extent that it grants the Waivers to the Prepetition Secured Creditors. As more fully explained below, there is no way for this Court to simply remove such Waivers from the Final DIP Order without destabilizing the Debtors' ability to access the DIP Facility and use the Prepetition Secured Creditors' cash collateral going forward.

The DIP Credit Agreement jointly and severally obligated each of the Debtors to repay the amounts due under the DIP Facility. Committee's App. No. 3, Exh. 3 at § 11.27. Critical elements of the financing terms reflected in the DIP Credit Agreement were the requirements that (a) the obligations be joint and several among the Debtors, (b) the loan security be senior (or prime) all existing secured and unsecured prepetition and postpetition debt of the Debtors, and (c) the Prepetition Secured Creditors needed to consent to, or not oppose or appeal from entry of the Interim DIP Order or the Final DIP Order.[5] Committee's App. No. 3 at Exh. 3. Through the Adequate Protection Package[6] provided to the Prepetition Secured Creditors, the Debtors were able to obtain the required consents.

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[5] Section 3.3(b) of the DIP Credit Agreement contains the prepetition lender consent language as a condition precedent to loan funding:

> (b) the Final Order shall (A) have been entered without opposition by any Specified Prepetition Secured Creditor, the PACE Bond Trustee, NantWorks, LLC or any other Person identified by Administrative Agent, (B) shall have been entered not later than thirty (30) days following the entry of the Interim Order and (C) be in effect and shall not have been reversed, modified, amended or stayed, and no motion seeking a reversal, modification, amendment or stay shall have been filed by any Person;

Comm. App. No. 3, Exh. 3 at §3.3(b).

[6] The Adequate Protection Package included the Prepetition Replacement Liens, Prepetition Adequate Protection Payments, Prepetition Superpriority Claims, stipulations relating to Validity, Perfection and Amount of Prepetition Liens and Section 506(c) Waiver and Section 552(b) Waiver, each as defined in the Final DIP Order (the "Adequate Protection Package"). Committee's App. No. 34 at ¶ 5(a)-(g).

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The Debtors' evidence regarding their need for postpetition financing was never challenged by the Committee, either at the Interim Hearing on September 5, 2018, Committee's App. No. 16, or the final hearing on October 3, 2018, Committee's App. No. 35, as described below. The Committee has never challenged the size of the DIP Facility at $185 million, nor its pricing, which could only be regarded as "below market". Committee's App. No. 3 at ¶ 18. Moreover, the Committee did not present any evidence to the contrary, or challenge the credibility of the Debtors' declarations that it had lost $175 million in fiscal year 2017 and was losing money at the same rate in fiscal year 2018, despite significant operational improvements at the Hospitals (defined below) and in the other aspects of the Debtors' business. Committee's App. No. 4 at 81 and 95-110; Committee's App. No. 3 at 11-13A.

Importantly, the Committee also fails to cite to any evidence in the record that suggests that the required support of the Prepetition Secured Creditors could have been obtained without all of the elements of the inducement Adequate Protection Package. Indeed, as is evidenced by the objection to the Final DIP Order lodged by the Bond Trustees (defined below), there is competent evidence that the prepetition secured creditors (the "Prepetition Secured Creditors") were extremely sensitive to the details of the Adequate Protection Package and its impact on each separate group of secured creditors[7]. Thus, the Debtors' ability to borrow on economically favorable terms, at a level that would reasonably assure a successful chapter 11 case, was the basis for the Bankruptcy Court's understanding of the

[7] The Prepetition Secured Creditors are comprised of six different lender groups who collectively hold the following debt: the 2005 Revenue Bonds, the 2015 Revenue Notes, the 2017 Revenue Notes, the MOB Financings (I and II), the PACE and Seismic Bonds, and the Secured Trade Financing Arrangement. Committee App. No. 3 at ¶¶ 4-9. They provided financing to the tax exempt Hospitals, VHS, Verity Medical Foundation and the non-tax exempt Verity Holdings, LLC. The 2005 Revenue Bonds, 2015 Revenue Notes and the 2017 Revenue Notes collateral packages did not overlap with the MOB Financings or the Secured Trade Financing. Committee's App. 3 at ¶¶ 4-10, 24.

situation. The parties created a thorough record for the Bankruptcy Court to review and the Bankruptcy Court did not abuse its discretion in granting the Waivers. As such, the Debtors ask that this Court (i) affirm the Bankruptcy Court's authorization of the Waivers and (ii) leave the Final DIP Order unchanged.

B. Factual Background

On August 31, 2018 (the "Petition Date"), the Debtors in these jointly administrated cases each filed a voluntary petition for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Committee's App. Nos. 1. Since the commencement of their cases, the Debtors have been operating their businesses as debtors in possession pursuant to §§1107 and 1108.

Debtor VHS, a California nonprofit public benefit corporation, is the sole corporate member of five Debtor California nonprofit public benefit corporations that operate six acute care hospitals (the "Hospitals") and other facilities in the state of California. Committee's App. No. 4 at ¶ 11.

VHS, the Hospitals, and their affiliated entities operate as a nonprofit health care system, with approximately 1,680 inpatient beds, six active emergency rooms, a trauma center, eleven medical office buildings, and a host of medical specialties, including tertiary and quaternary care. Committee's App. No. 4 at ¶ 12.

On the Petition Date, the Debtors had approximately 850 inpatients. Committee's App. No. 4 at ¶17. The scope of the services provided by the Debtors is exemplified by the fact that during the calendar year 2017, the Hospitals provided medical services to over 50,000 inpatients and approximately 480,000 outpatients. Committee's App. No. 4 at ¶ 12.

After the Petition Date, on September 17, 2018, the Office of the United States Trustee appointed the Committee. Debtors' App. No. 3.

C. The Debtors' DIP Facility

Upon the filing of the Chapter 11 Cases, the Debtors had an immediate and demonstrated need for access to debtor in possession financing and the use of

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prepetition cash collateral as of the Petition Date. Committee's App. No. 3 at ¶¶ 12-13. As noted above, the Debtors were losing approximately $175 million annually. Committee's App. No. 4 at ¶ 95. Absent the Bankruptcy Court's approval of the use of cash collateral and access to new financing, the existence of the Hospitals would have been threatened and the ability of the Hospitals to survive as a going concern would have been irreparably harmed. Committee's App. No. 3 at ¶ 11A.

The Debtors determined, following a robust solicitation of the market, that the $185 million DIP Facility proposed by DIP Lender represented their best offer for postpetition financing. Committee's App. No. 3 at ¶¶ 17-18.

The DIP Facility provides the DIP Lender with valid, perfected, continuing, enforceable, non-avoidable first priority liens and security interests on the Collateral (as defined in the DIP Credit Agreement), with such liens to prime all other liens and security interests on the Collateral in existence on the Petition Date (the "Priming Liens"). Committee's App. No. 3 at ¶ 40.

In exchange for the use of the Prepetition Secured Creditors' cash collateral and in order to induce their consent to the Priming Liens, the Debtors offered their Prepetition Secured Creditors certain forms of adequate protection, including cross collateralization of secured debt tranches, junior liens on postpetition receivables, payment of contractual non-default interest (but solely to the extend they remained over secured), payment of legal and financial advisor fees and the challenged Waivers.[8] Committee's App. No. 3 at ¶¶ 19-24.

On August 31, 2018, the Debtors filed their *Emergency Motion of Debtors for Interim and Final Orders (A) Authorizing The Debtors To Obtain Post Petition Financing (B) Authorizing The Debtors To Use Cash Collateral And (C) Granting Adequate Protection To Prepetition Secured Creditors Pursuant To 11 U.S.C.*

[8] *See* n. 6, *supra*.

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§§105, 363, 364, 1107 And 1108 (the "DIP Financing Motion"). Committee's App. No. 2. That same day, the Debtors also filed their *Emergency Motion For Entry Of Order: (I) Authorizing The Debtors To (A) Pay Prepetition Employee Wages And Salaries, And (B) Pay And Honor Employee Benefits And Other Workforce Obligations; And (II) Authorizing And Directing The Applicable Bank To Pay All Checks And Electronic Payment Requests Made By The Debtors Relating To The Foregoing* [Debtors' App. No. 4] (the "Wage Motion") and their *Emergency Motion For Entry Of An Order Authorizing Debtors To Honor Prepetition Obligations To Critical Vendors* [Debtors' App. No. 5] (the "Critical Vendor Motion").

D. Support for the DIP Facility

In addition to the Declaration of Richard G. Adcock In Support of Emergency First-Day Motions (the "Adcock Decl."), [Committee's App. No. 4], the most important sources of factual support for the Bankruptcy Court's determinations were the two declarations of Anita Chou, Chief Financial Officer of VHS filed in support of the DIP Financing Motion (the "Chou Declarations"). Committee's App. No. 3 and Committee's App. No. 21, Exh. 2. The Chou Declarations outline, among other things, (i) the Debtors' dire financial condition, (ii) its anticipated difficulties in making payroll and keeping vendor support for postpetition trade financing, and (iii) its need to avoid undue pressure to close or rapidly liquidate the Hospitals early in the Chapter 11 Cases. Committee's App. No. 3 at ¶ 11A, p. 6-7. The Chou Declarations also provide the testimony necessary to establish that all other proposed postpetition lenders sought higher interest rates and fees on the offered lending and/or "insisted upon a prompt sales process to dispose of all or substantially all of the Debtors' assets." Committee's App. No. 3 at ¶ 18.

