

CASE NO. 2:19-cv-133-RGK
IN THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

(Chapter 11 Bankruptcy Case No: 2:18-bk-20151-ER)

In re Verity Health System of
California, Inc., et al.

Debtors

XAVIER BECERRA, California
Attorney General,

Appellant,

v.

VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., et al, THE
OFFICIAL CREDITOR'S
COMMITTEE, COUNTY OF SANTA
CLARA,

Appellees.

CALIFORNIA ATTORNEY
GENERAL'S OPENING BRIEF

[Appendix filed concurrently]

Place: United States Courthouse:
255 East Temple Street,
Los Angeles, CA 90012,
Courtroom 850, 8th Floor
Judge: R. Gary Klausner

XAVIER BECERRA
Attorney General of California
JAMES M. TOMA
Supervising Deputy Attorney General
ALICIA BERRY
Deputy Attorney General
State Bar No. 228367
300 South Spring Street, Suite 1702
Los Angeles, CA 90013
Telephone: (213) 269-6550
Fax: (213) 897-7605
E-mail: Alicia.Berry@doj.ca.gov
Attorneys for Xavier Becerra,
California Attorney General



TABLE OF CONTENTS

	Page
INTRODUCTION	1
I. Statement of Appellate Jurisdiction	3
II. Statement of Issues Presented and the Applicable Standard of Appellate Review for Each Issue	4
III. Statement of the Case	5
A. Statement of Facts	5
B. Procedural Background	8
C. Rulings Presented for Review	9
SUMMARY OF THE ARGUMENT	9
ARGUMENT	11
I. The Bankruptcy Court Erred in Ruling that the Sale to the County Did Not Require the Continued Application of the Attorney General’s Health and Safety Protections within the AG Conditions	11
A. The Attorney General Has Authority Over Nonprofit Corporations	11
B. Every Statute Should Be Construed with Reference to the Whole System of Law of Which it is Part	14
C. The Attorney General’s Authority under Applicable Nonbankruptcy Law to Enforce His Existing Conditions is not an “Interest in Property” under 11 U.S.C. § 363(f).	15
II. The Bankruptcy Court Erred in Ruling that the Attorney General Waived Application of his Conditions	22
III. The Bankruptcy Court Erred in Applying the Doctrine of Equitable Estoppel	24
IV. The Court Erred by Excluding Evidence Related to Waiver and Equitable Estoppel	25
RELIEF REQUESTED	25
CERTIFICATE OF COMPLIANCE	27

TABLE OF AUTHORITIES

	Page
FEDERAL CASES	
<i>Anderson v. City of Bessemer</i> 470 U.S. 564 (1985)	22
<i>Baker & Drake, Inc. v. Public Serv. Comm. of Nevada</i> 35 F.3d 1348 (9th Cir. 1994)	21
<i>Chevron USA, Inc. v. Natural Resources Defense Council, Inc.</i> 467 U.S. 837 (1984)	15
<i>Davis v. Michigan Dep't of Treasury</i> 489 U.S. 803 (1989)	15
<i>Gabriel v. Alaska Elec. Pension Fund</i> 773 F.3d 945 (9th Cir. 2014)	24
<i>Hamilton v. State Farm Fire & Cas. Co.</i> 270 F.3d 778 (9th Cir. 2001)	5
<i>Hudson v. Martingale Inv., LLC (In re Hudson)</i> 504 B.R. 569 (9th Cir. BAP 2014)	4
<i>In re HHH Choices Health Plan, LLC</i> 554 B.R. 697 (Bankr. S.D.N.Y. 2016)	19
<i>In re Leckie Smokeless Coal Co.</i> 99 F.3d 573 (4th Cir. 1996)	19, 20
<i>In Re Martin</i> 542 B.R. 479 (9th Cir. BAP 2015)	5
<i>In re Oyster Bay Cove, Ltd.</i> 196 B.R. 251 (1996)	15, 16
<i>In re PBBPC, Inc.</i> 484 B.R. 860 (B.A.P. 1st Cir. 2013)	19, 20
<i>In Re St. Mary Hospital</i> 86 B.R. 393 (Bankr. E.D. Pa. 1988)	13

TABLE OF AUTHORITIES
(continued)

	Page
<i>In re Stevens</i>	
68 B.R. 774 (D. Me. 1987)	13
<i>In re Trujillo</i>	
378 B.R. 526 (B.A.P. 6th Cir. 2007)	5
<i>Integrated Sols., Inc. v. Serv. Support Specialties, Inc.</i>	
124 F.3d 487 (3d Cir. 1997)	21
<i>Intel Corp. v. Hartford Acc. & Indem. Co.</i>	
952 F.2d 1551,1559 (9th Cir. 1991)	4, 22
<i>Matter of SK Foods, L.P.</i>	
676 F.3d 798 (9th Cir. 2012)	3
<i>Midlantic National Bank v. New Jersey Department of Environmental Protection</i>	
474 U.S. 494 (1986)	11, 12
<i>Ohio v. Kovacs</i>	
469 U.S. 274 (1985)	11
<i>Penn Terra Limited v. Department of Environmental Resources, Commonwealth of Pennsylvania</i>	
733 F.2d. 267 (Third Cir. 1984)	21
<i>Salyers v. Metro Life Ins. Co.</i>	
871 F.3d 934 (9th Cir. 2017)	22
<i>TrafficSchool.com, Inc. v. Edriver Inc.</i>	
653 F.3d 820 (9th Cir. 2011)	5
<i>U.S. ex. rel. Fullington v. Parkway Hosp.</i>	
351 B.R. 280 (E.D.N.Y. 2006)	18
<i>Zerand-Bernal, Inc. v. Cox</i>	
23 F.3d 159 (7th Cir. 1994)	21

TABLE OF AUTHORITIES
(continued)

	Page
STATE CASES	
<i>Aguilar v. Association for Retarded Citizens</i> 234 Cal.App.3d 21(1991)	15
<i>Brown v. Superior Court</i> 37 Cal.3d 477 (1984)	15
<i>D’Amico v. Board of Medical Examiners</i> 11 Cal.3d 1 (1974)	11
<i>Erskine v. Upham</i> 56 Cal.App.2d 235 (1942)	25
<i>Holt v. College of Osteopathic Physicians and Surgeons</i> 61 Cal.2d 750 (1964). Case	10
<i>In re Ventura</i> 217 Cal.App.2d 50 (1963)	10
<i>In re Veteran’s Industries, Inc. of Long Beach v. Thomas C. Lynch</i> 8 Cal.App.3d 902 (1970)	10
<i>In re Zahn</i> 16 Cal.App.3d 106 (1971)	10
<i>Kay v. Kay</i> 188 Cal.App.2d 214 (1961)	22
<i>Morris v. Williams</i> 67 Cal.2d 733 (1967)	15
<i>Singh v. Cross</i> 60 Cal.App. 309 (1922)	25
<i>Snidow v. Hill</i> 87 Cal.App.2d 803 (1948)	25
<i>Tahoe Nat’l Bank v. Phillips</i> 4 Cal.3d 11 (1971)	25

TABLE OF AUTHORITIES
(continued)

	Page
FEDERAL STATUTES	
11 U.S.C.	
§ 363(d).....	2, 10, 12, 17, 18-20
§ 363(d)(1).....	2, 13
§ 363(d)(2).....	18
§ 363(d), 541(f) & 1129(a)(16)	17
§ 363(f)	<i>passim</i>
§ 541(f)	2, 10, 17, 19, 20
§ 1129(a)(16)	13
26 U.S.C.	
§ 501(c)(3)	17
28 U.S.C.	
§ 158	3
§ 158(a).....	3
§ 158(a)(1)	3
§ 959(b).....	11, 12, 13, 22
§ 2106	26
Bankruptcy Abuse Prevention and Consumer Protection Act of 2005	
BAPCPA.....	<i>passim</i>
§ 1221(d).....	13, 19
§ 1221(e).....	10, 17, 18, 19
Coal Industry Retiree Health Benefit Act of 1992	20
STATE STATUTES	
Cal. Corp. Code § 5914	6, 10, 13, 14
Cal. Corp. Code § 5917	12

