United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Wednesday, August 12, 2020 **Hearing Room 1568**

10:00 AM

2:18-20151 Verity Health System of California, Inc. **Chapter 11**

#8.00 Hearing re [4993] Second Amended Joint Chapter 11 Plan Of Liquidation (Dated July 2, 2020) Of The Debtors, The Prepetition Secured Creditors,And The Committee

Docket 0

Matter Notes:

8/12/2020

The tentative ruling will be the order.
Party to lodge order: As set forth in the Tentative Ruling

POST PDF OF TENTATIVE OR AMENDED TENTATIVE RULING TO CIAO

Tentative Ruling:

8/12/2020

Note: Telephonic Appearances Only. The Courtroom will be unavailable for in-court appearances. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, ext. 188 no later than one hour before the hearing. The cost for persons representing themselves has been waived.

(Amended after hearing in RED.) For the reasons set forth below, the outstanding objections to confirmation of the Plan are **OVERRULED**, and the Plan is **CONFIRMED**.

Pleadings Filed and Reviewed:

1) Memorandum of Law in Support of Confirmation of Second Amended Joint Chapter 11 Plan (Dated July 2, 2020) of the Debtors, the Committee, and Prepetition Secured Creditors [Doc. No. 5385]
   a) Second Amended Joint Chapter 11 Plan of Liquidation (Dated July 2, 2020) of

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the Debtors, the Prepetition Secured Creditors, and the Committee [Doc. No. 4993] (the "Plan")

b) Disclosure Statement Describing Second Amended Joint Chapter 11 Plan of Liquidation (Dated July 2, 2020) of the Debtors, the Prepetition Secured Creditors, and the Committee [Doc. No. 4994]
c) Order Granting Joint Motion for an Order Approving: (I) Proposed Disclosure Statement; (II) Solicitation and Voting Procedures; (III) Notice and Objection Procedures for Confirmation of Amended Joint Plan; (IV) Setting Administrative Claims Bar Date; and (V) Granting Related Relief [Doc. No. 4997]
d) Declaration of Service of Solicitation Materials [Doc. No. 5346]
e) Certification of Andres A. Estrada With Respect to the Tabulation of Votes on the Second Amended Joint Chapter 11 Plan of Liquidation (Dated July 2, 2020) of the Debtors, the Prepetition Secured Creditors, and the Committee [Doc. No. 5371] (the "Voting Declaration")
f) Notice of Certain Plan Supplements to the [Plan] [Doc. No. 5443]

2) Confirmation Objections:
a) Objection of Cigna Entities to [Plan] [Doc. No. 5231]
i) Notice of Resolution of Objection of Cigna Entities to [Plan] [Doc. No. 5396]
b) Creditor Seoul Medical Group Inc.'s Notice of Reservation of Rights to Objection to the Debtors' Confirmation of Their [Plan] [Doc. No. 5268]
c) Toyon Associates, Inc.'s Limited Objection to Confirmation [Doc. No. 5281]
i) Toyon Associates, Inc.'s Objection to Debtors' Evidence in Support of Confirmation [Doc. No. 5407]
d) Limited Objection and Reservation of Rights of Infor (US), Inc. with Respect to [the Plan] [Doc. No. 5282]
e) Objection of Strategic Global Management, Inc. to Confirmation of [Plan] [Doc. No. 5288]
i) Strategic Global Management, Inc.'s Response to "Memorandum of Law in Support of Confirmation of the [Plan]" [Doc. No. 5448]
ii) Notice of Administrative Expense Claim [filed by SGM] [Doc. No. 5197]
f) Objection of Health Net of California, Inc. to Confirmation of Plan [Doc. No. 5292]
g) Objection of California Attorney General to Confirmation of [Plan] [Doc. No. 5294]

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h) UnitedHealthcare Ins. Company's Objection to Confirmation [Doc. No. 5326]
i) Limited Objection of SCAN Health Plan to Confirmation of Plan [Doc. No. 5337]
j) Applecare Medical Group, Inc., Applecare Medical Group St. Francis, Inc., and Applecare Medical Management, LLC's Objection to Confirmation of [Plan] [Doc. No. 5339]
    i) AppleCare Medical Group, Inc., AppleCare Medical Group, St. Francis Inc., and AppleCare Medical Management LLC's Amended Motion for Allowance of an Administrative Expense Claim [Doc. No. 5445]
k) GRM Information Management Services Inc.'s Limited Objection to Plan [Doc. No. 5341]
l) Long Beach Memorial Medical Center's Limited Objection to Confirmation of [Plan] [Doc. No. 5342]
m) Objection of Premier, Inc. to Confirmation of [Plan] [Doc. No. 5343]
n) Blue Shield's Conditional Joinder, Limited Objection, or Reply to Objections to Confirmation of [Plan] [Doc. No. 5417]

3) Reply papers:
a) Omnibus Reply to Certain Objections to Confirmation of [the Plan] [Doc. No. 5419]
b) Omnibus Reply to Certain Objections to Confirmation of [the Plan] [Doc. No. 5425]
c) Supplement Regarding Proposed Resolution of Objections Asserted by Certain Payors Re Confirmation of [the Plan] [Doc. No. 5455]
d) Debtors' (I) Request to Strike or, in the Alternative, Overrule Strategic Global Management, Inc.'s Unauthorized "Surreply" in Support of SGM's Confirmation Objection and (II) Response to Toyon Associates, Inc.'s Evidentiary Objections to the Declaration of Peter C. Chadwick in Support of the Confirmation Brief [Doc. No. 5456]