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E. The DIP Orders and Final DIP Ruling

On September 6, 2018, the Bankruptcy Court held a hearing (the "Interim Hearing") on the DIP Financing Motion and thereafter entered an interim order approving the Debtors' entry into the DIP Credit Agreement with the DIP Lender on an interim basis (the "Interim DIP Financing Order"). Committee's App. No. 9.

The Interim DIP Financing Order provides:

> In light of the Prepetition Secured Creditors' agreement that their Prepetition Liens shall be subject to the Carve Out and subordinate to the DIP Liens, the Prepetition Secured Creditors are each entitled to a waiver of any "equities of the case" exception under section 552(b) of the Bankruptcy Code, and a waiver of the provisions of section 506(c) of the Bankruptcy Code.

The Debtors hereinafter refer to these waivers as the "Section 552(b) Waiver" and the "Section 506(c) Waiver", together, the "Waivers". Committee's App. No. 9 at ¶ 4(e).

The Debtors engaged in extensive negotiations to gain the Prepetition Secured Creditors' consent to the Final DIP Order. As befitted their $202 million senior secured status in the prepetition cash collateral generated by the Hospitals, [Committee's App. No. 3 at ¶4], on September 19, 2018, U.S. Bank, National Association ("US Bank"), as both the 2015 Notes Trustee and 2017 Notes Trustee and Prepetition Secured Creditor, filed a reservation of rights related to the Debtors' DIP Motion (the "US Bank ROR"). Debtors' App. No. 6. The crux of the US Bank ROR was a requirement that their senior position be preserved at all levels of adequate protection and that they otherwise reserved their rights with respect to the Final DIP Order. In other words, their consent was not to be taken for granted by the Debtors or the Bankruptcy Court.

Six days later, on September 25, 2018, Prepetition Secured Creditors UMB Bank, N.A., and Wells Fargo Bank, N.A., as trustees for $259.4 million of

prepetition tax exempt revenue bonds (the "Bond Trustees"),[9] also filed an objection to the DIP Financing Motion (the "Bond Trustee Objection"). Committee's App. No. 18. The Bond Trustees argued that the Debtors were obligated to provide the Prepetition Secured Creditors with adequate protection in exchange for the use of their cash collateral and the granting of the Priming Liens. The Bond Trustees were particularly troubled by the Debtors' position on how adequate protection should work under that certain Second Amended and Restated Intercreditor Agreement dated December 1, 2017 (the "Intercreditor Agreement") vis à vis the 2015 Notes Trustee and the 2017 Notes Trustee.[10] Contrary to the suggestion by the Committee,[11] the Bond Trustees suggested the holders now would be willing to offer postpetition financing to the Debtors under terms similar to those provided by Ally Bank as an independent third party lender. After a strenuous oral argument on the adequacy and accuracy of the Adequate Protection Package and a further modification to the Final DIP Order, the Bond Trustees ultimately agreed not to oppose to the terms of the Final DIP Order. Committee's App. No. 35 at 25. That last Prepetition Secured Creditor consent made it possible

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[9] The Series 2005A, G and H bonds. Committee's App. No. 3 at ¶ 4.

[10] UMB in particular argued: "The Debtors' [adequate protection lien structure] would completely upend the Debtors' prepetition capital structure. Among other wholesale changes this structure would cause, this structure would force [UMB] to serve as unwilling guarantors of each other Prepetition Secured Creditor in these cases at the expense of [UMB's] own interests, in effect imposing an intercreditor arrangement on non-debtor third parties. Committee's App. No. 18 at ¶ 30.

[11] *See* Committee's Brief at 2 and 18, n.2. It is meaningful for this Court to understand that the Debtors went to the market first, before asking the Prepetition Secured Creditors, if they were interested in matching the negotiated terms. It was the Debtors' solicitation of the market that yielded the most favorable terms, for which Prepetition Secured Creditor consent was still required. Committee's App. No. 3 at ¶18; Committee's App. No 3 at Exh. 3, §§ 3.1(a)(i) and 3.3(b).

for the Debtors to comply with the "no challenge" borrowing requirement contained in §3.3(b) of the DIP Credit Agreement.[12]

By contrast, the Committee filed its opposition (the "Committee Objection") to the Debtors' DIP Financing Motion on September 27, 2018. Committee's App. No. 23. In their objection, the Committee argued, without the presentation of additional evidence, the same thing that they argue today, *i.e.,* that the Debtors should not be permitted to (i) waive their ability to surcharge the Prepetition Secured Creditors under §506(c) of the Bankruptcy Code or (ii) waive the estates' rights under §552(b) of the Bankruptcy Code with respect to the Prepetition Secured Creditors. Committee's App. No. 23 at ¶¶ 24-30. The Committee also requested an increase in the Carve Out Cap and Investigation Cap, both of which positions ultimately yielded positive results. Committee's App. No. 23 at ¶¶ 41-43.

On October 3, 2018, the Bankruptcy Court held the final hearing (the "Final Hearing") on the DIP Motion. After hearing argument from various parties, including the Committee, the Bankruptcy Court overruled all objections to the DIP Financing Motion, including the Committee's Objection, and approved the DIP Financing Motion on a final basis. Committee's App. No. 29 at 10-11.

The Bankruptcy Court adopted its tentative ruling, dated October 3, 2018 (the "Incorporated Tentative Ruling"), as part of the Final DIP Order. Committee's App. No. 29. In the Incorporated Tentative Ruling, the Bankruptcy Court expressly reasoned, based upon the factual record before it, that the DIP Facility gives the Debtors a "realistic opportunity to sell their assets for a price that will yield between $150–$225 million in excess of existing secured debt." Committee's App. No. 29 at 8. Clearly, that reasoning was consistent with the finding of benefit to the estate. Indeed, reviewing the record closely, the Bankruptcy Court also found that absent the DIP Facility, "simply to maintain operations over the first thirteen weeks

[12] *See* n. 5, *supra*.

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of the case, the Debtors must plug a funding shortfall in excess of $100 million." *Id*. Such inferences were entirely consistent with the record before it. *See* Committee's App. No. 3 at 11-13A.

Relying upon the uncontroverted Chou Declarations, the Bankruptcy Court found that the "Debtors were unable to obtain financing on more favorable terms than those proposed by the DIP Lender." Committee's App. No. 29 at 9. In conjunction with identified cases permitting the §506(c) Waiver, where necessary to induce additional credit[13] or avoid its loss,[14] that finding was the foundation for the Incorporated Tentative Ruling, which further addressed the nature of the Prepetition Secured Creditors' consents and both of the Committee's Waiver challenges. As to the Section 506(c) Waiver, the Bankruptcy Court said: "Here, the Court finds that the §506(c) [waiver] was necessary to induce the DIP Lender to extend the financing. The Committee's objection to the §506(c) waiver is overruled." Committee's App. No. 29 at 11 (emphasis added). With respect to the Section 522(b) Waiver, the Bankruptcy Court similarly found that:

> Like §506(c) waivers, §552(b) waivers are routinely granted in large Chapter 11 cases as a means of adequately protecting the cash collateral of secured creditors. In view of the approximately $550 million in secured debt, the **fact that the Debtors were able to obtain the assent of most of the secured creditor body with respect to the proposed financing package is significant. It was reasonable for the Debtors to grant the secured creditors a §552(b) waiver in order to obtain such consent**.

Committee's App. No. 29 at 11 (emphasis added).

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[13] *See, e.g., In re Real Mex Restaurants, Inc.*, Case No. 11-13122 (BLS) (Bankr. D. Del. Nov. 4, 2011); *In re Metaldyne Corp*., 2009 WL 2883045 (Bankr. S.D.N.Y. 2009);

[14] *In re Antico Mfg. Co.*, 31 B.R. 103, 106 n.1 (Bankr. E.D.N.Y. 1983) (holding that the §506(c) waiver was "not so detrimental or improper as to jeopardize the loss of the entire financing package").

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On October 4, 2018, the Bankruptcy Court entered the Final DIP Order. Committee's App. No. 34. In so doing, the Bankruptcy Court relied upon the evidence presented and argument of counsel at the Interim Hearing and the Final Hearing, the Adcock Decl., by the Debtors' chief executive officer, the Moloney Decl., by the Debtors' lead investment adviser, and the Chou Declarations, by the Debtors' chief financial officer. Committee's App. Nos. 16, 35, 4, 21, 3, and 21. Thus, the Bankruptcy Court had a more than adequate evidentiary record upon which to base its decision.