TABLE OF AUTHORITIES
(continued)

	Page
Cal. Corp. Code § 5920	13, 6
Cal. Corp. Code § 5926	<i>passim</i>
Cal. Corp. Code §§ 5914-5930	<i>passim</i>
Cal. Corp. Code, Chapter 9, n. , § 1.....	11
Cal. Govt. Code, § 12598	11
 STATE REGULATIONS	
Cal. Code Regs. Title 11,	
§ 999.5, subd. (e)(5)	6
§ 999.5, subd. (e)(6)	6
§ 999.5, subd. (f).....	6
§ 999.5, subd. (h) (2018)	1
 CONSTITUTIONAL PROVISIONS	
Cal. Const., Article V, § 13	11, 13
 COURT RULES	
Federal Rules of Bankruptcy Procedure Rule 8015(a)(7)	27
Federal Rules of Evidence § 403	25
 OTHER AUTHORITIES	
Daniel A. DeMarco & Nancy A. Valentine, <i>Health Care Hazards and Eleemosynary Elocutions Bapcpa Changes the Sale of Nonprofit Health Care Assets</i>	22
Kevin F. Donohue, <i>Crossroads in Hospital Conversions-A Survey of Nonprofit Hospital Conversion Legislation</i> , 8 Annals Health L. 39, 42 n. 28 (1999) (“Since 1997, 90 bills covering conversions of hospitals, health plans and health maintenance organizations have been introduced in 34 states.”)	17

INTRODUCTION

The California Attorney General (“Attorney General”) is responsible for protecting assets held in charitable trusts, including non-profit hospitals. This appeal concerns the continued enforcement of health and safety protections required by the Attorney General through his statutory authority following a sale of a nonprofit debtor’s assets in the underlying bankruptcy case.

Nonprofit health facilities have a substantial and beneficial effect on the provision of health care to the people of California including providing uncompensated care to uninsured low-income families and under-compensated care to the poor, elderly, and disabled. Under California Corporations Code sections 5914-5930, the Attorney General is entrusted to review the transfer of nonprofit hospital assets to ensure that the public’s welfare and interest in the charitable assets is fully protected – an exercise of his police and regulatory powers. In December 2015, nonprofit corporation Verity Health System of California, Inc., and its subsidiaries, (collectively “Verity” or “Debtors”) obtained the Attorney General’s conditional consent to a proposed change in governance and control of its general acute care hospitals – including O’Connor Hospital in San Jose and Saint Louise Regional Hospital in Gilroy. The express terms of the Attorney General imposed requirements to protect the public and ensure continued access to needed healthcare. These requirements (“AG Conditions”) were to remain in place for 15 years, though certain conditions expire sooner. (Appendix, Doc. 1, p. 181 and 266.) The AG Conditions also explicitly apply to future owners. (*Ibid.*) While the requirements remain in place, parties can seek to clarify and/or modify them under state law. Cal. Code Regs. Tit. 11, § 999.5, subd. (h) (2018).

Notably, the Attorney General is given express authority to enforce his conditions pursuant to Corporations Code section 5926. Thus, the continued operation and enforcement of the AG Conditions is in furtherance of the Attorney General’s police and regulatory powers under Corporations Code sections 5914-

1 5930.

2 The Bankruptcy Court in the present matter authorized the sale of the
3 nonprofit assets - O'Connor Hospital and Saint Louise Regional Hospital - to the
4 County of Santa Clara ("County") free and clear of the continued application of the
5 AG Conditions that are authorized under state law. The Bankruptcy Court wrongly
6 interpreted the Attorney General's authority, and incorrectly applied important
7 California law and federal bankruptcy laws enacted to protect the public and that
8 authority, respectively. Sections 363(d) and 363(f) of the Bankruptcy Code (Title
9 11 of the United States Code) apply in this matter and both require that sales of
10 debtor's assets be in accordance with applicable non-bankruptcy law.

11 The Bankruptcy Court ignored the Attorney General's express authority under
12 Corporations Code section 5926 to enforce his conditions, and instead allowed the
13 sale of these nonprofit hospitals free and clear of the 2015 AG Conditions.

14 The Bankruptcy Court's disregard for the Attorney General's authority to
15 enforce existing conditions at issue here undermines Congress' decision to enact
16 specific Bankruptcy Code provisions that require compliance with applicable non-
17 bankruptcy laws in precisely these types of transactions. Pursuant to the
18 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),
19 Congress added an express provision to the Bankruptcy Code requiring that sales of
20 nonprofit debtor corporation's assets be subject to applicable non-bankruptcy law.
21 *See* 11 U.S.C. §363(d)(1) and § 541(f). California Corporations Code sections
22 5914-5930 apply when a hospital owned or operated by a nonprofit corporation
23 transfers control or governance of its assets to a for-profit or mutual benefit
24 corporation. Corporations Code section 5926 allows the Attorney General the
25 authority to enforce these conditions. The Bankruptcy Court's incorrect
26 interpretation of California Corporations Code sections 5914-5930 resulting in the
27 Bankruptcy Court's failure to apply non-bankruptcy law to the sale of the nonprofit
28 debtor's assets requires reversal by this Court.

I. STATEMENT OF APPELLATE JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 158. See 28 U.S.C. § 158(a)(1) (“The district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees . . . of bankruptcy judges[.]”) This Court possesses appellate jurisdiction over the Bankruptcy Court’s final orders where it resolves and seriously affects substantive rights and finally determines the discrete issue to which it is addressed. 28 U.S.C. § 158(a); *Matter of SK Foods, L.P.*, 676 F.3d 798, 802 (9th Cir. 2012). The “Order (A) Authorizing the Sale of Certain of the Debtors’ Assets to Santa Clara County Free and Clear of Liens, Claims, Encumbrances, and Other Interests; (B) Approving the Assumption and Assignment of an Unexpired Lease Related Thereto; and (C) Granting Related Relief” entered on December 27, 2018 (Sale Order) filed and entered on December 27, 2018 (Appendix Doc. 15) resolved and seriously affected the Attorney General’s substantive rights to enforce health and safety protections imposed when Attorney General Harris consented with conditions to the change in governance and control of Daughters of Charity Health System (now known as Verity) in 2015. The AG Conditions contained five sets of required health and safety protections, one for each of the hospitals. (Appendix, Docs. 1 [AG Conditions] and 5 [health care impact reports].)

The health and safety protections within the AG Conditions specifically contemplated a future sale of the hospitals, and required that O’Connor Hospital and Saint Louise Regional Hospital retain specific healthcare services for at least ten years from the closing date of the transaction, including: 24-hour emergency medical service; intensive care services; coronary care services; obstetric services; sub-acute care services; women’s health services; reproductive health services; and stroke services and designation as a primary stroke center; as well as additional services including cancer and cardiac services, for a period of five years. (Appendix, Doc. 1 [AG Conditions] at 178-179, 263-264.) These AG Conditions

1 remain in operation, and are enforceable by the Attorney General pursuant to
 2 Corporations Code section 5926. However, the Bankruptcy Court erroneously
 3 concluded that “neither Cal. Corp. Code §5926 nor any of the other provisions set
 4 forth in Cal. Corp. Code §§ 5914-5930 provide the Attorney General with authority
 5 to enforce the Conditions against Santa Clara if Santa Clara acquires the Hospitals.”
 6 (Appendix, Doc. 14.)

7 The Sale Order incorporated a document that set forth the Bankruptcy Court’s
 8 reasons for his ruling, the “Memorandum of Decision Overruling Objections of the
 9 California Attorney General to the Debtors’ Sale Motion (“Memorandum of
 10 Decision”) filed and entered December 26, 2018 (Appendix Doc. 14). Appellant,
 11 Xavier Becerra, Attorney General of California (Attorney General) filed his timely
 12 appeal of the Sale Order and Memorandum of Decision on January 7, 2019.
 13 (Appendix Docs. 16.)