4) Stipulations resolving issues:
a) Order Approving Stipulation Among Debtors, Creditors' Committee and Aetna Life Insurance Company for Resolution of Plan Objection [Doc. No. 5350]
    i) Stipulation Among Debtors, Creditors' Committee and Aetna Life Insurance Company for Resolution of Plan Objection [Doc. No. 5338]
b) Stipulation Between the Debtors and Swinerton Builders Resolving Informal Confirmation Objection [Doc. No. 5463]

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I. Facts and Summary of Pleadings

On August 31, 2018 (the "Petition Date"), Verity Health System of California, Inc. ("VHS") and certain affiliated entities (collectively, the "Debtors") each filed voluntary Chapter 11 petitions. **[Note 1]** The Debtors' cases are being jointly administered.

Debtor VHS, a California nonprofit public benefit corporation, is the sole corporate member of the following five Debtor California nonprofit public benefit corporations that, on the Petition Date, operated six acute care hospitals: O'Connor Hospital ("OCH"), Saint Louise Regional Hospital ("SLRH"), St. Francis Medical Center ("SFMC"), St. Vincent Medical Center ("SVMC"), Seton Medical Center ("SMC"), and Seton Medical Center Coastside ("Seton Coastside" and, together with OCH, SLRH, SFMC, and SVMC, the "Hospitals"). SMC and Seton Coastside (collectively, "Seton") operated under one consolidated acute care hospital license.

As of the Petition Date, VHS, the Hospitals, and their affiliated entities (collectively, the "Verity Health System") operated as a nonprofit health care system in California, with approximately 1,680 inpatient beds, six active emergency rooms, a trauma center, and a host of medical specialties, including tertiary and quarternary care. In 2017, the Hospitals provided medical services to over 50,000 inpatients and 480,000 outpatients.

On June 16, 2020, the Debtors, the Official Committee of Unsecured Creditors (the "Committee"), and the Prepetition Secured Creditors **[Note 2]** (collectively, the "Plan Proponents") filed the *Amended Joint Chapter 11 Plan of Liquidation (Dated June 16, 2020) of the Debtors, the Prepetition Secured Creditors, and the Committee* [Doc. No. 4879] (the "Plan") and an accompanying disclosure statement [Doc. No. 4880] (the "Disclosure Statement"). On July 2, 2020, the Court entered an order (1) approving the Disclosure Statement as containing adequate information and (2) establishing solicitation and voting procedures. Doc. No. 4997.

A. The Debtors' Prepetition Capital Structure

VHS, Verity Business Services ("VBS"), and the Hospitals are jointly obligated parties on approximately $461.4 million of outstanding secured debt, consisting of:

1) $259.4 million outstanding tax exempt revenue bonds, loaned to provide funds for capital improvements and to refinance certain tax exempt bonds previously issued in 2001 (the "2005 Revenue Bonds"); and

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2) $202 million outstanding tax exempt revenue notes, issued in 2015 (the "2015 Revenue Notes") and 2017 (the "2017 Revenue Notes"), loaned for working capital purposes.

Verity Holdings, LLC ("Holdings") was created in 2016 to hold and finance the Debtors' interests in six medical office buildings whose tenants are primarily physicians and other practicing medical groups. Holdings is the borrower of approximately $66 million through two series of non-recourse financing secured by separate deeds of trust and revenue and accounts pledges, including lease rents on each medical building, pursuant to the Medical Office Building ("MOB") I Loan Agreement with Verity MOB Financing LLC ("MOB I") and MOB II Loan Agreement with Verity MOB Financing II LLC ("MOB II") (collectively, the "MOB Financings").

B. The Failed SGM Sale and Related Litigation

On May 2, 2019, the Court entered an order authorizing the Debtors to sell SFMC, SVMC, and Seton to Strategic Global Management, Inc. ("SGM"). *See* Doc. No. 2306 (the "SGM Sale Order"). Pursuant to the Asset Purchase Agreement approved in connection with the SGM Sale (the "SGM APA"), SGM made a good-faith deposit of $30 million (the "Deposit").

On November 27, 2019, the Court entered a memorandum of decision and accompanying order rejecting SGM's allegation that the Debtors had failed to comply with certain of the conditions and obligations imposed upon them by the SGM APA, and that these alleged failures to perform had resulted in a Material Adverse Effect which relieved SGM of its obligation to close the SGM Sale. *See* Bankr. Doc. Nos. 3723 (the "Material Adverse Effect Memorandum") and 3724 (the "Material Adverse Effect Order"). The Court stated: "Article 1.3 [of the SGM APA] obligates SGM to close the sale 'promptly but no later than ten (10) business days following the satisfaction' of all conditions precedent. As all conditions precedent were satisfied on November 19, 2019, SGM is obligated to close the sale by no later than December 5, 2019." Material Adverse Effect Memorandum at 7. The Material Adverse Effect Order provided in relevant part: "Pursuant to § 1.3 of the APA, SGM is obligated to close the SGM Sale by no later than December 5, 2019." Material Adverse Effect Order at ¶ 1.