As originally entered and ultimately modified, the Final DIP Order provides for several aggregated findings of fact, in paragraphs K, N and P, which are highly relevant to the questions of the legality of the Priming Liens, granted by the Debtors in favor of the DIP Lender, as well as the grant of adequate protection to the Prepetition Secured Creditors and the appropriateness of the need for their consent. These findings were built around (a) the unchallenged need for continued borrowing, (Findings K(i) and (ii)), (b) the statutory requirement of adequate protection for use of prepetition collateral (Finding K(ii)), (c) the Court's perception based upon the evidence presented of the best interests of the estates (*Id.*) and (d) the acknowledged importance of the Debtors' mission to save lives and provide quality health care. *Id*.

Finding K(i) also addressed the connection between the Prepetition Secured Creditors' consents and the Debtors' ability to obtain postpetition financing:

> The priming of the Prepetition Liens of the Prepetition Secured Creditors on the Prepetition Collateral, … under section 364(d) of the Bankruptcy Code, as contemplated by the DIP Financing Agreements, as authorized by the Interim Order and this Final Order, and as further described below, **is consented to by the Prepetition Secured Creditors … , and will enable the Debtors to continue borrowing under the DIP Facility and to continue operating their businesses for the benefit of their estates** and creditors.

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Committee's App. No. 34 at ¶ K(i) (emphasis added).

In similar fashion, Finding K(ii) reflects a determination that approval of the DIP Facility was in the "best interests of Debtors, their estates, and their creditors" and focused upon the connection between the Debtors' "lifesaving patient care for vulnerable populations" and the need for postpetition borrowing to preserve going concern value and avoid irreparable harm. Committee's App. No. 34 at ¶ K(ii).

Contrary to the Committee's assertion,[15] the Bankruptcy Court specifically found in Findings N, P(i) and R that the Prepetition Secured Creditors were not the only beneficiaries of the Adequate Protection Package. Indeed, the estates benefited from the opportunity to preserve going concern value for all creditors under a DIP financing pricing structure that was "fair, reasonable, and the best available". Further, in the event of a collapse of the Chapter 11 Cases, administrative creditors would benefit from the Prepetition Secured Creditors' further subordination of their liens to the Carve Out. Specifically, the Bankruptcy Court also found that the Prepetition Secured Creditors:

> […] shall be entitled to receive adequate protection, as set forth in this Final Order, pursuant to sections 361, 363 and 364 of the Bankruptcy Code, for any diminution in the value of their … interests in the Prepetition Collateral … **resulting from, among other things, the subordination to the Carve Out (as defined herein) and to the DIP Liens (as defined herein), the Debtors' use, sale or lease of such Prepetition Collatera**l …, including Cash Collateral, and the imposition of the automatic stay from and after the Petition Date (collectively, and solely to the extent of such diminution in value, the "Diminution in Value").

[15] *See* Committee's Brief at 2, "In other words, the so-called "price" demanded by the Prepetition Secured Creditors for keeping the Hospitals open until the Hospitals could be sold—a clear benefit to the secured creditors—was that the Chapter 11 Cases be run first and foremost for their economic benefit, notwithstanding any provisions of the Bankruptcy Code that might provide for unsecured creditors to share in the proceeds from the sales."

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> The terms and conditions of the DIP Facility … are **fair, reasonable, and the best available** under the circumstances, reflect the Debtors' exercise of prudent business judgment consistent with their fiduciary duties, and are supported by reasonably equivalent value and consideration.
>
> The **Prepetition Secured Creditors have consented to the use of their respective interests in Cash Collateral**, subject to the terms and conditions set forth in this Order.

See Committee's App. No. 34 at ¶¶ N, P(i) and R, respectively (emphasis added).

In addition, as entered on October 6, 2018, paragraph 5 of the Final DIP Order included the specifics of the Debtors' the negotiated Adequate Protection Package designed to protect the interests of the Prepetition Secured Creditors in the Prepetition Collateral "on account of the granting of the DIP Liens, subordination to the Carve Out, any Diminution in Value arising out of the Debtors' use, sale, or disposition or other depreciation of the Prepetition Collateral, including Cash Collateral" resulting from imposition of the automatic stay. Committee's App. No. 34 at 20. The order also reflects the Bankruptcy Court's conclusion that the Debtors, the DIP Lender and Prepetition Secured Creditors all acted in good faith in connection with negotiating the DIP Facility, that each is entitled to the protections of §364(e) of the Bankruptcy Code. Committee's App. No. 34 at ¶ 28.

Equally important for purposes of this appeal, the Bankruptcy Court determined that the DIP Lender and the Prepetition Secured Creditors were all acting in reliance on the consents and findings reflected in the Final DIP Order. "The Debtors, the DIP Agent, the DIP Lender, the Prepetition Secured Creditors …rely on this Final Order in good faith." *Id*. (emphasis added).

Most importantly, with respect to the Waivers, the Bankruptcy Court specifically concluded that the Prepetition Secured Creditors were entitled to such

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waivers on account of their agreements to "be subject to the Carve Out and subordinate to the DIP Liens". Committee's App. No. 34 at ¶ 5(f).

F. Motions to Reconsider or Amend Findings and Stipulations Affecting the DIP Appeal

On October 17, 2018, the Retirement Plan for Hospital Employees (the "RPHE") filed a *Motion to Alter or Amend Final Order (I) Authorizing Post Petition Financing* (the "Motion to Reconsider"). Debtors' App. No. 7. That same day, Swinerton Builders, Inc. ("Swinerton") filed the *Motion Pursuant to Bankruptcy Rule 7052(b) for Amendment of Findings in Final Order* (the "7052 Motion"). Debtors' App. No. 8.

On October 22, 2018, the Bankruptcy Court entered an order denying the RPHE's Motion to Reconsider. Committee's App. No. 37.

On October 31, 2018, the Debtors timely filed their Objection to Swinerton's 7052 Motion. Debtors' App. No. 9. The Bankruptcy Court initially set the 7052 Motion on for a hearing in early December of 2018. Debtors' App. Nos. 10 and 11. The Debtors and Swinerton later agreed to adjourn the 7052 Motion hearing date first to January 23, 2019, and then to February 20, 2019. Debtors' App. Nos. 12 and 13.

Although the 7052 Motion had not been resolved, on November 29, 2018, the Committee filed its *Notice of Appeal and Statement of Election* (the "DIP Appeal"). Debtors' App. No. 14.

The Committee did not seek a stay of the Final DIP Order in connection with the DIP Appeal. Instead, prior to resolution of the 7052 Motion, on January 14, 2019, the Committee and the DIP Lender entered into that *Stipulation Between Ally Bank and Official Committee of Unsecured Creditors Regarding DIP Order Appeal* (the "DIP Lender Stipulation"). Debtors' App. No. 2. Pursuant to the DIP Lender Stipulation, the Committee and the DIP Lender agreed that "even if the Committee is successful in its appeal, the Final DIP Order and DIP Financing Agreements shall

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remain in full force and effect as to the DIP Agent, DIP Lender, DIP Protections, and all of the other rights and protections granted to the DIP Lender and DIP Agent under the Final DIP Order and the DIP Financing Agreements. Debtors' App. No. 2 at ¶ A. Effectively, through the DIP Lender Stipulation, the Committee attempted to walk away from the impact of its appeal on the Debtors' ability to borrow prospectively, and the Bankruptcy Court's conclusions regarding mutual reliance in good faith.

On January 20, 2019, the Committee filed an objection to the Second Stipulation to Continue the Hearing on the 7052 Motion (the "7052 Objection"). Debtors' App. No. 15. In their 7052 Objection, the Committee argued that the delay in hearing and determining the 7052 Motion has caused a delay in the Committee's ability to pursue their DIP Appeal. Debtors' App. No. 15 at ¶16. The Committee provides that on December 14, 2018, the Bankruptcy Appellate Panel for the Ninth Circuit issued an Order suspending briefing on the DIP Appeal because "[e]ven though a notice of appeal was filed on November 29, 2018, the bankruptcy court has jurisdiction to hear the timely tolling motion, and the notice of appeal is held in abeyance until the motion is resolved." Debtors' App. No. 15 at ¶13, citing to B.A.P. ECF No. 4.

On February 1, 2019, the Debtors and Swinerton entered into a stipulation resolving the 7052 Motion (the "Swinerton Stipulation"). Debtors' App. No. 16. Per the Swinerton Stipulation, the Debtors, Swinerton and the Committee requested that the Court enter an order approving the stipulation and closing the record with respect to the Final DIP Order. Debtors' App. No. 16 at ¶ D.

On February 4, 2019, the Bankruptcy Court entered the *Order Approving Stipulation Between Debtors and Swinerton Builders, Resolving Rule 7052 Motion for Amendment of Finding in Final Order (I) Authorizing Postpetition Financing* (the "Rule 7052 Order"). Debtors' App. No. 1. Pursuant to the Rule 7052 Order,

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the Bankruptcy Court closed the record with respect to the Final DIP Order. The Committee still has not sought a stay of the Final DIP Order.