14 **II. STATEMENT OF ISSUES PRESENTED AND THE APPLICABLE STANDARD** 15 **OF APPELLATE REVIEW FOR EACH ISSUE**

16 1. Whether the Bankruptcy Court erred in ruling that the Attorney General
 17 had waived his right to object to the sale of O’Connor Hospital and Saint Louise
 18 Regional Hospital to the County free and clear of the AG Conditions as a matter of
 19 law. Under California law, waiver is a question of fact. Waiver is an affirmative
 20 defense, for which the party asserting it bears the burden of proof. *Intel Corp. v.*
 21 *Hartford Acc. & Indem. Co.*, 952 F.2d 1551,1559 (9th Cir. 1991). A Bankruptcy
 22 Court’s interpretation of state law is reviewed de novo. *In re Park at Dash Point,*
 23 *L.P.*, 985 F.2d 1008, 1010 (9th Cir. 1993).

24 2. Whether the Bankruptcy Court erred by excluding the declarations
 25 submitted by the Attorney General and the Debtor in response to the Bankruptcy
 26 Court’s request for further briefing as a matter of law. A bankruptcy court’s
 27 evidentiary rulings are reviewed for abuse of discretion. *Hudson v. Martingale*
 28 *Inv., LLC (In re Hudson)*, 504 B.R. 569, 573 (9th Cir. BAP 2014). A Bankruptcy

1 Court abuses its discretion if it applies the wrong legal standard, misapplies the
2 correct legal standard, or if its factual findings are clearly erroneous.

3 *TrafficSchool.com, Inc. v. Edriver Inc.*, 653 F.3d 820, 832 (9th Cir. 2011).

4 3. Whether the Bankruptcy Court erred in holding that the Attorney General
5 was equitably estopped from contesting the sale of the hospitals free and clear of
6 the existing AG Conditions as a matter of law. The application of the doctrine of
7 equitable estoppel is reviewed for abuse of discretion. *Hamilton v. State Farm Fire*
8 *& Cas. Co.*, 270 F.3d 778, 780 (9th Cir. 2001).

9 4. Whether the Bankruptcy Court erred in holding that the Attorney
10 General's health and safety conditions imposed under California law are an
11 "interest in...property" for purposes of 11 U.S.C. section 363(f). And whether a
12 debtor-in-possession may sell a nonprofit corporation's assets free and clear of the
13 conditions notwithstanding the Bankruptcy Abuse Prevention and Consumer
14 Protection Act of 2005 that requires a transfer of property held by a nonprofit
15 corporation debtor can only be made in accordance with any applicable
16 nonbankruptcy laws that govern such a transfer of property. A bankruptcy court's
17 interpretation of state law is reviewed de novo. *In re Park at Dash Point, L.P.*, 985
18 F.2d 1008, 1010 (9th Cir. 1993). The Bankruptcy Court's legal conclusions and
19 interpretation of statutory law are reviewed de novo. *In Re Martin*, 542 B.R. 479,
20 483 (9th Cir. BAP 2015). "De novo means that the [district] court determines the
21 law independently of the [bankruptcy] court's determination." *In re Trujillo*, 378
22 B.R. 526, 529 (B.A.P. 6th Cir. 2007).

23 **III. STATEMENT OF THE CASE**

24 **A. Statement of Facts**

25 On July 31, 2015, Daughters of Charity Health System and Daughters of
26 Charity Ministry Services Corporation (collectively, "Daughters") submitted
27 written notice of its proposed System Restructuring and Support Agreement with
28 BlueMountain Capital Management, LLC, pertaining to the change in governance

1 and control of Daughters and its acute care hospitals to the Attorney General for
2 review and approval pursuant to California Corporations Code sections 5914 and
3 5920. The assets of Daughters included O'Connor Hospital in San Jose and Saint
4 Louise Regional Hospital in Gilroy.

5 During the review of the transaction, a healthcare expert was retained to
6 evaluate the potential impact of the transaction on the availability and accessibility
7 of healthcare services to each of the communities served by the hospitals, as
8 required by the California Code of Regulations, Title 11, section 999.5, subd. (e)(5)
9 and (e)(6). The regulations require the health care expert to assess the effect of the
10 agreement on emergency services, reproductive health services, and any other
11 health care services that the hospital is providing, the provision of services to Medi-
12 Cal patients and county indigent patients, staffing and the availability of care, the
13 likely retention of employees as it may affect continuity of care, and any mitigation
14 measures proposed by the hospital to reduce any potential adverse effect on health
15 care services. Cal. Code Regs. Tit. 11, § 999.5, subd. (e)(6) (2018). The
16 regulations require that the Attorney General evaluate the effect of the transaction
17 on the public, including the availability and accessibility of health care services to
18 the affected community. Cal. Code Regs. Tit. 11, § 999.5, subd. (f). The expert
19 prepared health care impact statements for each of the hospitals involved in the
20 transaction. (Appendix, Doc. 5.) These healthcare impact statements included
21 interviews with medical staff, management, and employees, board members, and
22 community representatives. These health care impact statements contained the
23 expert's analysis of financial, utilization, and health care services, demographic
24 characteristics, payer mix, hospital utilization records and trends, health status
25 indicators, and hospital market share information in formulating an opinion
26 regarding the potential impact of the transaction on the community.

27 On December 3, 2015, after careful deliberation, public meetings, and
28 consultation with a healthcare expert pursuant to state law (Cal. Corp. Code, §§

1 5914-5930), the Attorney General issued a decision to consent with conditions to
2 the change in governance and control of Daughters (now known as Verity). The
3 decision contained five sets of required health and safety protections, one for each
4 hospital. (Appendix, Docs. 1 [AG Conditions] and 5 [health care impact reports].)
5 The transaction between Daughters and BlueMountain specifically contemplated a
6 future sale of the hospitals through the Purchase Option Agreements listed in
7 Condition II. (Appendix, Doc. 1.) As such, Condition I of the AG Conditions
8 provides that the conditions shall be legally binding on the parties to the
9 transaction, including any future owner or operator of the hospitals – without
10 limitation. (Appendix, Doc. 1.)

11 Following Verity's acceptance of the AG Conditions, the transaction closed on
12 December 14, 2015. The health and safety protections within the AG Conditions
13 expressly required that O'Connor Hospital and Saint Louise Regional Hospital
14 retain specific healthcare services for at least ten years from the closing date of the
15 transaction, including: 24-hour emergency medical service; intensive care services;
16 coronary care services; obstetric services; sub-acute care services; women's health
17 services; reproductive health services; and stroke services and designation as a
18 primary stroke center; as well as additional services including cancer and cardiac
19 services, for a period of five years. (Appendix, Doc. 1 [AG Conditions] at 178-179,
20 263-264.)

21 On August 31, 2018, Debtors each filed a voluntary petition for relief under
22 chapter 11 of the Bankruptcy Code. In the underlying bankruptcy case, Verity
23 sought to sell O'Connor and Saint Louise hospitals to the County without the
24 continued application of the AG Conditions required by state law. Without these
25 health and safety protections, the County will not be required to continue to operate
26 O'Connor or Saint Louise as general acute care hospitals, or provide the healthcare
27 services required by the AG Conditions.

28 //

B. Procedural Background

On October 1, 2018, Verity filed its motion seeking approval of form of the asset purchase agreement with the County, and the bidding procedures, and seeking an order authorizing the sale of the property free and clear of all claims, liens and encumbrances (“Bid Procedures Motion”). (Appendix, Doc. 2.) On October 10, 2018, the Attorney General filed his response to the Bid Procedures Motion wherein he objected to a sale free and clear of the AG Conditions. (Appendix, Doc. 3.) Verity filed its reply to the Bid Procedures Motion on October 17, 2018, followed by the Attorney General’s sur-reply on October 22, 2018. (Appendix, Docs. 4 and 5, respectively.) The Bankruptcy Court’s October 30, 2018 order did not rule on the objections asserted by the Attorney General, finding such objections premature. However, the objections were preserved for the sale hearing. (Appendix, Doc. 6.)

Beginning in late October 2018, staff from the Attorney General’s Office began discussions with counsel for the County regarding the applicability of the AG Conditions. On November 2, 2018, the County submitted a request for clarification of certain of the AG Conditions for O’Connor Hospital and Saint Louise Regional Hospital. (Appendix, Doc. 8 [County Request for Clarification], p. 858-901.) On November 9, 2018, the Attorney General issued a response clarifying that the AG Conditions identified in the November 2 letter would not be enforced against the County. (Appendix, Doc. 8 [AG Letter of Clarification], p. 903-905.)