On December 3, 2019, SGM appealed the Material Adverse Effect Order, along with two other orders pertaining to the SGM Sale (the "Appeals," and the orders

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appealed, the "Appealed Orders"). SGM did not close the SGM Sale on December 5, 2019, or thereafter. The Debtors terminated the SGM APA, effective as of December 27, 2019. *See* Doc. No. 3899.

On May 14, 2020, the District Court dismissed the Appeals as moot. *See* Case No. 2:19-cv-10352-DFS, Doc. No. 59. On June 11, 2020, the District Court vacated the Appealed Orders. *See* Case No. 2:19-cv-10352-DFS, Doc. No. 65. On July 8, 2020, the Debtors appealed the vacatur of the Appealed Orders to the Ninth Circuit. *See* Case No. 2:19-cv-10352-DFS, Doc. No. 66.

On January 3, 2020, the Debtors commenced an adversary proceeding (the "Adversary Proceeding") against SGM and others, alleging, *inter alia*, breaches of the SGM APA and promissory fraud. On March 5, 2020, the District Court withdrew the reference to the Adversary Proceeding. *See* Case No. 2:20-cv-00613-DSF, Doc. No. 23.

On July 10, 2020, SGM filed a counterclaim against the Debtors (the "SGM Counterclaim"). *See* Case No. 2:20-cv-00613, Doc. No. 41. Among other things, the SGM Counterclaim alleges that the Debtors (1) breached the SGM APA by failing to properly maintain the hospitals and (2) wrongfully retained the Deposit.

On August 4, 2020, the District Court held that the Debtors' First Amended Complaint against SGM and others stated claims upon which relief could be granted. *See* Case No. 2:20-cv-00613, Doc. No. 56.

C. Summary of the Plan

1. General Overview

The Plan implements a comprehensive compromise among the holders of the Secured 2005 Revenue Bond Claims, the Debtors, and the Committee. In return for the agreement by the holders of the Secured 2005 Revenue Bond Claims to accept a partial payment of their claims on the Effective Date, the Debtors will dismiss with prejudice litigation commenced by the Committee for the benefit of the Debtors against the Prepetition Secured Creditors, and waive preserved claims against Verity MOB Financing LLC and Verity MOB Financing II LLC.

The Plan creates a Liquidating Trust to collect and liquidate the Debtors' remaining assets. Holders of the Secured 2005 Revenue Bond Claims will receive a cash payment of approximately $124.2 million on the Effective Date (equal to roughly half the amount of the allowed claims). The remaining amount of the Secured 2005 Revenue Bond Claims will be satisfied through First Priority Trust Beneficial Interests to be issued by the Liquidating Trust. It is anticipated that the Allowed Secured 2005

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Revenue Bond Claims will be paid in full.

As a result of the willingness of the holders of the Secured 2005 Revenue Bond Claims to receive a deferred payment of a portion of their claims, the Debtors will have sufficient cash on hand to pay on the Effective Date all allowed Administrative Claims and all other allowed secured claims.

The claims of holders of Allowed General Unsecured Claims will be satisfied through Second Priority Trust Beneficial Interests to be issued by the Liquidating Trust. It is anticipated that holders of Allowed General Unsecured Claims will receive a recovery of approximately 0.5%.

The Plan deems the Debtors substantively consolidated for the purposes of claim allowance and distribution, which treats the Debtors' assets and liabilities as if they were pooled without actually merging the Debtor entities.

2. The Plan's Classification Structure

The following table sets forth the Plan's classification structure:

Class	Designation	Impairment	Entitled to Vote
1A	Other Priority Claims	Not Impaired	No (deemed to accept)
1B	Secured PACE Tax Financing Claims	Not Impaired	No (deemed to accept)
2	Secured 2017 Revenue Notes Claims	Impaired	Yes
3	Secured 2015 Revenue Notes Claims	Impaired	Yes
4	Secured 2005 Revenue Bond Claims	Impaired	Yes
5	Secured MOB I Financing Claims	Impaired	Yes
6	Secured MOB II Financing Claims	Impaired	Yes
7	Secured Mechanics Lien Claims	Impaired	Yes
8	General Unsecured Claims	Impaired	Yes
9	Insured Claims	Impaired	Yes
10	2016 Data Breach Claims	Impaired	Yes
11	Subordinated General Unsecured Claims	Impaired	No (deemed to reject)

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12	Interests	Impaired	No (deemed to reject)

The treatment of each class is as follows:

Class	Designation	Treatment
1A	Other Priority Claims	Paid in full in cash on the Effective Date
1B	Secured PACE Tax Financing Claims	Paid in accordance with the *Order Approving Stipulation Resolving California Statewide Communities Development Authority Lien Release Pursuant to Proposed Sale of Certain of Debtors' Assets Related to Seton Medical Center* [Doc. No. 4613]
2	Secured 2017 Revenue Notes Claims	On the Effective Date, paid $42 million plus (i) accrued but unpaid postpetition interest and (ii) accrued but unpaid reasonable, necessary out-of-pocket fees and expenses of the 2017 Notes Trustee and the Master Trustee, less certain adjustments
3	Secured 2015 Revenue Notes Claims	On the Effective Date, paid $160 million plus (i) accrued but unpaid postpetition interest and (ii) accrued but unpaid reasonable, necessary-out-of-pocket fees and expenses of the 2015 Notes Trustee and Master Trustee, less certain adjustments
4	Secured 2005 Revenue Bond Claims	On the Effective Date, paid not less than $124.2 million. The remainder of the claims will be satisfied through the Liquidating Trust's issuance of First Priority Beneficial Trust Interests.
5	Secured MOB I Financing Claims	On the Effective Date, paid $46,363,095.90, plus (i) accrued but unpaid postpetition interest and (ii) accrued but unpaid reasonable, necessary out-of-pocket fees and expenses of Verity MOB Financing LLC
6	Secured MOB II Financing Claims	On the Effective Date, paid $20,061,919.48, plus (i) accrued but unpaid postpetition interest and (ii) accrued but unpaid reasonable, necessary out-of-pocket fees and expenses of Verity MOB Financing II LLC

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7	Secured Mechanics Lien Claims	Paid in full in cash on the Effective Date
8	General Unsecured Claims	Entitled to receive Second Priority Trust Beneficial Interests, which are projected to yield a recovery of approximately 0.5%
9	Insured Claims	On the Effective Date, entitled to receive automatic relief from the automatic stay and the injunctions provided under the Plan, for the sole and limited purpose of permitting each Holder to seek recovery before a court of competent jurisdiction from the applicable and available Insurance Policies maintained by or for the benefit of any of the Debtors. To the extent that a recovery under the Insurance Policy is insufficient to satisfy the claim, or there are no available Insurance Policies, each Holder shall be entitled to an Insured Deficiency Claim, which shall be treated as an Allowed General Unsecured Claim.
10	2016 Data Breach Claims	Entitled to receive two years of credit monitoring services
11	Subordinated General Unsecured Claims	No recovery
12	Interests	No recovery

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3. Voting Results

All classes entitled to vote have accepted the Plan, as set forth in the following table:

Class	Description	Ballots Cast	Percentage Accepting in Number	Percentage Accepting in Dollar Amount
2	Secured 2017 Revenue Notes Claims	1	100%	100%
3	Secured 2015 Revenue Notes Claims	7	100%	100%
4	Secured 2005 Revenue Bond Claims	264	97.73%	99.93%
5	Secured MOB I Financing Claims	1	100%	100%
6	Secured MOB II Financing Claims	1	100%	100%
7	Secured Mechanics Lien Claims	6	100%	100%
8	General Unsecured Claims	777	94.72%	82.47%
9	Insured Claims	16	87.5%	71.43%
10	2016 Data Breach Claims	40	90%	94.01%

4. Conditions Precedent to the Effective Date

The Plan's Effective Date is the first business day after all of the following conditions have been satisfied:

1) An unstayed Confirmation Order shall have been entered by the Court, Plan at § 12.2(a);
2) The SFMC Sale shall have closed, *id.* at § 12.2(b);
3) The Seton Sale shall have closed, *id.* at § 12.2(c);
4) The Debtors shall have sufficient Cash to satisfy all payments required to be made under the Plan on the Effective Date, *id.* at § 12.2(d);
5) The Debtors shall have sufficient cash to fund the Liquidating Trust Reserves, *id.* at § 12.2(e); and

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6) All documents, instruments, and agreements necessary to implement the Plan shall have been executed and delivered by the parties thereto, *id.* at § 12.2(f).

5. Post-Effective Date Governance

The following shall occur on the Effective Date:

1) The Committee shall be dissolved and the Post-Effective Date Committee shall be appointed. *Id.* at § 7.11(a)–(b). The Post-Effective Date Committee shall (i) consult and coordinate with the Liquidating Trustee as to the administration of the Liquidating Trust and the Liquidating Trust Assets; and (ii) consult and coordinate with the Liquidating Trustee as to the administration of the Post-Effective Date Debtors. *Id.* at § 7.11(c).
2) The following Debtors shall be dissolved: Verity Business Services ("VBS"), Holdings, De Paul Ventures, LLC, and De Paul Ventures—San Jose Dialysis, LLC. *Id.* at § 5.1.
3) The properly donor-restricted assets of the Saint Louise Regional Hospital Foundation and O'Connor Hospital Foundation shall be transferred pursuant to approvals to be received from the California Attorney General. *Id.* at § 5.4.
4) The board members of VHS shall resign and the Post-Effective Date Board of Directors of VHS shall be appointed. *Id.* at § 5.9(a). The Post-Effective Date Board of Directors shall oversee the Liquidating Trustee in his or her capacity as president of the Post-Effective Date Debtors consistent with the terms of this Plan. *Id.* at § 5.9(b).

After the Effective Date, the following Debtors shall continue in existence: SFMC and Seton (the "Sale-Leaseback Debtors"), SLRH and OCH (the "SCC Debtors"), SVMC, St. Vincent Dialysis, and VHS (collectively, the "Post-Effective Date Debtors"). *Id.* at § 5.8.

The Sale-Leaseback Debtors shall continue in existence for the limited purposes of (i) maintaining their rights as licensees under the SFMC and Seton Hospital Licenses so Prime and AHMC may obtain their general acute care hospital licenses from the California Department of Public Health and their hospital permits from the California State Board of Pharmacy and (ii) maintaining the respective Hospital's Medicare and Medi-Cal Provider Agreements until the changes of ownership to Prime and AHMC are approved. *Id.* at § 5.8.