V. ARGUMENT

A. The Committee's Appeal Is Moot

(i) As a Threshold Matter, Equitable Mootness Bars this Appeal

Equitable mootness is a prudential doctrine by which a court elects not to reach the merits of a bankruptcy appeal. *In re Transwest Resort Props., Inc.*, 801 F.3d 1161, 1167-68 (9th Cir. 2015) (citing *Rev Op Grp. v. ML Manager LLC (In re Mortgs. Ltd.)*, 771 F.3d 1211, 1215 n. 2 (9th Cir. 2014)). Equitable mootness arises "when there has been a comprehensive change of circumstances ... so as to render it inequitable for this court to consider the merits of the appeal." *In re Mortgs., Ltd.*, 771 F.3d at 1214. For an appeal to be equitably moot, "[t]he question is whether the case presents transactions that are so complex or difficult to unwind that the doctrine of equitable mootness would apply." *Motor Veh. Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.),* 677 F.3d 869, 880 (9th Cir. 2012). In other words, "[e]quitable mootness concerns whether changes to the status quo following the order being appealed make it impractical or inequitable to unscramble the eggs." *Castaic Partners II, LLC v. Daca-Castaic, LLC (In re Castaic Partners II, LLC)*, 823 F.3d 966, 968 (9th Cir. 2016).

Although the doctrine of equitable mootness is most commonly applied to avoid disturbing plans of reorganization, the doctrine is not a stranger to appeals from other kinds of orders, namely DIP financing and cash collateral orders. *See, e.g., In re Samuel*, 2018 WL 3639047 (B.A.P. 9th Cir. July 31, 2018) (holding that an appeal of a cash collateral order is moot if the funds have been spent); *Dahlquist v. First Nat'l Bank*, 737 F.2d 733, 735 (8th Cir. 1984) (same); *Congress Fin. Corp. v. Shepard Clothing Co. (In re Shepard Clothing Co.)*, 2002 WL 1739021, at *1 (D. Mass. July 26, 2002) (appeal moot where the time period covered by the cash collateral order has expired and the collateral authorized to be spent has been used);

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Bankwest, N.A. v. Todd, 49 B.R. 633, 637-38 (D.S.D. 1985) (court finding cash collateral order moot to the extent of the amounts already expended by debtors, but finding appeal still equitably moot as to the unspent funds because it would be both "economially unwise and inequitable" to reverse the cash collateral order); *Aurelius Capital Master, Ltd. v. Tousa Inc.*, 2009 WL 6453077 (S.D. Fla. Feb.6, 2009) (the court expressed concerns about "unraveling" and "fashioning" a new cash-collateral order at that stage of the bankruptcy).

Courts should consider the following four factors in determining whether an appeal is equitably moot: (1) whether a stay pending appeal was sought, (2) whether the order has been substantially consummated, (3) what effect will a remedy have on third parties not before the court, and (4) whether the court can fashion effective and equitable relief. *In re Transwest Resort*, 801 F.3d 1167-68 (citing *Motor Vehicle Cas. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 677 F.3d 869, 881 (9th Cir. 2012)). While these factors pertain to an appeal from a bankruptcy court's confirmation order, certain of them are nonetheless relevant to an appeal from a DIP financing order.

The first factor, whether a stay was sought, is relevant here. In *In re Transwest Resort,* the court said it must be cautious in applying equitable mootness when a party has been diligent about seeking a stay. Where the appellant "sat on its rights" and "failed to seek a stay while pursuing an appeal" weighed heavily in favor of holding the appeal to be equitably moot. *Id.* (citing *In re Mortgs. Ltd.,* 771 F.3d at 1214). Here, the Committee did not seek a stay pending appeal, because they obviously wanted the estate to have access to the DIP Facility.

With respect to the second factor, the Final DIP Order is substantially consummated. The Final DIP Order authorized the Debtors to use the Prepetition Secured Creditors' cash collateral and the Debtors have, in fact, been using their cash collateral to pay for operating expenses, as well as the costs of maintaining the Hospitals, since the Petition Date. In *In re Samuel*, the 9th Circuit B.A.P. found

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satisfaction of this factor to "weigh heavily in favor of mootness." 2018 WL 3639047, at* 3.

The third factor requires this Court to consider the effects on third parties not before the court. This factor also weighs heavily in favor of mootness as the parties who received the cash collateral funds and extended postpetition credit (*i.e.* the Debtors' employees, critical vendors, and other trade creditors) are not before this Court. As noted by the court in *In re Samuel*, these creditors "relied on the bankruptcy court's order and presumably spent the funds long ago. Thus, clawing back money from these third parties would be largely impracticable, even if possible." *Id.* Further, the appeal would remain moot as to unspent funds because it would be both "economically unwise and inequitably" to reverse the cash collateral order. *Id.* citing *Bankwest, N.A. v. Todd*, 49 B.R. 633, 637-38 (D.S.D. 1985). Here, the Committee has not asked this Court to claw funds back from third parties or the DIP Lender who have been paid with the Prepetition Secured Creditors' cash collateral. Nonetheless, the effect of any reversal of the Final DIP Order as it relates to the Prepetition Secured Creditors' Waivers could be detrimental to third parties who have extended credit to the Debtors on a postpetition basis in reliance on the Final DIP Order. Any modification to the Final DIP Order could result in either the DIP Lender terminating the Debtors' ability to draw on the DIP Facility or the Prepetition Secured Creditors denying the Debtors' use of their cash collateral in the future. In either instance, those third parties will have been treated inequitably and suffer economically.

The fourth factor, whether the bankruptcy court on remand may be able to devise an equitable remedy without creating an uncontrollable situation for the bankruptcy court, is also particularly relevant here. In this instance there is no way the Bankruptcy Court can fashion an equitable remedy without substantially threatening the future of these Chapter 11 Cases.

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First, the DIP Credit Agreement provides, as a condition for the DIP Lender to provide the revolving DIP Facility, that the Final DIP Order shall be in effect and shall not be modified or amended. Committee's App. No. 3, Exh. 3 at ¶ 3.3(b). Second, the DIP Credit Agreement lists the modification, reversal, revocation or supplement to the Final DIP Order as an event of default. Committee's App. No. 3, Exh. 3 at ¶ 9.1(q)(xii). Therefore, should the Final DIP Order be vacated or modified as a result of this appeal, the DIP Lender would not be obligated to continue to provide the revolving DIP Facility. In short, there is no way that this Court can grant the relief sought in this appeal without creating an uncontrollable situation for the Bankruptcy Court and without putting the future of these Chapter 11 Cases into great jeopardy. As such, this appeal is equitably moot.

(ii) The DIP Lender Stipulation Further Renders this Appeal Equitably Moot

Further complicating matters here is the DIP Lender Stipulation, to which neither the Debtors nor the Prepetition Secured Creditors are parties, and which was never approved by the Bankruptcy Court. However, it was executed by the Committee and the DIP Lender and provides that:

> even if the Committee is successful in its appeal, the Final DIP Order and DIP Financing Agreements shall remain in full force and effect as to the DIP Agent, the DIP Lender, the DIP Protections, and all of the other rights and protections granted to the DIP Lender and DIP Agent under the Final DIP Order and the DIP Financing Agreements.

Debtors' App. No. 2 at ¶ A. In executing the DIP Lender Stipulation, the Committee agreed that regardless of the outcome of their appeal, the Final DIP Order would remain in full force and effect as to the DIP Lender.

But in reality, the Committee has no control over the position of the Prepetition Secured Creditors or the Bankruptcy Court with respect to what might happen in the event this Court reverses the decision below and vacates a portion of

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the Final DIP Order. It is important to recall that the Prepetition Secured Creditors did not start with a common collateral package or even common rights in a particular form of collateral. The creditors under the MOB Financings, for example, hold taxable notes with completely distinct prepetition collateral from a single Debtor (Verity Holdings, LLC). Committee's App. No. 34 at ¶ G. By contrast, the tax exempt 2005 Revenue Bonds share certain prepetition collateral from the Hospitals with the 2015 Revenue Notes and 2017 Revenue Notes, but also are parties to a complex Intercreditor Agreement. *Id.* at ¶¶ F and G. It is far from clear, what would be the comparative value of the Adequate Protection Package to each of Prepetition Secured Creditors in the absence of the challenged Waivers. It is therefore uncertain which, if any, of the Prepetition Secured Creditors would continue to consent to the Priming Liens or the prospective use of any remaining prepetition cash collateral. Indeed, since the Bankruptcy Court did not approve the DIP Lender Stipulation, it is clear that absent the prospective consent from all of the Prepetition Secured Creditors, the DIP Lender would have every right to assert a default under the DIP Credit Agreement in the event this Court were to vacate a portion of the Final DIP Order and remand it for further proceedings.