On December 12, 2018, Debtors’ filed their Debtors’ Notice of Motion and Motion for the Entry Of (I) an Order (1) Approving Form of Asset Purchase Agreement for Stalking Horse Bidder and for Prospective Overbidders to Use, (2) Approving Auction Sale Format, Bidding Procedures and Stalking Horse Bid Protections, (3) Approving Form of Notice to be Provided to Interested Parties, (4) Scheduling a Court Hearing to Consider Approval of the Sale to the Highest Bidder and (5) Approving Procedures Related to the Assumption of Certain Executory

1 Contracts and Unexpired Leases; and (II) an Order (A) Authorizing the Sale of
 2 Property Free and Clear of All Claims, Liens and Encumbrances; Memorandum of
 3 Points and Authorities In Support (“Motion for Sale”). (Appendix, Doc. 7.) On
 4 December 14, 2018, the Attorney General filed its Response to the Motion for Sale.
 5 (Appendix, Doc. 8.) On December 21, 2018, the Court issued its Preliminary
 6 Findings and Conclusions, and requested the Debtors, the Attorney General, the
 7 Official Committee of Unsecured Creditors, and the County submit further briefing
 8 by December 24, 2018. (Appendix, Doc. 9.)

9 The Attorney General submitted his Response on December 24, 2018, and his
 10 errata dated December 26, 2018. (Appendix, Docs. 11 and 13.) Debtor submitted a
 11 Response on December 24, 2018, and on that date also submitted the Declaration of
 12 Douglas Press. (Appendix, Docs. 10 and 12.) On December 26, 2018, the
 13 Bankruptcy Court issued its Memorandum of Decision Overruling the Objections
 14 of the Attorney General to the Debtors’ Sale Motion, and its Sale Order on
 15 December 27, 2018. (Appendix, Docs. 14 and 15.)

16 On January 7, 2019 the Attorney General filed a Notice of Appeal and
 17 Statement of Election. (Appendix, Doc. 16.)

18 **C. Rulings Presented for Review**

19 In the Memorandum of Decision, the Bankruptcy Court ruled that the Attorney
 20 General waived his objections to the sale of the hospitals, was equitably estopped
 21 from objecting, and that the “sale is not subject to Attorney General review because
 22 the hospitals are being sold to Santa Clara, which is a public entity...” (Appendix,
 23 Doc. 14, p. 980.) “The Debtors are authorized to sell the Hospitals free and clear of
 24 the Conditions, pursuant to § 363(f)(1).” (Appendix Doc. 14, p. 983.) The Sale
 25 Order incorporated the Memorandum of Decision. (Appendix, Doc. 15, p. 987.)

26 **SUMMARY OF THE ARGUMENT**

27 The Debtors are nonprofit public benefit corporations that hold charitable
 28 assets. The Attorney General, as a representative of the public, is responsible for

1 protecting assets held in charitable trust, and has primary responsibility for the
 2 enforcement of charitable trusts. *Holt v. College of Osteopathic Physicians and*
 3 *Surgeons*, 61 Cal.2d 750, 754-755 (1964). Case law also establishes that the
 4 Attorney General represents the public beneficiaries of the charitable trust. *In re*
 5 *Veteran's Industries, Inc. of Long Beach v. Thomas C. Lynch*, 8 Cal.App.3d 902
 6 (1970) [the Attorney General has the duty to protect the beneficiaries' interest in a
 7 charitable trust]; *In re Ventura*, 217 Cal.App.2d 50, 57 (1963) [the Attorney
 8 General has standing to protect charitable gifts]; *In re Zahn*, 16 Cal.App.3d 106,
 9 114 (1971) [the Attorney General represents the public which benefits by a
 10 charitable trust].

11 California Corporations Code section 5914(a) states that any nonprofit
 12 corporation that operates or controls a health facility is required to obtain the
 13 written consent of the Attorney General prior to entering into any agreement or
 14 transaction to transfer governance or control of its assets to a for-profit corporation.
 15 And California Corporations Code section 5926 grants the Attorney General the
 16 authority to enforce his conditions. The rules of statutory construction make it clear
 17 that the Attorney General retains the authority to enforce his conditions regardless
 18 of whether the assets are subsequently sold through a bankruptcy action. California
 19 Corporations Code section 5926 applies whether a hospital is subsequently sold.

20 Express provision of BAPCPA including § 1221(e) make it clear that the
 21 Attorney General's authority to regulate transfers of nonprofit healthcare assets of a
 22 debtor is preserved under 11 U.S.C. §§ 363(d) and 541(f). The Bankruptcy Court
 23 erred in holding that the Attorney General's statutory authority to enforce existing
 24 conditions under California law is an "interest in property" under 11 U.S.C. section
 25 363(f) from which the Debtor can sell its assets "free and clear." The Bankruptcy
 26 Court based its erroneous holding on cases involving pure monetary claims based
 27 on state law. Here, however, the Attorney General's authority to enforce existing
 28 conditions that require the continuation of critical health and welfare services is not

1 a pure monetary claim and is expressly preserved by the Bankruptcy Code.

2 Section 959(b) of title 28 of the United States Code applies when a debtor is
3 liquidating its assets as held by the United States Supreme Court in *Midlantic*
4 *National Bank v. New Jersey Department of Environmental Protection*, 474 U.S.
5 494, 507 (1986). In *Ohio v. Kovacs*, 469 U.S. 274 (1985) the Court recognized the
6 application of section 959(b) even where a debtor is liquidating its assets. Other
7 courts have applied section 959(b) where the state was exercising its inherent
8 regulatory and police powers in a chapter 7 or other liquidation situation. There is
9 no liquidation exception to a trustee's obligation to comply with the law.

10 ARGUMENT

11 **I. THE BANKRUPTCY COURT ERRED IN RULING THAT THE SALE TO THE 12 COUNTY DID NOT REQUIRE THE CONTINUED APPLICATION OF THE 13 ATTORNEY GENERAL'S HEALTH AND SAFETY PROTECTIONS WITHIN 14 THE AG CONDITIONS**

15 **A. The Attorney General Has Authority Over Nonprofit 16 Corporations**

17 Xavier Becerra is the elected Attorney General of the State of California and
18 is the chief law officer of the State, as was Attorney General Kamala Harris before
19 him. Cal. Const., art. V, § 13. The Attorney General has broad constitutional,
20 common law and statutory powers under the state constitution to protect the public.
21 Cal. Const., art. V, §13; *D'Amico v. Board of Medical Examiners*, 11 Cal.3d 1, 14-
22 15 (1974).

23 The California Legislature concluded that nonprofit health facilities have a
24 substantial and beneficial effect on the provision of health care to the people of
25 California including providing uncompensated care to uninsured low-income
26 families and under-compensated care to the poor, elderly, and disabled. Cal. Corp.
27 Code, Ch. 9, Note, § 1, Stats. 1996 ch. 1105. The Attorney General is charged with
28 the supervision and regulation of nonprofit corporations and other charitable trusts
in this state. Cal. Govt. Code, § 12598.

//

1 Under California Corporations Code section 5917, the Attorney General can
2 consent, consent with conditions, or deny the proposed transaction. Under
3 California Corporations Code section 5917, the Attorney General is required to
4 consider several factors in making his determination: whether the terms and
5 conditions of the transaction are reasonable, whether the transaction result in
6 inurement to any person or entity, whether the transaction is at fair market value,
7 whether the market value has been manipulated by the parties to cause a decrease in
8 the value of the assets, whether the use of sale proceeds are consistent with the
9 charitable trust, whether the transaction constitutes any breach of trust, whether the
10 Attorney General has been given sufficient information, whether the transaction
11 effects the availability and accessibility of health care services to the affected
12 community, and whether the transaction is in the public interest.