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SVMC, St. Vincent Dialysis, and the SCC Debtors shall continue in existence for the limited purpose of receiving Medi-Cal, Medicare, and Quality Assurance Payments. *Id.* at § 5.8(c)–(d). VHS shall continue in existence to provide support services required under various interim agreements entered into by the Debtors to facilitate the Prime Sale and the AHMC Sale. *Id.* at § 5.8(e).

From and after the Effective Date, the Liquidating Trust may use and dispose of Liquidating Trust Assets, and take any of the actions consistent with the Plan and/or the Liquidating Trust Agreement without approval of the Court and free of the restrictions of the Bankruptcy Code, the Bankruptcy Rules, and the Local Bankruptcy Rules, provided that the Liquidating Trust will be administered so that it qualifies as a liquidating trust under 26 C.F.R. § 301.7701–4(d). *Id.* at § 6.4. The Liquidating Trustee shall be selected by the Committee with the consent of the Master Trustee, such consent not be unreasonably withheld. *Id.* at § 6.5(a).

Unless and until the First Priority Trust Beneficial Interests are paid in full, any decisions of the Liquidating Trustee to settle, compromise, affect, waive, or release any rights of the Liquidating Trust in any assets having a nominal value of $50,000 or more shall require the consent of the Master Trustee, which consent may be withheld in its sole discretion. *Id.* at § 6.5(c).

The Liquidating Trustee is not permitted to distribute the Deposit to creditors or take any other action which would reduce or dissipate the Deposit, unless permitted by an unstayed judgment or order entered by the District Court having jurisdiction over the Adversary Proceeding.

6. Treatment of Administrative Claims Other than Professional Claims

The Plan's provisions pertaining to the treatment of Administrative Claims, other than Professional Claims, are as follows:

Each Holder of an Allowed Administrative Claim shall be paid in full in Cash on the Effective Date, unless the Allowed Administrative Claim is based on liabilities incurred by the Debtors in the ordinary course of business after the Petition Date, in which case the Holder shall be paid in the ordinary course of business. *Id.* at § 2.1. If the Administrative Claim has not been Allowed on the Effective Date, the Holder shall receive payment from the Administrative Claims Reserve. *Id.*

The Administrative Claims Reserve shall be established on the Effective Date in an amount determined by the Bankruptcy Court in order to satisfy all Administrative Claims that have not been Allowed as of the Effective Date and all Allowed

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Administrative Claims that will be paid after the Effective Date. *Id.* at § 15.3. In the event that the Debtors, the Liquidating Trustee, or the Master Trustee objects to an Administrative Claim, the Bankruptcy Court shall determine the Allowed amount of such Administrative Claim. *Id.*

All Administrative Claims that become Allowed after the Effective Date shall be paid solely from the Administrative Claims Reserve, and shall not constitute a claim against the Liquidating Trust, the Liquidating Trustee, or any of the Liquidating Trust Assets. *Id.* No Holder of an Administrative Claim shall have recourse for any deficiency in the payment of its Administrative Claim against any of the Released Parties, the Post-Effective Date Debtors, the Post-Effective Date Board of Directors, the Liquidating Trustee, the Post-Effective Date Committee, or the Liquidating Trust. *Id.*

7. Treatment of Professional Claims

The Plan requires all Professionals seeking an award on account of a Professional Claim, other than Ordinary Course Professionals, to file final applications for allowance of compensation for services rendered and reimbursement of expenses incurred by no later than sixty days after the Effective Date. *Id.* at § 2.2. Professionals shall receive Cash in an amount equal to 100% of the amount of their Allowed Professional Claim. *Id.*

8. Exculpation Clause

The Plan contains an exculpation clause applicable to any "Released Party," defined as "the Estates, the Debtors, the Committee, the members of the Committee, the Indenture Trustees and their affiliates, and each current and/or former member, manager, officer, director, employee, counsel, advisor, professional, or agents of each of the foregoing who were employed or otherwise serving in such capacity before or after the Petition Date." *Id.* at § 1.147. The exculpation clause provides:

> To the maximum extent permitted by applicable law, each Released Party shall not have or incur any liability for any act or omission in connection with, related to, or arising out of the Chapter 11 Cases (including, without limitation, the filing of the Chapter 11 Cases), the marketing and the sale of Assets of the Debtors, the Plan and any related documents (including, without limitation, the negotiation and consummation of the Plan, the pursuit of the Effective Date, the administration of the Plan, or the property to be distributed

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under the Plan), or each Released Party's exercise or discharge of any powers and duties set forth in the Plan, except with respect to the actions found by Final Order to constitute willful misconduct, gross negligence, fraud, or criminal conduct, and, in all respects, each Released Party shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the Plan. Without limitation of the foregoing, each such Released Party shall be released and exculpated from any and all Causes of Action that any Person is entitled to assert in its own right or on behalf of any other Person, based in whole or in part upon any act or omission, transaction, agreement, event or other occurrence in any way relating to the subject matter of this Section.

Id. at § 13.7.