While §364(e) clearly protects the DIP Lender's collateral position with respect to any loans already made under the DIP Credit Agreement,[16] that is not the end of the discussion should this Court preclude acceptance of the negotiated Waivers. The DIP Credit Agreement also provides that any Prepetition Secured Creditor opposition to the prospective reliance on the Priming Liens would be a failure of a condition precedent to future draws.[17] Therefore the only way the Committee could prospectively live up to the assurances it provides under the DIP Lender Stipulation is to leave the Final DIP Order unchanged. In making those

[16] *See* p. 15, *supra*.

[17] *See* n. 5, *supra*.

assurance to the DIP Lenders, the Committee effectively confirmed that its appeal should be considered moot.

(iii) Statutory Mootness Also Bars this Appeal

The Bankruptcy Code provides certain protections to entities that extend credit or financing to a chapter 11 debtor in possession in good faith. 11 U.S.C. §364(e). Accordingly, in addition to being equitably moot, the Committee's appeal is also moot by virtue of §364(e) of the Bankruptcy Code.[18]

The Ninth Circuit addressed §364(e) in *In re Adam's Apple, Inc.*, 829 F.2d 1484 (9th Cir.1987). At issue in that case was an interim financing agreement wherein the bank agreed to advance funds to a debtor in exchange for converting the bank's pre-petition unsecured debt to secured debt. *Id.* at 1486. The court explained that it could not reach the merits of the appeal until it first decided whether the case was moot, *i.e.*, whether there was any available remedy not barred by §364(e). *Id.* at 1489 n. 7. In finding that §364(e) broadly protects any requirement or obligation that was part of a postpetition creditor's agreement to finance, the Ninth Circuit concluded it could not invalidate the new security that had been granted to the bank without "affect[ing] the validity" of the new debt. The court reasoned that "[s]ection 364 was designed to provide a debtor a means to obtain credit after filing bankruptcy," and therefore any agreements or conditions necessary to obtain that credit were protected by §364(e). *Id.* at 1488. The court explained that "the purpose of 364(e) was to overcome a good faith lender's

[18] Section 364(e) provides:

> The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

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reluctance to extend financing in a bankruptcy context by permitting reliance on a bankruptcy judge's authorization." *Id.* Since protecting the validity of any clause of the debt agreement that might have motivated the creditor to extend the credit served this purpose, it followed that §364(e) protected the [provision of the financing agreement] issue, and the appeal was indeed moot. *Id.*

Similarly, in *In re Cooper Commons, LLC*, the Ninth Circuit again held that "any provisions of the financing agreement that [the lender] might have bargained for or that helped to motivate its extension of credit are protected by §364(e)." 430 F.3d 1215, 1220 (9th Cir. 2005). The court reasoned that since the bankruptcy court expressly found that the lender and the debtor negotiated the postpetition financing in good faith and at arms' length, and since the appellant failed to secure a stay pending appeal, the appellant's substantive claims were mooted by §364(e) of the Bankruptcy Code. *Id.*

Here, the record clearly reflects the fact that all parties negotiated in good faith, [Committee's App. No. 34 at ¶ 28], that the DIP Lenders would not have provided the DIP Facility without the Prepetition Secured Creditors' consent to the DIP Facility and that the Prepetition Secured Creditors would not have provided their consent to the DIP Facility, Priming Liens, or the use of their prepetition cash collateral without the Adequate Protection Package, including the Waivers. Committee's App. No 3, Exh. 3, §§ 3.1(a)(i) and 3.3(b) and Committee's App. No 34 at ¶ 5(f). Whether or not authorizing use the of cash collateral always is synonymous with extending credit, in the context of this revolving DIP Facility, all eligible expected receipts from prepetition cash collateral created the borrowing base, and upon receipt, were to be used to immediately repay postpetition indebtedness.[19] Thus the Waivers were part of the agreements and conditions the DIP Lender "bargained for or that helped to motivate [their] extension of credit"

[19] *See* Committee's App. No. 3, Exh. 3 at 5, regarding borrowing base and draws.

and as such, are protected by §364(e). *In re Cooper Commons*, LLC, 430 F.3d at 1220.

Further the Final DIP Order contains a finding by the Bankruptcy Court that the Debtors, the DIP Lender and the Prepetition Secured Creditors each acted in good faith in connection with negotiating the DIP Credit Agreement and further provides that in the event any or all of the provisions of the Final DIP order are reversed, modified, amended or vacated by the Bankruptcy Court or any other court, the DIP Lender and the Prepetition Secured Creditors are entitled to the protections provided in section 364(e) of the Bankruptcy Code. Since the Committee did not obtain a stay pending appeal, this appeal is moot.

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B. <u>The Committee Misstates The Appropriate Standard Of Review</u>

(i) The Court Should Review the Bankruptcy Court's Decision for <u>Abuse of Discretion, Not *De Novo*</u>

Orders issued by a trial court relating to equitable determinations and choices of remedies, are reviewed for abuse of discretion. *Stone v. City and County of San Francisco*, 968 F.2d 850, 861 (9th Cir. 1992) (citing *Swann v. Charlotte-Mecklenburg Bd. Of Educ.*, 402 U.S. 1, 15, (1971)). That proposition is equally well established for both district court and bankruptcy appellate panel review of bankruptcy decisions. *See, e.g., In re Lee*, 2018 WL 7501124 *7 and *In re Sunnymead Shopping Ctr. Co.*, 178 B.R. 809, 814 (B.A.P. 9th Cir. 1995) (finding bankruptcy court's decision regarding adequate protection did not constitute an abuse of discretion); *see also In re A&C Properties*, 784 F.2d 1377 (9th Cir. 1986) (a bankruptcy court's order approving a trustee's application to compromise the controversy is reviewed for an abuse of discretion); and *Levernier v. Educ. Credit Mgmt. Corp. (In re Levernier),* 307 B.R. 684, 686 (C.D. Cal. 2004) (finding that a bankruptcy court's choice of remedies is reviewed for an abuse of discretion).

In *In re Sunnymead,* the court considered adequate protection to be a remedy. The court said, "by definition, adequate protection payments do not harm a creditor, but serve as a way to protect its interest in bankruptcy, where state remedies are not available." *In re Sunnymead,* 178 B.R. at 815. Accordingly, this Court must review the issues on appeal under the abuse of discretion standard.

(ii) The Abuse of Discretion Test Allows Significant Deference Towards the Lower Court's Ruling

In *Hinkson*, the Ninth Circuit adopted a two-part "significantly deferential" test to determine objectively whether a district court has abused its discretion. 585 F.3d at 1261-62. The *Hinkson* court said that first, they must review *de novo* whether the trial court identified the correct legal rule to apply to the relief requested. *Id.* If the trial court identified the correct legal rule, the court must then move to the second step of the abuse of discretion test, which provides that the court may reverse a discretionary trial court factual finding if the court is "left with the definite and firm conviction that a mistake has been committed." *Id.* citing *United States v. U.S. Gypsum Co.*, 333 U.S. 364 at 395 (1948). The *Hinkson* court held that the second step of the abuse of discretion test is to determine whether the trial court's application of the correct legal standard was (1) "illogical," (2) "implausible," or (3) without "support in inferences that may be drawn from the facts in the record." *Id.* quoting *Anderson v. City of Bessemer City, N.C.*, 470 U.S. 564 at 577 (1985). If any of those apply, only then can the court have a "definite and firm conviction" that the district court reached a conclusion that was a "mistake" or was not among its "permissible" options, and thus that it abused its discretion by making a clearly erroneous finding of fact.[20] *Id.* at 1262.

[20] The *Hinkson* Court went on to find that when "an appellate court reviews a district court's factual findings, the abuse-of-discretion and clearly erroneous standards are indistinguishable: A court of appeals would be justified in concluding that a district court had abused its discretion in making a factual finding only if the finding were clearly erroneous." *Id.* at 1259 (citing *Cooter & Gell.*, 496 U.S. at 405).

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The Committee cites two cases for its proposition in favor of *de novo* review. First, the Committee cites to *U.S. v. McConney*, 728 F.2d 1195 (1984), which provides no support. The Supreme Court said "if application of the rule of law to the facts requires an inquiry that is 'essentially factual,' -- one that is founded 'on the application of the fact-finding tribunal's experience with the mainsprings of human conduct,' -- the concerns of judicial administration will favor the district court, and the district court's determination should be classified as one of fact reviewable under the clearly erroneous standard." *McConney*, 728 F.2d at 1202 (internal citations omitted) (emphasis added).

Second, the Committee's reliance on *People's Capital & Leasing Corp., v. Big3D, Inc. (In re Big3D, Inc.)*, 438 B.R. 214 (B.A.P. 9th Cir. 2010), is equally unavailing. The Committee cites *Big3D* for the proposition that "in reviewing adequate protection determination, appellate court must first 'determine *de novo* whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested [and] [i]f the bankruptcy court identified the correct legal rule, we then determine whether its application of the correct legal standard [to the facts] was (i) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record.'" Committee's Brief at 9. But the totality of the BAP proffered standard of review is an expression of "abuse of discretion" not *de novo* review.