13 Attorney General Harris exercised her police and regulatory powers pursuant
14 to California state law in December 2015 when she issued a decision to consent
15 with conditions to the change in governance and control of Daughters (now Verity.)
16 The terms of the AG Conditions were to remain in place for 15 years, though
17 certain conditions expire sooner. (Appendix, Doc. 1, [AG Conditions] p. 181 and
18 266.) As such, the continued operation of the AG Conditions is a continuation of
19 the Attorney General's police and regulatory powers under Corporations Code
20 sections 5914-5930. The Bankruptcy Court was required to apply non-bankruptcy
21 law under Bankruptcy Code sections 959(b) and the amendments to the Bankruptcy
22 Code in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 of
23 sections 363(d)(1), 541(f), 1129(a)(16), and 1221(d) that specifically provide that
24 applicable non-bankruptcy law applies to sales of assets by a nonprofit debtor.

25 The Supreme Court held in *Midlantic National Bank v. New Jersey*
26 *Department of Environmental Protection*, 474 U.S. 494, 507 (1986), in a Chapter
27 11 case that converted to a liquidation proceeding in a Chapter 7, that the
28 Bankruptcy Code does not preempt "a state statute or regulation that is reasonably

1 designed to protect the public health or safety....” The Court noted Congress’
 2 intentions that the trustee’s efforts “to marshal and distribute the assets of the
 3 estate” give way to the governmental interest in public health and safety. *Id.* at 502.
 4 In addition, other courts have applied section 959(b) where the state was exercising
 5 its inherent regulatory and police powers in a Chapter 7 or other liquidation
 6 situation. *H.L.S. Energy Co., Inc.* 151 F.3d 434 (5th Cir. 1998) and *In re Stevens*,
 7 68 B.R. 774 (D. Me. 1987).

8 The Court in *In Re St. Mary Hospital*, 86 B.R. 393, 398 (Bankr. E.D. Pa.
 9 1988) held that “the task of deciding which laws are so significant that they cannot
 10 be violated is not ours to choose. The statutory provision [section 959(b)] requires
 11 that all laws must be followed by the debtor in possession.”

12 The legislative history regarding sections 363(d)(1), 1129(a)(16), and 1221(d)
 13 clearly shows Congress’s intent to give greater influence to state regulators and
 14 attorneys general, and limit the ability of trustees or debtors-in-possession to use,
 15 sell or lease property of a nonprofit corporation in derogation of laws regarding
 16 important state interests. (11 U.S.C. §§ 363(d)(1), 1129(a)(16), 1221(d).)

17 This is especially true when government entities are enforcing their police and
 18 regulatory powers, such as Corporations Code sections 5914 and 5920 et seq. Here,
 19 the Attorney General protected the health, safety, and welfare of the communities
 20 served by the hospitals owned and controlled by the Debtors by requiring that the
 21 facilities provide essential health care services, including emergency services,
 22 minimum levels of charity care (free or discounted care), participation in the Medi-
 23 Cal and Medicare programs, and seismic safety. (Appendix, Doc. 1 [AG
 24 Conditions]; Cal. Const., art. V, § 13.)

25 Under both California law and the express terms of the conditions, the County
 26 as the purchaser takes the assets subject to the conditions. (Cal. Corp. Code, 5926;
 27 Appendix, Doc. 1 [AG Conditions].) The Attorney General’s decision is binding
 28 on any future owner or operator, successor, successor in interest, assignee or other

1 transferee of the healthcare facilities.

2 Condition I of the decision related to O'Connor Hospital states:

3 These Conditions shall be legally binding on [the parties], any other
 4 subsidiary, parent, general partner, limited partner, member, affiliate,
 5 successor, successor in interest, assignee, or person or entity serving in
a similar capacity of any of the above-listed entities [omitted]...., any
entity succeeding thereto as a result of consolidation, affiliation,
 6 merger, or acquisition of all or substantially all of the real property or
operating assets of O'Connor Hospital, or the real property on which
 7 O'Connor Hospital is located, any and all current and future owners,
lessees, licensees, or operators of O'Connor Hospital, and any and all
 8 current and future lessees and owners of the real property on which
O'Connor Hospital is located.

9 These Conditions shall be legally binding on the following entities, as
 10 defined in Operating Asset Purchase Option Agreement, Operating
Asset Purchase Agreement, Real Estate Purchase Option. Agreement,
 11 and the Real Estate Purchase Agreement, when the closing occurs on
the Operating Asset Purchase Agreement and the Real Estate Purchase
 12 Agreement: the Option Holders, Purchaser and its Affiliates, "OpCo" a
Delaware limited liability company, owned directly or indirectly by
 13 funds managed by BlueMountain Capital Management LLC, and
"PropCo" a Delaware limited liability company that will elect to be
 14 treated for tax purposes as a real estate investment trust, owned
directly or indirectly by funds managed by BlueMountain Capital
 15 Management LLC, Integrity Healthcare, LLC, a Delaware limited
liability company, Integrity Healthcare Blocker, LLC, a Delaware
 16 limited liability company, any other subsidiary, parent, general partner,
limited partner, member, affiliate, successor, successor in interest,
 17 managing member, assignee, or person or entity serving in a similar
capacity of any of the above-listed entities, any entity succeeding
 18 thereto as a result of consolidation, affiliation, merger, or acquisition
of all or substantially all of the real property or operating assets of
 19 O'Connor Hospital, or the real property on which O'Connor Hospital is
located, any and all current and future owners, lessees, licensees, or
 20 operators of O'Connor Hospital, and any and all current and future
 21 lessees and owners of the real property on which O'Connor Hospital is
located. (Appendix, Doc. 1 [AG Conditions], p. 179-180 and 264-265,
emphasis added.)

22
 23 **B. Every Statute Should Be Construed with Reference to the
 Whole System of Law of Which it is Part**

24 Here, it is undisputed that Attorney General Harris exercised her statutory
 25 authority to review the transfer of governance and control from Daughters to
 26 BlueMountain in 2015. (Cal. Corp. Code 5914.) The Attorney General now seeks
 27 to enforce the health and safety protections within the AG Conditions pursuant to
 28 state law. (Cal. Corp. Code 5926.)

1 It is a fundamental rule of statutory construction that every statute should be
 2 construed with reference to the whole system of law of which it is a part so that all
 3 may be harmonized and have effect. *Brown v. Superior Court* 37 Cal.3d 477, 484
 4 (1984). Statutory interpretation requires a more detailed examination of the context
 5 of the statute. *See, e.g., Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809
 6 (1989) (“[S]tatutory language cannot be construed in a vacuum. It is a fundamental
 7 canon of statutory construction that the words of a statute must be read in their
 8 context and with a view to their place in the overall statutory scheme.”).

9 Construction of a statute by officials charged with its administration, including
 10 their interpretation of authority vested in them to implement and carry out its
 11 provisions, is entitled to great weight and courts should defer to the agency. *Morris*
 12 *v. Williams* 67 Cal.2d 733 (1967); *Aguilar v. Association for Retarded Citizens* 234
 13 Cal.App.3d 21(1991); and *Chevron USA, Inc. v. Natural Resources Defense*
 14 *Council, Inc.* 467 U.S. 837, 844 (1984). The Attorney General should be given
 15 deference to interpret California laws concerning matters under his authority.

16 **C. The Attorney General’s Authority under Applicable**
 17 **Nonbankruptcy Law to Enforce His Existing Conditions is not**
 18 **an “Interest in Property” under 11 U.S.C. § 363(f).**

19 After erroneously concluding that “[t]he Conditions are an ‘interest in
 20 property’ within the meaning of §363(f),” the court acknowledged the following
 21 purpose of the AG Conditions: “[t]he Conditions provide that any owner of the
 22 Hospitals must furnish specified levels of emergency services, intensive care
 23 services, cardiac services, and various other services.” (Appendix, Doc. 14.) But
 24 the court then reasoned that “[t]he required service levels were derived based upon
 25 the historical experience of the prior operator. As such, the Conditions are monetary
 26 obligations arising from the ownership of property.” (*Ibid.*) The fact that service
 27 levels were derived from historical experience does not mean that the conditions are
 28 then monetary obligations – this conclusion is erroneous.