"Causes of Action" means

any and all present or future claims, rights, legal and equitable defenses, offsets, recoupments, actions in law or equity or otherwise, choses in action, obligation, guaranty, controversy, demand, action suits, damages, judgments, third-party claims, counter-claims, cross-claims against any Person, whether known or unknown, liquidated or unliquidated, foreseen or unforeseen, existing or hereafter arising, whether based on legal or equitable relief, whether arising under the Bankruptcy Code or federal, state, common, or other law or equity, whether or not the subject of a pending litigation or proceedings on the Effective Date or thereafter, including without limitation: (a) all Avoidance Actions; (b) all other claims in avoidance, recovery, and/or subordination; (c) all SGM Claims; (d) all claims against Integrity Healthcare, LLC and BlueMountain Capital Management LLC; and (e) all other actions described in the Disclosure Statement, the Confirmation Order, the Schedules, or the Plan; provided, however, (x) any claims arising under the Interim Agreements and (y) any claims or other litigation compromised as part of a Creditor Settlement Agreement, are, in each case, excluded.

Id. at § 1.30.

D. Summary of Unresolved Confirmation Objections and the Debtors' Responses Thereto [Note 3]

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SGM Objection

SGM asserts an Administrative Claim in the minimum amount of $45.2 million, consisting of the $30 million Deposit, accrued interest on the Deposit in the estimated amount of $6.2 million, professional fees incurred in connection with defending against the Adversary Proceeding in the estimated amount of $4 million, professional fees incurred in prosecuting the SGM Counterclaim in the estimated amount of $2 million, and other out-of-pocket costs and professional fees incurred in connection with the SGM APA in the estimated amount of $3 million.

SGM makes the following objections to confirmation of the Plan:

1) The Plan is not feasible because there is no indication that the Administrative Claims Reserve includes sufficient funding for SGM's administrative claim.
2) The Plan violates § 1129(a)(9) because it provides that SGM's administrative claim can be satisfied only from the Administrative Claims Reserve, and bars SGM from asserting a claim against the Liquidating Trust Assets in the event the Administrative Claims Reserve is not sufficient to satisfy SGM's claim.
3) The Plan bars SGM from seeking disgorgement of Professional Claims in the event that the Administrative Claims Reserve is inadequate to satisfy SGM's administrative claim. The Plan thus impermissibly discriminates against SGM since it provides that Professional Claims will be paid in full but leaves open the possibility that SGM's administrative claim may not be paid in full.
4) The Plan improperly eliminates SGM's setoff and recoupment rights against the Debtors, which could prejudice SGM's ability to defend itself in the Adversary Proceeding and prosecute the SGM Counterclaim.

Debtors respond to SGM's confirmation objection as follows:

1) Because SGM's alleged Administrative Claim is not yet allowed, the Debtors are not required to set aside cash in the Administrative Claims Reserve sufficient to satisfy the full amount of the claim as alleged by SGM. Instead, the Court can assess the Plan's feasibility by estimating the amount of SGM's Administrative Claim. The Debtors have agreed to set

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aside the entirety of the $30 million Deposit. The reserve of the Deposit is more than sufficient—for example, even if SGM had a 50% chance of success, the value of the SGM Counterclaim is only $17.28 million, just over half the amount reserved by the Debtors.

2) SGM lacks standing to object to Plan provisions concerning setoff and recoupment. SGM does not have a right of setoff because it has no prepetition claims, and § 553(a) only preserves prepetition claims. SGM's contention that the Plan's provisions cutting off recoupment rights are intended to prejudice its ability to assert the SGM Counterclaim or defend itself in the Adversary Proceeding is mistaken. The Plan provision cutting off recoupment rights applies only to a "Claim," defined in the Plan to refer to a prepetition claim only. The provision does not apply to SGM's alleged Administrative Claim.

3) The Plan's bar upon the disgorgement of Professional Claims is permissible. Courts have held that the Bankruptcy Code does not authorize the disgorgement of professional fees upon insolvency. *See In re Santa Fe Med. Grp., LLC*, 557 B.R. 223, 227 (Bankr. D.N.M. 2016) and *In re Home Loan Serv. Corp.*, 533 B.R. 302, 304–05 (Bankr. N.D. Cal. 2015).

Toyon Objection

Similar to SGM, Toyon Associates, Inc. ("Toyon") asserts that the Administrative Claims Reserve is not sufficient to satisfy Toyon's administrative claim, which Toyon asserts exceeds $12.5 million. The Debtors state that they have reserved $250,000 on account of Toyon's administrative claim, and that this amount is more than adequate given that Toyon's claim is unliquidated and is unlikely to succeed.

Premier Objection

Premier, Inc., directly and through its affiliates ("Premier") is a party to seven prepetition agreements with the Debtors (the "Premier Agreements"). Each of the Premier Agreements was assumed as part of a settlement agreement with the Debtors resolving certain financial and operating disputes between the parties [Doc. No. 2352] (the "Premier Settlement"). Premier objects to the Plan on the grounds that (1) the Plan is unclear about the source of the payment of the Debtors' obligations under the Premier Settlement; that (2) the Plan fails to specify the duration of the Post-Effective Date Debtors; and that (3) the Plan's release provisions are unduly broad.

Debtors state that the Plan is clear that that pre-Effective Date obligations,

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including those associated with the Premier Settlement, will be satisfied in the ordinary course of business; that the Plan specifies that the Post-Effective Date Debtors shall continue to exist until the expiration of the Interim Agreements; and that the Plan's release provisions are permissible.