Accidently or deliberately, the Committee omits a key phrase from the *Big3D* quotation. In *Big3D*, the Ninth Circuit B.A.P. actually said:

> a bankruptcy court's decision regarding adequate protection **is reviewed for abuse of discretion**." *In re Big3D*, 436 B.R. at 291 (citing *Paccom Leasing Corp. v. Deico Elects., Inc. (In re Deico Elects., Inc.)*, 139 B.R. 945, 947 (B.A.P. 9th Cir. 1992)) (emphasis added). In applying an abuse of discretion test, we first 'determine de novo whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested and ….'

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438 B.R. at 219 (citing *United States v. Hinkson*, 585 F.3d 1247, 1262 (9th Cir. 2009)) (emphasis added).

The *Big3D* court clearly states that the review of a bankruptcy court's decision regarding adequate protection is done on the abuse of discretion standard. *Id.* The *Big3D* two-part test for determining whether a court has abused its discretion, was laid out in *Hinkson*. Here, the correct legal rule to be applied is not in dispute, as the Committee does not deny that the Prepetition Secured Creditors were entitled to adequate protection under §364(d)(1)(B)[21]. The Committee also does not deny that the statute does not expressly preclude the Waivers in return for consent or otherwise.[22] As such, whether the Bankruptcy Court's application of the correct legal standard to the facts was illogical, implausible or without support in inferences that may be drawn from the facts in the record involves both a deferential weighing of the Bankruptcy Court's findings under *Hinkson, supra*, and an examination of whether substantial evidence in the record as a whole exists to support the Bankruptcy Court's findings. *See In re Roth,* 662 Fed. App. 540, 542 (9th Cir. 2016).

However, the Committee professes that the facts are not in dispute here (while nonetheless referring to the Bankruptcy Court's factual findings as "dubious")[23] Instead, it purports to merely challenge whether the Bankruptcy Court correctly interpreted the relevant sections of the Bankruptcy Code, *i.e.,* whether the Bankruptcy Code mandates a contrary result. However, the crux of the

[21] Section 364(d)(1)(B) allows the bankruptcy court to authorize priming liens in connection with a debtor's postpetition financing only if the prepetition lienholder, subject to the priming, is granted adequate protection of its interest in the property subject to the priming lien.

[22] Section 506(c) provides that "The Trustee **may** recover from property securing an allowed secured claim, the necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, … " (emphasis added).

[23] *See* Committee's Brief at 17.

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Committee's argument is that the Bankruptcy Court failed to "narrowly tailor" the Prepetition Secured Creditors' Adequate Protection Package "to the circumstances of the Chapter 11 Case", *i.e.,* abused its discretion in exercising its power to control the exercise and availability of remedies. Committee's Brief at 20.

The Committee even cites to several cases that pronounce adequate protection to be a flexible concept; one to be tailored to the particular facts and circumstances of each case, on a case-by-case basis by the Bankruptcy Court. Committee's Brief at 21 (citing *In re Am. Mariner Indus., Inc.*, 27 B.R. 1004, 1006-07 (B.A.P. 9th Cir. 1983); *In re Pelham Street Assocs.*, 131 B.R. 260-263 (Bankr. D. R.I. 1991)). But the Committee cannot point to any statutory text indicating that the Waivers are impermissible subjects of bargaining between a debtor and its secured creditors. Indeed, the DIP Lender Stipulation makes clear that some Waivers are acceptable to the Committee; just not those negotiated by the Debtors with the Prepetition Secured Creditors. Accordingly, review by this Court must be subject to the abuse of discretion standard, and not a *de novo* review.

C. The Debtors Met Their Burden To Establish An Appropriately Tailored Adequate Protection Package And The Bankruptcy Court Did Not Abuse Its Discretion By Authorizing The Waivers

(i) The Facts in the Record Support the Waivers

Where a bankruptcy court is tasked with making a discretionary decision, as in the case of both approval of postpetition financing under section 364 or approving a debtor's proposed grant of adequate protection under sections 361, 362, 363 or 364, the lower court should be affirmed absent clear legal error or abuse of discretion in applying the law to the facts. *In re Big3D, Inc.*, 438 B.R. at 219 (citing *In re Deico Electronics, Inc.*, 139 B.R. at 947)*; see also In re Sonora Desert Dairy, L.L.C.*, 2015 WL 65301, at *9 (B.A.P. 9th Cir. Jan. 15, 2015) (An adequate protection determination and an authorization to use cash collateral are factual

issues reviewed for clear error) (citing *Martin v. United States (In re Martin)*, 761 F.2d 472, 478 (8th Cir.1985)). The Committee ignores the Debtors' legitimate effort to balance the interests of creditors and the case through first day Wage Motion and Critical Vendor Motion, plus obtaining the DIP Facility benefiting the Committee's constituency, against the Debtors' burden to establish the adequacy of protections against diminution of value arising from such balancing efforts and the imposition of the automatic stay in order for the Prepetition Secured Creditor to get the benefit of their bargain. *In re Center Wholesale, Inc.*, 788 F.2d 541, 544 (9th Cir. 1986); *In re Sonora Desert Dairy, L.L.C.*, 2015 WL 65301, at *11.

While asserting to this Court that this appeal is really one about legal standards to be applied and the "facts are established" or "are not in dispute",[24] the Committee repeatedly challenges the quality of the Bankruptcy Court's findings of fact. It uses the term "dubious" to challenge a "number of findings".[25] While submitting not a scrap of evidence to the contrary, the Committee asserts that the Bankruptcy Court's finding, that the Prepetition Secured Creditors' consent was a necessary aspect of the DIP Facility, is "perplexing".[26]

The need for the Prepetition Secured Creditors' consent is at the core of the Debtors' dispute with the Committee. The Committee alleges that the Bankruptcy Court failed to "narrowly tailor" the Adequate Protection Package when it authorized the Debtors' negotiated grant of the Waivers as part of the Prepetition Secured Creditors' Adequate Protection Package. *See* Committee's Brief at 20. However, the Committee cannot deny that the Prepetition Secured Creditors were entitled to adequate protection *from the Debtors* in these Chapter 11 Cases *inter alia* (a) for use of cash collateral generally and to pay prepetition claims and (b) to

[24] *See* Committee's Brief at 8-9.

[25] *See* Committee's Brief at 17.

[26] *See* Committee's Brief at 18, n.2

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protect against consequences of being primed under §364 of the Bankruptcy Code. Further, the Committee ignores the DIP Credit Agreement's requirement that the Prepetition Secured Creditors consent to being primed. Committee's App. No 3, Exh. 3, §§ 3.1(a)(i) and 3.3(b).

Section 361 of the Bankruptcy Code provides that when adequate protection is required under §364, such adequate protection may be provided by (1) requiring periodic cash payments, (2) providing replacement liens or (3) "granting such other relief … as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." *See* 11 U.SC. §364. The statutory "indubitable equivalent" means the secured creditor is to get the full benefit of its bargain. *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988). Here, in the context of six different tranches of secured debt covering different and sometimes overlapping debtors, the Debtors successfully negotiated overlapping forms of adequate protection, which the Bankruptcy Court authorized the Debtors' to grant as contemplated and authorized in §361(1) and (2) of the Bankruptcy Code.

It is unsurprising that since a secured creditor is typically permitted to charge a debtor with the cost of maintaining property or liquidating collateral, the Bankruptcy Court also used the catch all language of §361(3) to authorize the Waivers as part of the Prepetition Secured Creditors' Adequate Protection Package. There is no evidence in this record that suggests or establishes that in doing so, the Bankruptcy Court abused its discretion as there is no evidence to suggest that the Bankruptcy Court either committed a clear error of judgment in the conclusion it reached upon weighing the relevant facts, or that its decision was (1) illogical, (2) implausible or (3) without support in inferences that may be drawn from the facts in the record.

Moreover, courts within the Ninth Circuit have found that debtors and bankruptcy courts have broad discretion in designing appropriate adequate

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protection awards. *See In re Deico Elects., Inc.*, 139 B.R. 945, 947 (B.A.P. 9th Cir. 1992) (the bankruptcy court has discretion to fix adequate protection, as dictated by the circumstances of the case and the sound exercise of the bankruptcy court's discretion); *In re Helionetics, Inc.*, 70 B.R. 433, 437 (Bankr. C.D. Cal. 1987) (finding that the bankruptcy court has discretion and flexibility in designing adequate protection remedies) (citing *In re American Mariner Industries, Inc.*, 734 F.2d 426, 434 (9th Cir. 1984) ("the debtor should be permitted maximum flexibility in structuring a proposal for adequate protection")).

The record clearly demonstrates that the Debtors were in need of both the DIP Facility and use of the Prepetition Secured Creditors' cash collateral, when it filed the DIP Financing Motion. Committee's App. No. 3 at ¶ 11. As provided in the Chou Declarations, without the use of the Prepetition Secured Creditors' cash collateral, the Debtors would not have been able to make payroll, safely maintain their hospital facilities or, most importantly, deliver effective patient care. Committee's App. No. 3 at ¶ 11A. To obtain the benefits of the DIP Facility, the Debtors also needed the consent of the Prepetition Secured Creditors.[27] That consent came with a price, which the Debtors agreed to pay to obtain the favorable pricing of the DIP Facility.