Conclusions of law are reviewed de novo. (*In re Oyster Bay Cove, Ltd.* 196

1 B.R. 251, 254 (1996). A bankruptcy court’s order authorizing a sale of property
2 “free and clear” of all liens has no impact on restrictions that run with the land. (*Id.*
3 at p. 255.) A sale of land ‘free and clear’ from these ‘interests,’ are not intended to
4 sever non-monetary property interests that are created by substantive State law.”
5 (*Ibid.*)

6 Here, the health and safety protections were issued by the state Attorney
7 General pursuant to state law and remain applicable to future owners for a period of
8 fifteen years. These health and safety protections are non-monetary interests and
9 more analogous to *In re Oyster Bay*, than the cases cited by the Bankruptcy Court.
10 In the current case, the health and safety protections within the AG Conditions are
11 not reducible to a money satisfaction, and restrict the use of the property for the
12 protection of the public.

13 The Bankruptcy Court based its holding on two rationales. First, the
14 Bankruptcy Court reasoned that the Attorney General does not have the authority to
15 review sales of health facilities involving public entities. However, this case is
16 about the continued enforcement of existing conditions properly imposed under
17 state law. (Cal. Corp. Code, § 5926.) Second, the court appears to assume that
18 because the provision of healthcare services was based on “historic experience of
19 the prior operator” it is analogous to purely monetary claims like tax or pension
20 liabilities. (Appendix, Doc. 14 [Memorandum of Decision] at 979.)

21 The Bankruptcy Court’s analysis is deeply flawed and, as a result, its holding
22 that the Attorney General’s police and regulatory authority is an “interest” that can
23 be stripped under section 363(f) is erroneous. In the BAPCPA, Congress made
24 clear that the Attorney General’s authority under California law to regulate the sale
25 of nonprofit hospitals to for-profit enterprises is preserved in bankruptcy, and is not
26 a mere “interest.” Congress enacted BAPCPA shortly after many states began
27 enacting laws giving their attorneys general or courts authority to review and
28 approve proposed conversions of nonprofit health-related entities to for-profit

1 systems. *See* Kevin F. Donohue, *Crossroads in Hospital Conversions-A Survey of*
 2 *Nonprofit Hospital Conversion Legislation*, 8 *Annals Health L.* 39, 42 n. 28 (1999)
 3 (“Since 1997, 90 bills covering conversions of hospitals, health plans and health
 4 maintenance organizations have been introduced in 34 states.”).

5 Cognizant of these state health and welfare regulatory statutes, Congress
 6 included in BAPCPA three amendments to the Bankruptcy Code relating to the
 7 transfer of nonprofit assets. *See* 11 U.S.C. §§ 363(d), 541(f) & 1129(a)(16).
 8 Section 363(d) provides that the trustee in a case involving a nonprofit debtor may
 9 only sell property in accordance with applicable non-bankruptcy law governing a
 10 transfer of such debtor’s property. Section 541(f) provides that a debtor’s property
 11 that is a tax-exempt, nonprofit charitable corporation under § 501(c)(3) of the
 12 Internal Revenue Code may be transferred to an entity that is not such a
 13 corporation, but only under the same conditions as would apply if the debtor had
 14 not sought bankruptcy protection. Section 1129(a)(16) ensures that no chapter 11
 15 plan may be confirmed unless all transfers of property under the plan are made in
 16 accordance with applicable non-bankruptcy law that governs the transfer of
 17 property by a nonprofit entity. Additionally, an uncodified BAPCPA provision,
 18 § 1221(e), clarifies that, regardless of state law, a bankruptcy court analyzing a
 19 transfer of nonprofit assets to a for-profit entity is not required to refer the
 20 proceeding to any other court or require the approval of another court for the
 21 transfer of property.

22 11 U.S.C. section 363(d) expressly preserves the Attorney General’s
 23 regulatory authority in the precise situation presented to the Bankruptcy Court.
 24 Section 363(d) provides:

25 The trustee may use, sell, or lease property under subsection (b) or (c)
 26 of this section—

27 (1) in the case of a debtor that is a corporation or trust that is not a
 28 moneyed business, commercial corporation, or trust, only in
 accordance with nonbankruptcy law applicable to the transfer of
 property by a debtor that is such a corporation or trust; and

1 (2) only to the extent not inconsistent with any relief granted under
 2 subsection (c), (d), (e), or (f) of section 362.

3 There is no dispute that Verity is “a corporation . . . that is not a moneyed
 4 business, commercial corporation, or trust.” Therefore, by the unambiguous terms
 5 of section 363(d)(1), any sale of property of Verity’s estate is permissible only if it
 6 complies with existing California law, including California Corporations Code
 7 section 5926. There are only two exceptions under section 363 to this bright line
 8 rule. Neither applies here.

9 First, 11 U.S.C. § 363(d)(2) clarifies that no sale of property can be
 10 inconsistent with an order affecting the automatic stay under certain subsections of
 11 section 362. Section 363(d) contains no exemption for relief granted under section
 12 363(f). Since section 363(f) was a part of the Bankruptcy Code when Congress
 13 added section 363(d)(1), it is inconceivable that the regulatory authority expressly
 14 preserved in section 363(d)(1) is an “interest” that can be eliminated under section
 15 363(f).

16 Moreover, in applying the police powers exception of § 362(b)(4), courts look
 17 to the purposes of the law that the government seeks to enforce, distinguishing
 18 between situations where the “state acts pursuant to its ‘police and regulatory
 19 power,’ and where the state acts purely to protect its status as a creditor.” *U.S. ex.*
 20 *rel. Fullington v. Parkway Hosp.*, 351 B.R. 280, 283 (E.D.N.Y. 2006) (citing
 21 *Safety-Kleen, Inc. v. Wyche*, 274 F.3d 846, 865 (4th Cir. 2001)). The courts have
 22 developed two tests for determining whether a particular state action is one that
 23 Congress intended to be excepted under § 362(b)(4): the pecuniary test and the
 24 public policy test. In order for the police powers exception to apply, an action by
 25 the state must satisfy one of these tests.

26 Second, the BAPCPA, § 1221(e), provides that “[n]othing in this section shall
 27 be construed to require the court in which a [chapter 11] case . . . is pending to
 28 remand or refer any proceeding, issue or controversy to any other court or to require

1 the approval of any other court for the transfer of property.”¹ Section 1221(e)
 2 demonstrates conclusively that Congress intended for state law to apply to transfers
 3 of charitable assets in a bankruptcy case, but not if the relevant state law required a
 4 state court procedure.

5 While most states have opted to empower their attorneys general to review
 6 proposed sales of nonprofit healthcare assets, some have vested that responsibility
 7 in their courts. *See, e.g., In re HHH Choices Health Plan, LLC*, 554 B.R. 697, 700
 8 (Bankr. S.D.N.Y. 2016) (noting that New York law ordinarily required the approval
 9 of the New York State Supreme Court for the transaction at issue, but applying
 10 section 1221 to conduct the review under state law). With section 1221(e),
 11 Congress demonstrated that it was familiar with the various state statutes regulating
 12 transfers of nonprofit assets and wanted such statutes to apply in bankruptcy, but
 13 not if it meant referring a proposed transaction to a state court. Implicit but clear in
 14 that policy choice is that Congress expected such review and consent to be
 15 exercised by state attorneys general and approved of that exercise of authority, even
 16 though it limited Bankruptcy Code section 363. The BAPCPA, § 1221(e),
 17 therefore cements the conclusion that the Attorney General’s authority to regulate
 18 transfers of non-profit healthcare assets is preserved under 11 U.S.C. §§ 363(d) and
 19 541(f).²

20 The Bankruptcy Court relied on *In re PBBPC, Inc.*, 484 B.R. 860, 862 (B.A.P.
 21 1st Cir. 2013) and *In re Leckie Smokeless Coal Co.*, 99 F.3d 573 (4th Cir. 1996) to
 22 conclude that, because the required service levels were derived based upon

23
 24 ¹ The section to which § 1221(e) refers is the same section of the BAPCPA
 25 that included the amendments that became sections 363(d) and 541(f). Pub. L. No.
 109-8, § 1221(e) (2005).

26 ² Another uncodified section of the BAPCPA, section 1221(d), further
 27 buttresses this conclusion by stating that “the court shall not confirm a [chapter 11]
 28 plan . . . without considering whether this section would substantially affect the
 rights of a party in interest. . . . The parties who may appear and be heard in a
 proceeding under this section include the attorney general of the State in which the
 debtor is incorporated, was formed, or does business.”