Long Beach Memorial Medical Center ("LBMMC") Objection

LBMMC is a 453-bed hospital located in Long Beach, CA. Prior to the Petition Date, LBMMC and SFMC entered into two agreements (the "LBMMC Agreements") under which LBMMC continues to delivery ordinary course medical services to SFMC post-petition, including cardiovascular, trauma, and pediatric care services. The Plan provides for the rejection of the LBMMC Agreements.

LBMMC requests that the Debtors provide information as to whether the Liquidating Trustee will request that services be provided by LBMMC subsequent to the rejection of the LBMMC Agreements. LBMMC also objects to the general injunction in § 13.6(a), which LBMMC contends is overly broad and violates § 524(e).

Debtors state that if Prime, the purchaser of SFMC, wants transitional or post-closing services from LBMMC, then Prime will need to contract directly with LBMMC for those services. Alternatively, if the Debtors so agree, the Debtors will pay for such services as a pass-through and be reimbursed for such services by Prime pursuant to the Transition Services Agreement. Debtors dispute LBMMC's contention that the Plan's general injunction is overly broad.

HealthNet Objection

HealthNet asserts that the Plan is not feasible because the Debtors do not intend to assume and assign to Prime a Medi-Cal services agreement between SFMC and HealthNet (the "HealthNet Agreement"). HealthNet contends that assignment of the HealthNet Agreement is one of the conditions imposed by the Attorney General on the Prime Sale; that the Prime Sale cannot close because Prime intends to reject the HealthNet Agreement in violation of the Attorney General's conditions; and that accordingly the Plan is not feasible since the proceeds of the SFMC Sale are necessary to fund the Plan.

Debtors' dispute HealthNet's contention that assumption and assignment of the HealthNet Agreement to Prime is among the conditions imposed by the Attorney General. Debtors state that the condition requires only that Prime enter into an agreement with HealthNet, not that Prime accept assignment of the existing HealthNet

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Agreement.

AppleCare Objection

AppleCare Medical Group, Inc., AppleCare Medical Group, St. Francis Inc., and AppleCare Medical Management, LLC (collectively, "AppleCare") asserts an administrative expense claim in the amount of $16,482,485.54 against SFMC. AppleCare argues that the Debtors have not established that the Administrative Claims Reserve contains sufficient funds to satisfy AppleCare's administrative claims.

The Debtors and AppleCare are engaged in negotiations in an attempt to consensually resolve the AppleCare Objection. *See* Doc. No. 5446. To facilitate continued negotiations, the Court will not issue a tentative ruling regarding the AppleCare Objection.

II. Findings of Fact and Conclusions of Law

A. The SGM Objection is Overruled [Note 4]

1. The Administrative Claims Reserve is Sufficient to Satisfy SGM's Administrative Claim

SGM argues that the Plan is not feasible because the Administrative Claims Reserve does not contain cash sufficient to pay the full amount of the administrative claim asserted by SGM (the "SGM Admin Claim"). SGM is mistaken.

In assessing the feasibility of the Plan, the Court must evaluate "the possibility that a potential creditor may, following confirmation, recover a large judgment against the debtor." *Sherman v. Harbin (In re Harbin)*, 486 F.3d 510, 517 (9th Cir. 2007). The Court is required to "exercise its sound discretion in considering how such litigation may affect the feasibility of any specific plan." *Id.*

Where, as here, the amount of an administrative claim has not yet been determined, the Court may estimate the amount of the claim for the purpose of determining plan feasibility. As explained by the court in *In re Adelphia Bus. Sols., Inc.*:

> [W]hen estimating claims, Bankruptcy Courts may use whatever method is best suited to the contingencies of the case, so long as the procedure is consistent with the fundamental policy of Chapter 11 that a reorganization "must be accomplished quickly and efficiently." *Bittner v. Borne Chemical Co.*, 691 F.2d at 135–37; *see also, e.g., In re Brints Cotton Mktg., Inc.*, 737 F.2d 1338, 1341 (5th Cir.1984), citing 3 *Collier on Bankruptcy* ¶ 502.03, at

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502–77 (15th ed.1983). Bankruptcy Courts have employed a wide variety of methods to estimate claims, including summary trial, *In re Baldwin–United Corp.*, 55 B.R. 885, 899 (Bankr.S.D.Ohio 1985), a full-blown evidentiary hearing, *In re Nova Real Estate Inv. Trust*, 23 B.R. 62, 65 (Bankr.E.D.Va.1982), and a review of pleadings and briefs followed by oral argument of counsel, *In re Lane*, 68 B.R. 609, 613 (Bankr.D.Haw.1986). In so doing, courts specifically have recognized that it is often "inappropriate to hold time-consuming proceedings which would defeat the very purpose of 11 U.S.C. § 502(c)(1) to avoid undue delay."

341 B.R. 415, 422–23 (Bankr. S.D.N.Y. 2003).

Estimation of the SGM Admin Claim is required here because awaiting the fixing or liquidation of the claim "'would unduly delay the administration of the case.'" *Id.* at 422 (citing § 502(c)). A jury trial in the Adversary Proceeding is set to commence on November 2, 2021. *See* 2:20-cv-00613-DSF, Doc. No. 51. It is probable that any judgment entered in the Adversary Proceeding will be appealed. In all likelihood, it will take at least two years, and possibly much longer, for the SGM Admin Claim to be liquidated.