The DIP Facility at issue here was the Debtors' only available source of postpetition financing and the DIP Lenders required that the Debtors provide Priming Liens in exchange for the DIP loans. Committee's App. No. 3 at ¶ 18. In the Final DIP Order, the Bankruptcy Court found that the Priming Liens were necessary to obtain the DIP Facility. Committee's App. No. 34 at ¶ N.

The Debtors needed to provide the Prepetition Secured Creditors with several types of adequate protection, including the Waivers, in order to induce the Prepetition Secured Creditors to consent to the Priming Liens and the Final DIP

[27] *See* n. 5, *supra*.

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Order. In providing such consent, the Prepetition Secured Creditors spared the Debtors a long and contentious fight over the Debtors' ability to prime their prepetition liens and use their cash collateral, which, as established above, was also essential for the viability of the Debtors' estates. In approving the Adequate Protection Package with the Waivers, the Bankruptcy Court ultimately determined that the terms of the Final DIP Order, including the Waivers, were a proper concession by the estate in exchange for the Prepetition Secured Creditors' consent to the Priming Liens and use of cash collateral, and a proper exercise of the Debtors' business judgment. Committee's App. No. 34 at ¶ P(i).

As noted above, the Bankruptcy Court's Final DIP Order contains a finding of fact that Prepetition Secured Creditors only consented to the use of their cash collateral, subject to the terms and conditions of the Final DIP Order, which clearly provide for the Waivers. Committee's App. No. 34 at ¶ R. As such, there is ample justification in this record to support the Bankruptcy Court's decision with respect to the Prepetition Secured Creditors' adequate protection award. Accordingly, the Bankruptcy Court did not abuse its discretion in granting the Waivers.

(ii) The Existence of an Equity Cushion Permits Priming, But Does Not Mandate It

Moreover, while the Bankruptcy Court did make findings related to an equity cushion [Committee's App. No. 29 at 9 and 14] the Bankruptcy Court also understood that at the time it entered the Final DIP Order, there was no guaranty that sales of the Debtors' assets would close at those values, let alone close at all. Both the Debtors and the Bankruptcy Court were and are aware of the fact that in the past, the California Attorney General has imposed conditions on the sales of hospitals so extreme that they have caused the prospective fair market value buyer to terminate the transaction. Committee's App. No. 16 at 16. In light of that fact, the Prepetition Secured Creditors had every justification to require the Waivers as part of their Adequate Protection Package, and the Bankruptcy Court properly

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exercised its discretion, after considering the facts and circumstances of the case, when allowing them.

The Committee argues that "the objective of providing adequate protection to prepetition secured parties is to preserve the status quo, not to better those parties' positions." Committee's Brief at 22. This argument suggests that the Prepetition Secured Creditors will recover more than 100% of what they are owed. That obviously cannot be the case. *See In re Lason, Inc.*, 300 B.R. 227, 235 (Bankr. D. Del. 2003) (finding a secured creditor is not entitled to receive more than 100% of its secured claim). This is not a situation where the Prepetition Secured Creditors will swap their claims and entitlements for shares in the Debtors or other potentially appreciating assets. Instead, the Prepetition Secured Creditors are entitled to the full benefit of their simple bargain as secured creditors. Having consented to the use of their cash collateral to benefit prepetition unsecured creditors through the Wage Motion and Critical Vendor Motion, and per the order of priorities set by the Bankruptcy Code, the Debtors' general unsecured creditors rightfully stand in line behind the Prepetition Secured Creditors.

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D. The Bankruptcy Court Has Broad Discretion To Grant The Waivers And Carry Out The Provisions Of The Bankruptcy Code

(i) The Waivers are Common and Permitted in this Circuit

It is not uncommon for debtors in chapter 11 cases to grant and for courts to approve, for the benefit of the debtor's prepetition secured lenders, waivers that mirror the Waivers at issue here. Such waivers are permitted in this Circuit. *See In re Cooper Commons LLC*, 512 F.3d 533 (9th Cir. 2008) (enforcing Central District of California Bankruptcy Court's approval of §506(c) waiver by debtor in possession in favor of prepetition lender); *In re Gardens Regional Hospital and Medical Center, Inc.*, Case No. 16-17463 (ER) (Bankr. C.D. Cal. July 28, 2016) (Docket No. 257) (authorizing §506(c) waiver for the benefit of the prepetition secured creditors in connection with approval of debtor's motion for postpetition

financing and use of cash collateral); *In re Flamingo Investments*, 2010 WL 5167376 (Bankr. C.D. Cal. 2010) (authorizing §506(c) waiver in connection with confirmation of debtor's chapter 11 plan of reorganization); *In re Walking Co.*, No. 09-15138, 2010 LEXIS 5194, (Bankr. C.D. Cal. Jan. 14, 2010) (same); *In re TRG Wood Products Inc.*, 2010 WL 5167544 (Bankr. C.D. Cal. 2010) (authorizing §506(c) and §552(b) waiver for prepetition secured lender in connection with approval of debtor's motion for use of cash collateral); *In re California Coastal Communities, Inc.*, Case No. 09-21712 (Bankr C.D. Cal. 2009) (Docket No. 559) (authorizing waiver of §552(b) "equities of the case" exception for the benefit of the prepetition secured creditors in connection with approval of debtor's motion for postpetition financing and use of cash collateral).

Here, in the Incorporated Tentative Ruling, the Bankruptcy Court cited to the following cases as support for the fact that waivers, such as those at issue here, are commonly necessary to induce lenders to extend credit. *See, e.g., In re Real Mex Restaurants, Inc.*, Case No. 11-13122 (BLS) (Bankr. D. Del. Nov. 4, 2011); *In re Metaldyne Corp.*, 2009 WL 2883045 (Bankr. S.D.N.Y. 2009); *In re Antico Mfg. Co.*, 31 B.R. 103, 106 n.1 (Bankr. E.D.N.Y. 1983) (holding that the §506(c) waiver was "not so detrimental or improper as to jeopardize the loss of the entire financing package"). Committee's App. No. 29 at 11. The Bankruptcy Court very clearly articulated its finding that "the §506(c) was necessary to induce the DIP Lender to extend the financing." Committee's App. No. 29 at 7.

The Committee contends that there was no need to induce the [Prepetition Secured Creditors] to lend (or not object to loans from other lenders). Committee's Brief at 24. Yet the Committee provides no evidence of, or support for, that contention. In fact, the record clearly establishes that the Debtors did need to induce the Prepetition Secured Creditors to consent to the DIP Facility, as the DIP Credit Agreement required that the Final DIP Order be entered without opposition by any Prepetition Secured Creditor. Committee's App. No. 3, Exh. 3 at ¶ 3.3. In

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light of the Debtors' tenuous financial condition at the time it brought the DIP Financing Motion, and in light of the fact that there was a very real possibility that any proposed sale of the Debtors' Hospitals could be compromised by conditions imposed on the sale by the California Attorney General, all of which is clearly set forth in this record, the Prepetition Secured Creditors were justified in requiring the Waivers in exchange for their consent to the use of their cash collateral and to the Priming Liens. The Bankruptcy Court did not abuse its discretion when it authorized these Waivers.

The Committee also contends that it was critical for the Bankruptcy Court to ensure that the terms of the DIP Facility, and accompanying adequate protection for the Prepetition Secured Creditors, did not impair the ability of the Debtors or the Committee to discharge their fiduciary duties. Committee's Brief at 26. At face value, this assertion by the Committee is not wrong. But it completely overlooks the fact that the Debtors needed to secure the DIP Facility in the first place. The only way for the Debtors to do so was to induce the Prepetition Secured Creditors to consent to not only the use of their cash collateral, which was a key component of the Debtors ability to finance its operations on a postpetition basis, but also to the Priming Liens, which would subordinate their pre-petition liens to those new liens granted to the DIP Lender. This record is clear; absent the Adequate Protection Package, including the Waivers, the Prepetition Secured Creditors would not have consented to the DIP Facility or authorized the use of their cash collateral. There can be no doubt that the Prepetition Secured Creditors consent (i) spared the Debtors a potentially long and costly fight over obtaining DIP financing and the use of cash collateral and (ii) paved the way for the Debtors to pursue the (one closed and one pending) sales of the Hospitals, which are ultimately expected to generate recoveries for the Committee's constituents. In short, these Chapter 11 Cases have strong potential to result in meaningful recoveries for the Debtors' unsecured

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creditors. It is doubtful that the same would have been true had the Debtors been unable to secure the DIP Facility.