1 historical experience of the prior operator, the AG Conditions are “monetary
 2 obligations arising from the ownership of property.” Appendix Doc. 14, p. 979.
 3 Neither of these cases involved the transfer of a nonprofit debtor’s assets. Because
 4 sections 363(d) and 541(f) expressly address state regulations regarding the transfer
 5 of nonprofit assets, both cases are inapposite.

6 In *PBBPC*, the bankruptcy court had entered an order authorizing a sale of the
 7 debtor’s assets and providing that (1) the transfer to the purchase would be free and
 8 clear of all encumbrances, including successor liability claims, (2) the purchaser
 9 would not be deemed a successor of the debtor, and (3) the purchase would not
 10 have any liability for any obligation of the debtor related to the assets by reason of
 11 the transfer of such assets. *PBBPC*, 484 B.R. at 861-62. The state Department of
 12 Unemployment Assistance subsequently notified the purchaser that the debtor’s
 13 unemployment experience rating would be applied to the purchaser, increasing the
 14 unemployment insurance contributions that would otherwise be due. *Id.* at 862-63.
 15 The purchaser then filed a motion to enforce the free and clear portions of the sale
 16 order. *Id.* at 863. On appeal, the Bankruptcy Appellate Panel for the First Circuit
 17 reasoned that the use of the debtor’s higher experience rating “is clearly intended to
 18 recover for the benefit of the Commonwealth . . . sums that the Debtor would have
 19 paid Since the motivation and underlying rationale for the successor rate
 20 structure is to recover money . . . it is an interest in the property sold.” *Id.* at 870.

21 In *Leckie Smokeless Coal*, the debtor sought a declaration from the
 22 Bankruptcy Court that purchasers of its assets would purchase free and clear of
 23 successor liability under the Coal Industry Retiree Health Benefit Act of 1992 to
 24 continue making premium payments to a pension plan and fund. *Leckie Smokeless*
 25 *Coal*, 99 F.3d at 576.

26 *PBBPC* and *Leckie Smokeless Coal* are nothing like the present case. The
 27 rights involved in these cases have nothing to do with a state’s regulatory authority
 28 to continue health and safety protections imposed under statutory authority. These

1 cases are in essence “successor liability” cases as they involve passing on the
 2 monetary liabilities stemming from the debtor to the new purchaser. Both involved
 3 the imposition of liability on a successor for a purely monetary loss occasioned by a
 4 private, for-profit debtor’s acts. It is not appropriate to analogize these purely
 5 monetary claims to the Attorney General’s authority to enforce existing conditions
 6 on the provision of specific healthcare services of a general acute care hospital. It
 7 is difficult to conceive of any affirmative act that does not entail some cost to the
 8 actor. *Cf. Penn Terra Limited v. Department of Environmental Resources,*
 9 *Commonwealth of Pennsylvania*, 733 F.2d. 267 (Third Cir. 1984) [an injunction
 10 requiring compliance with environmental laws costing money to comply with does
 11 not convert an injunctive obligation to a “claim” in bankruptcy]. If such amorphous
 12 “costs” are equivalent to a purely monetary claim, then there are few if any legal
 13 obligations that are not “interests” susceptible to section 363(f).

14 Furthermore, by ruling that the Attorney General’s act of regulating was an
 15 “interest in property” simply because it is based upon the historical experience of
 16 the prior operator, the Bankruptcy Court essentially nullified the applicability of
 17 non-bankruptcy law in bankruptcy and the police power exception of the
 18 Bankruptcy Code. Bankruptcy law should not be used to place buyers above the
 19 law, leaving the public at risk without the protection of important public health and
 20 safety laws. *See Zerand-Bernal, Inc. v. Cox*, 23 F.3d 159, 163 (7th Cir. 1994); *see*
 21 *also Integrated Sols., Inc. v. Serv. Support Specialties, Inc.*, 124 F.3d 487, 493 (3d
 22 Cir. 1997) (“[N]either § 363(b)(1) nor § 704(1) expressly authorizes the trustee to
 23 sell property in violation of state law transfer restrictions . . .”).³ Here, the

24 ³ The Ninth Circuit has also recognized that bankruptcy preemption applies
 25 in very limited circumstances “(1) where a state statute facially or purposefully
 26 carves an exception out of the Bankruptcy Code, or (2) where a state statute is
 27 concerned with economic regulation rather than with protecting the public health
 28 and safety.” *Baker & Drake, Inc. v. Public Serv. Comm. of Nevada*, 35 F.3d 1348,
 1353 (9th Cir. 1994) (holding that the Bankruptcy Code did not preempt Nevada’s

1 Attorney General's authority to enforce existing health and safety protections is an
 2 exercise of his power to protect the health, safety and welfare of the people of
 3 California as stated by the California Legislature when the statutes were enacted.

4 It is conceivable that, before the BAPCPA, there was disagreement as to
 5 whether a state's power to regulate transfers of nonprofit assets was preserved in
 6 bankruptcy under 28 U.S.C. § 959(b) or otherwise. "Now, Congress has resolved
 7 the controversy squarely in favor of the restrictions nonbankruptcy law imposes on
 8 the transfer of assets of not-for-profit corporations." Daniel A. DeMarco & Nancy
 9 A. Valentine, *Health Care Hazards and Eleemosynary Elocutions Bapcpa Changes*
 10 *the Sale of Nonprofit Health Care Assets*, Am. Bankr. Inst. J., October 2005, at 16.

11 **II. THE BANKRUPTCY COURT ERRED IN RULING THAT THE ATTORNEY** 12 **GENERAL WAIVED APPLICATION OF HIS CONDITIONS**

13 "Waiver...occurs when a 'party's acts are so inconsistent with an intent to
 14 enforce the right as to induce a reasonable belief that such right has been
 15 relinquished.'" *Salyers v. Metro Life Ins. Co.* 871 F.3d 934, 938 (9th Cir. 2017).
 16 Moreover, the party asserting waiver bears the burden of proof. *Intel Corp. v.*
 17 *Hartford Acc. & Indem. Co.* 952 F.2d 1551, 1559 (9th Cir. 1991). Under California
 18 law, waiver is a question of fact. *Kay v. Kay*, 188 Cal.App.2d 214, 218 (1961).

19 A finding is clearly erroneous when, although there is evidence to support it,
 20 the reviewing court on the entire evidence is left with a definite and firm conviction
 21 that a mistake has been committed. *Anderson v. City of Bessemer*, 470 U.S. 564,
 22 574 (1985).

23 The Attorney General has not changed his position throughout this bankruptcy
 24 action: any sale of O'Connor Hospital and Saint Louise Regional Hospital to the

25
 26
 27 ban on taxi leasing, a regulation intended to secure the public convenience and
 28 safety). These factors are wholly absent in this matter.

1 County is subject to the AG Conditions. (Appendix, Doc. 3 [AG Bid Procedure
2 Response], Doc 5 [AG Bid Procedure Sur-Reply].)

3 Assistant County Counsel was advised just prior to the filing of the AG
4 Response on December 14 that the Attorney General did not object to the sale as
5 long as the conditions as currently or subsequently clarified remained in place.
6 (Appendix, Doc 11 [Declaration of Angela Sierra], p. 939-940.) The intent of the
7 Attorney General was clear, and any argument that the Attorney General intended
8 to waive his objections is without merit. In this case, Debtors submitted a proposed
9 transaction to the Attorney General in 2015, and thereafter implicitly and explicitly
10 agreed that the AG Conditions would bind successors, and further waived any right
11 to seek judicial relief with respect to each and every Condition. (Appendix, Doc. 1
12 [AG Conditions], at 180, 190, 265, 276.)

13 Condition I, applicable to both O'Connor Hospital and Saint Louise Regional
14 Hospital, provides that the conditions shall be legally binding on "any successor in
15 interest" and "any and all current and future owners, lessees and owners of the real
16 property on which the hospital is located." (*Id.*)

17 Moreover, Debtors further waived any right to seek judicial relief from each
18 and every Condition. O'Connor Hospital's Condition XXI and Saint Louise
19 Regional Hospital's Condition XXII state in relevant part: "[A]ll parties listed in
20 Condition I...are deemed to have explicitly and implicitly consented to the
21 applicability and compliance with each and every Condition and to have waived
22 any right to seek judicial relief with respect to each and every Condition."
23 (Appendix, Doc. 1 [AG Conditions], at 190, 276.) Verity is expressly bound by the
24 AG Conditions, and waived all rights to judicial relief with respect to the
25 conditions. (*Id.*) As such, the only party that has waived any rights is the Debtors.

26 //

27 //

28 //

1 **III. THE BANKRUPTCY COURT ERRED IN APPLYING THE DOCTRINE OF** 2 **EQUITABLE ESTOPPEL**

3 The doctrine of equitable estoppel requires: 1.) the party to be estopped must
4 know the facts, 2.) he must intend that his conduct shall be acted on, 3.) the party
5 asserting the right to estoppel must be ignorant of the true facts, and 4.) the party
6 asserting estoppel must act in reliance and to his injury. *Gabriel v. Alaska Elec.*
7 *Pension Fund*, 773 F.3d 945, 955 (9th Cir. 2014).

8 Here, the County has failed to prove three factors of the four-prong test in
9 *Gabriel*. First, there has been no showing that the Attorney General intended the
10 December 14, 2018 filing to be treated as a waiver. In fact, moments before the
11 filing took place, the Chief Assistant Attorney General explained to the Assistant
12 County Counsel that the language in the Attorney General’s Response to Debtors’
13 Motion for Entry of (I) An Order (1) Approving Form of Asset Purchase
14 Agreement for Stalking Horse Bidder, and (II) An Order (A) Authorizing the Sale
15 of Property Free and Clear of all Claims, Liens and Encumbrances (Appendix, Doc.
16 8.) meant that the Attorney General did not object to the sale as long as the
17 conditions, as clarified, remained in place. (Appendix, Doc 11 [Declaration of
18 Angela Sierra] p. 939.) Thus, the Attorney General did not intend the filing to
19 waive all objections to the sale of the hospital, and no evidence has been introduced
20 that negates this fact. Rather, the County was apprised of the Attorney General’s
21 position moments before the December 14, 2018 filing. (*Ibid.*)

22 Second, the County “agreed to discuss, post-sale, how to address the other
23 conditions under a variety of approaches” and that “ongoing discussions with the
24 County about the other conditions were contemplated outside the Court process.”
25 (Appendix, Doc. 12 [Declaration of Douglas Press], p. 946.) As such, not only was
26 the County apprised of the Attorney General’s position, the County agreed that the
27 parties would continue discussions about the AG Conditions post-sale – which
28 requires that the AG Conditions survive the sale order.

1 Lastly, there is no evidence that the County or Debtors were injured as
 2 required by the fourth prong. The County and Debtors argued that they would have
 3 argued more strenuously, but this is not a cognizable injury. Moreover, because the
 4 County was aware that the Attorney General did not intend to waive his AG
 5 Conditions, there was no reliance and no injury to support the application of the
 6 equitable estoppel doctrine. This ruling was in error and requires reversal.

7 **IV. THE COURT ERRED BY EXCLUDING EVIDENCE RELATED TO WAIVER**
 8 **AND EQUITABLE ESTOPPEL**

9 Here, the court erred by relying on Federal Rules of Evidence section 403 in
 10 excluding “parol evidence” that negated a finding that the Attorney General
 11 intended to waive his objections, and that the County had a reasonable belief that
 12 the Attorney General had waived his objections. The Court found that the
 13 consideration of two declarations consisting of three pages each, would result in
 14 undue delay. (Appendix, Doc. 14, p. 6-7.)

15 The parol evidence rule is not a rule of evidence but is one of substantive law.
 16 *Tahoe Nat’l Bank v. Phillips*, 4 Cal.3d 11, 22-23 (1971). Moreover, the parol
 17 evidence rule is inapplicable in the context of the equitable doctrines of waiver and
 18 estoppel. Rather, under California law, waiver can be proven through the
 19 admission of parol evidence. *Singh v. Cross*, 60 Cal.App. 309, 317 (1922); *Erschine*
 20 *v. Upham*, 56 Cal.App.2d 235, 247 (1942); *Snidow v. Hill*, 87 Cal.App.2d 803, 808
 21 (1948).

22 In the instant case, the Court held that the Attorney General had waived his
 23 objections by excluding relevant evidence that proved that the County did not have
 24 a reasonable belief that the Attorney General had waived the enforcement of his
 25 conditions. This ruling was in error and requires reversal.

26 **RELIEF REQUESTED**

27 The Attorney General respectfully requests that this Court reverse the
 28 Bankruptcy Court’s determination that the sale of hospitals to the County does not

1 allow for the continued application of the health and safety protections within the
2 AG Conditions, as well as the Bankruptcy Court's ruling with respect to waiver and
3 equitable estoppel, and order the Bankruptcy Court to: amend the Sale Order to
4 require the County to abide by the remaining AG Conditions, and vacate the
5 Memorandum of Decision. *See* 28 U.S.C. § 2106.

6 Dated: February 22, 2019

Respectfully submitted,

7 XAVIER BECERRA
8 Attorney General of California
9 JAMES M. TOMA
Supervising Deputy Attorney General

10 /s/ Alicia Berry

11 ALICIA BERRY
12 Deputy Attorney General
13 *Attorneys for Xavier Becerra,*
California Attorney General

14 LA2018502412 / Appellant Opening Brief.docx
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rules of Bankruptcy Procedure Rule 8015(a)(7), the undersigned certifies that the Appellant's Opening Brief complies with the type-volume limitation and that the Appellant's Opening Brief contains 9,367 words (excluding the cover page, tables, signature blocks and required certificates) as counted by the computer program used to prepare the Attorney General's Opening Brief.

Dated: February 22, 2019

Respectfully submitted,

XAVIER BECERRA
Attorney General of California
JAMES M. TOMA
Supervising Deputy Attorney General

/s/ Alicia Berry

ALICIA BERRY
Deputy Attorney General
*Attorneys for Xavier Becerra,
California Attorney General*

LA2018502412 / Appellant Opening Brief.docx

CERTIFICATE OF SERVICE

Case Name: **In re: VERITY HEALTH
SYSTEMS OF CALIFORNIA,
INC.**

Case No. **2:19-cv-133-RGK**

I hereby certify that on **February 22, 2019** I *electronically filed* the following documents with the Clerk of the Court by using the CM/ECF system:

**CALIFORNIA ATTORNEY GENERAL'S OPENING BRIEF
[Appendix filed concurrently]**

Participants in the case who are registered CM/ECF users will be served by the CM/ECF system.

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service with postage thereon fully prepaid that same day in the ordinary course of business.

I further certify that some of the participants in the case are not registered CM/ECF users. On **February 22, 2019**, I have caused to be mailed in the Office of the Attorney General's *internal mail system*, the foregoing document(s) by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within three (3) calendar days to the following non-CM/ECF participants:

SEE ATTACHED SERVICE LIST

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on **February 22, 2019**, at Los Angeles, California.

Jane Miyamura
Declarant

/s/ Jane Miyamura
Signature

Service List

Electronic Notification

The following parties are currently on the list to receive email notice/service for this case.

- **James Cornell Behrens**
jbehrens@milbank.com
- **Alicia Kathleen Berry**
Alicia.Berry@doj.ca.gov, jane.miyamura@doj.ca.gov, james.toma@doj.ca.gov
- **Gregory Raymond Jones**
gjones@mwe.com
- **James W Kapp**
jkapp@mwe.com
- **Jessica Mariani**
jmariani@mwe.com
- **Tani M Moyron**
tania.moyron@dentons.com, chris.omeara@dentons.com
- **Mark Shinderman**
mshinderman@milbank.com, dmuhrez@milbank.com

Service by U.S. Mail

The following parties are currently **NOT** on the list to receive email notice/service for this case and will instead receive notice/service by U.S. mail.

Gregory A. Bray
MILBANK, TWEED, HADLEY & McCLOY
2029 Century Park East, 33rd Floor
Los Angeles, CA 90067