The Committee's contention that such Waivers are not supported by Congressional or legislative intent is made without any reference to legislative history. Committee's Brief at 29 and 34. The Committee does not cite any committee report or other Congressional statement that would suggest that the Waivers are anathema to Congress' view of the Bankruptcy Code. The Committee also does not cite to any authority that contradicts the unambiguous language of the statute itself, which provides that trustee's right to surcharge a secured creditor's collateral is permissive. *See* 11 U.S.C. §506(c). Instead, the Committee's assertion that §506(c) can only be waived "under very limited circumstances", relies entirely on cases decided outside of this Circuit which do not address the waiver issue. Committee's Brief at 29.[28]

(ii) The Cases Cited in Support of the Committee's Argument Are Distinguishable

The Committee principally cites to *Hartford Fire Ins. Co. v. Norwest Bank Minn., N.A. (In re Lockwood Corp.)*, 223 B.R. 170, 176 (B.A.P. 8th Cir. 1998), which relies on the Eighth Circuit B.A.P.'s decision in *Hartford Underwriters Inc. Co v. Magna Bank, N.A. (In re Hen House Interstate, Inc.)*, 150 F. 3d 868 (8th Cir. 1998). In *Hen House*, the 8th Circuit issued a blanket ruling that immunizing agreements that prohibit surcharge payment obligations under §506(c) are unenforceable, on the basis that such provisions could operate as a windfall to the

[28] The legislative history of §506(c) supports the Debtors' argument that the trustee's right to surcharge a secured creditor's collateral is permissive, and not mandatory. It provides that "any time the trustee or debtor in possession expends money to provide for the reasonable and necessary cost and expense of preserving or disposing of a secured creditor's collateral, the trustee or debtor in possession **is entitled to** recover such expenses from the secured party." *See* 124 Cong. Rec. H11089 (Sept. 28, 1978), reprinted in 1978 U.S. Code Cong. & Ad. News 6436, 6451 (emphasis added).

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secured creditors at the expense of the administrative claimants. *Id.* 870-71. While resisting the breadth of the Circuit's mandate, the *Lockwood* Court went on to add that they "are constrained to follow the Eighth Circuit's expansive holding on this issue as binding precedent" but noted that the factual basis for the *Hen House* holding differed markedly from the matter at bar. *Id.* at n. 7.

Hen House concerned an immunizing agreement between a prepetition secured creditor and a debtor while in *Lockwood*, the immunizing provision was entered into postpetition by a potential secured creditor contracting to immunize its potential future collateral from surcharge under Section 506(c). The *Lockwood* Court cautioned that being required to void such a clause, as a result of the *Hen House* precedent, could result in "the wellspring of postpetition lending by new lenders, **to be greatly diminished**, or even to evaporate completely." *Id.* (emphasis added). This prohibition against waiver of the 506(c) surcharge articulated by the Eighth Circuit, however, does not exists in the Ninth Circuit or in the Central District of California. *See, e.g., In re Cooper Commons, In re Gardens Regional Hospital, In re Flamingo Investments* cited at p. 34, supra.

The Committee also cites to *In re Colad Grp.*, 324 B.R. 208, 224 (W.D.N.Y. 2005) where the court refused to allow the secured creditor the benefit of the §506(c) waiver stating simply that "this court can discern no basis to allow a secured creditor to ignore [§506(c)'s application]. Here, the record is replete with discernable reasons to allow for the Waivers.

The Committee cites to *In re InteliQuest Media Corp.* to support its contention that waivers of the right to surcharge under section 506(c) are "against public policy and unenforceable per se." Committee's Brief at 31. This is not correct. In *In re InteliQuest Media*, the Bankruptcy Appellate Panel for the Tenth Circuit did not find such waivers to be per se unenforceable, but instead held that the postpetition 506(c) waiver in favor of the prepetition lender was enforceable under principles of res judicata where the debtor had previously agreed to such

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waiver in a final order that was not appealed. 326 B.R. 825 (B.A.P. 10th Cir. 2005). In its decision, the *InteliQuest* court recognized that only a few courts have dealt with the enforceability of a postpetition §506(c) waiver and recognized, in a footnote, that one court, *In re Ridgeline Structures, Inc.*, 154 B.R. 831, 832 (Bankr. D. N.H 1993), has declined to approve such a waiver, finding it to be against public policy and unenforceable per se. *In re InteliQuest*, 326 B.R. at n. 31.

In *In re Ridgeline*, the court was asked to review and approve a stipulation between the debtor and the Federal Deposit Insurance Company that was reached and filed in open Court at the outset of the hearing, without the objection period and hearing notice required by Rule 4001(d). 154 B.R. at 831. In addition, the stipulation at issue provided for a waiver of the debtor's right against the FDIC under §506(c) "no matter what action, inaction, or acquiescence by FDIC might occur." *Id.* The *Ridgeline* court found it could not insulate any party from the consequences of their conduct no matter how egregious. *Id.* In a footnote, the *Ridgeline* court acknowledges the decision in *In re Film Equipment Rental Co.*, 1991 WL 274464 (S.D.N.Y. Dec. 12, 1991), where the court enforced a §506(c) waiver and noted that in that case, there was "no assertion of any egregious conduct that would render enforcement unconscionable." *In re Ridgeline,* 154 B.R. at n. 2. Accordingly, upon review, it is clear that the Ridgeline case is readily distinguishable from the case at bar as there is no allegation of egregious conduct or an attempt to secure the waivers at issues without proper notice.

(iii) The Committee Mischaracterizes the Prepetition Secured Creditors' Involvement in these Chapter 11 Cases

The Committee challenges the Debtors' Section 506(c) Waiver in favor of the Prepetition Secured Creditors because, the Committee asserts, the Prepetition Secured Creditors "were offered but declined the opportunity to provide [DIP financing and], sought out the adequate protection they received simply to sit out the Chapter 11 Cases and ride the coattails of the DIP Lender to maximize their

recovery." Committee's Brief at 33, *see also* 18 at n. 2. Here, the Committee paints a picture of the Prepetition Secured Creditors' involvement in this case that cannot be farther from the truth. The Committee does so in order to support their argument that there was no need for the Debtors or the Bankruptcy Court to induce or incentivize Prepetition Secured Creditors' cooperation in this case. This argument is not supported by the facts of this case.

In making this argument, the Committee completely overlooks all of the concessions the Prepetition Secured Creditors have made for the benefit of the Debtors' Bankruptcy estate. As noted above, the Prepetition Secured Creditors have not only agreed to the use of their cash collateral but they have also consented to the Priming Liens. *See* pp 10-11 and 13 *supra*. Without each of these contributions, the Debtors would not have been able to secure the DIP Facility and pursue the assets sales for the benefit of all creditors, and particularly, the general unsecured creditors. *Id.* Therefore, it is disingenuous for the Committee to downplay the importance of the Prepetition Secured Creditors' contribution to these Chapter 11 Cases. Here, the Bankruptcy Court considered the facts and circumstances of these Chapter 11 Cases and correctly recognized both the value contributed by the Prepetition Secured Creditors' and the risks that they were subjected to.

(iv) The Section 552(b) Waiver is Appropriate at this Time

The Committee lastly argues that the Bankruptcy Court's grant of the Section 552(b) Waiver is premature rather than impermissible. Committee's Brief at 37. As support for this proposition, the Committee cites to the distinguishable S*print Nextel Corp. v. U.S. Bank Nat'l Ass'n (In re TerreStar Network, Inc.)*, where an unsecured creditor brought an adversary proceeding challenging the validity and priority of the secured creditor's lien on the debtor's broadcast license. 457 B.R. 254, 272-73 (Bankr. S.D.N.Y. 2011). Specifically, the unsecured creditor asserted that the lien should be invalidated or subordinated under § section 552(b)(1)'s

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equities of the case" doctrine. *Id.* at 270. While the parties cross moved for summary judgment on other issues, on this issue, the secured creditor conceded that the factual record was incomplete. *Id.* As a result, the Court concluded that the fact dependent equitable claim would not be ripe for summary judgment until after the completion of discovery. *Id.* at 258. The Committee also cites to the equally inapposite case *In re Heilman*, 2010 WL 3909167 (Bankr. D.S.D. Sept. 29, 2010), where the court declined to consider the debtors' entitlement to relief under §552 because the debtors did request relief under §552.

In this brief, the Debtors', by contrast, have cited to numerous cases allowing the Section 552(b) Waiver. *See* p. 36, *supra*. Further, the factual record here is clear: the Debtors gave the Prepetition Secured Creditors the Waivers as part of the consideration for consenting to the DIP Facility. As such, the Bankruptcy Court appropriately authorized the Debtors' grant of the Waivers in the Final DIP Order.

VI. CONCLUSION

Accordingly, the Debtors respectfully request that this Court either dismiss the Committee's appeal as equitably or statutorily moot, or affirm the Bankruptcy Court's Final DIP Order approving the Waivers.

Dated: April 15, 2019

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Bankruptcy Procedure 8015(a)(7), the undersigned certifies that the Appellee's Opening Brief complies with the type-volume limitation and that the Appellee's Opening brief contains 12,576 words (excluding the cover page, tables, signature blocks and required certificates) as counted by the computer program used to prepare the Appellee's Opening Brief.

DATED: April 15, 2019

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