There is no merit to SGM's contention that this Court's estimation of the SGM Admin Claim for plan feasibility purposes will usurp the District Court's exclusive jurisdiction over the Adversary Proceeding. The Court estimates the SGM Admin Claim only for the purpose of determining whether the Plan can be confirmed. Estimation of the claim has no effect whatsoever on the Adversary Proceeding. *See In re Bicoastal Corp*., 122 B.R. 771, 775 (Bankr. M.D. Fla. 1990) ("There is no question that the estimation of claims in bankruptcy does not establish a binding legal determination of the ultimate validity of a claim nor a binding determination of any issues."). Bankruptcy courts routinely estimate claims arising in connection with litigation for plan confirmation purposes, with the understanding that the ultimate amount of the claim will be determined through the underlying litigation. *See, e.g.*, *Adelphia*, 341 B.R. at 422; *In re Spansion, Inc.*, 426 B.R. 114, 146 (Bankr. D. Del. 2010) (estimating administrative claim alleged to be $100 million at $4.2 million for plan confirmation purposes); *In re Chemtura Corp.*, 448 B.R. 635, 649 (Bankr. S.D.N.Y. 2011).

A time-consuming evidentiary hearing to estimate SGM's claim is not appropriate, as such a proceeding would defeat the very purpose of estimation—expeditious confirmation of the Plan. *See Adelphia*, 341 B.R. at 422. Current

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projections indicate that unsecured creditors will receive $8.1 million, or only approximately 0.5% of their claims. *See* Doc. No. 4994, Ex. A. The delay arising from a protracted evidentiary hearing to estimate the SGM Admin Claim could push the estates into administrative insolvency.

The Court will estimate SGM's claim based upon its review of the pleadings and briefing filed in the Adversary Proceeding. *See Adelphia*, 341 B.R. at 422–23 (finding review of the pleadings in pending litigation to be an appropriate means of claims estimation). Having conducted such a review, the Court estimates the SGM Admin Claim to have a value of $0. *See Harbin*, 486 F.3d at 520 n.7 (stating that the Court is not prohibited "from valuing [the] claim at zero" as long as it "exercise[s] its own judgment in reaching such a conclusion").

The SGM Counterclaim alleges that Debtors breached the SGM APA by, among other things, (1) failing to fulfill their obligation under § 8.6 to obtain an order authorizing the sale of the hospitals free and clear of certain conditions which the California Attorney General alleged he had the authority to impose; (2) failing to fulfill their obligation under § 8.7 to obtain a settlement agreement with the California Department of Healthcare Services (the "DHCS"); and (3) failing to operate the hospitals in accordance with applicable law. Based upon these alleged breaches, SGM contends that it is entitled to return of the Deposit plus additional damages and interest in the approximate amount of $15.2 million.

The Court finds that SGM has only a negligible chance of prevailing upon its claims. First, SGM alleges that the Debtors breached § 8.6 by failing to obtain an order authorizing the sale free and clear of the Attorney General conditions. But on November 14, 2019, the Court entered an order providing in relevant part:

> Solely and exclusively for purposes of the APA (as defined below) and the Motion, the Additional Conditions (as defined in section 8.6 of that certain asset purchase agreement [Docket No. 2305-1] (the "APA")) are an "interest in property" for purposes of 11 U.S.C. § 363(f). The Assets (as defined in the APA) are being sold free and clear of the Additional Conditions without the imposition of any other conditions which would adversely affect the Purchaser (as defined in the APA).

Doc. No. 3611 (the "Supplemental Sale Order").

The Supplemental Sale Order contained language almost identical to the language contemplated in § 8.6 of the SGM APA. Specifically, § 8.6 states that the Debtors will

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have satisfied the obligations imposed thereunder if they obtain "an order … finding that the Additional Conditions are an 'interest in property' for purposes of 11 U.S.C. § 363(f), and that the Assets can be sold free and clear of the Additional Conditions without the imposition of any other conditions, which would adversely affect the Purchaser." SGM APA at § 8.6 [Doc. No. 2305-1].

SGM further alleges that the Debtors were in breach of § 8.6 because the Supplemental Sale Order was subject to an appeal at the time the Debtors demanded that SGM close the sale. Section 8.6 excused SGM from closing the sale if the Supplemental Sale Order was subject to an appeal. Its purpose was to protect SGM by insuring that once the sale had closed, there would be no possibility that the Additional Conditions could be reimposed upon the hospitals through reversal of the Supplemental Sale Order on appeal. Such a situation could occur only if the Attorney General appealed the Supplemental Sale Order, which was impossible, since the Attorney General expressly waived his right to appeal. It was never contemplated that SGM would appeal the Supplemental Sale Order, which the Debtors obtained for its benefit. In the Court's view, SGM's appeal of the Supplemental Sale Order was a cynical ploy to manufacture a frivolous excuse for failing to close the sale. For these reasons, the Court finds that SGM has little chance of prevailing upon its allegation that the Debtors failed to satisfy § 8.6 of the SGM APA.

Second, SGM alleges that the Debtors breached § 8.7 by failing to obtain a settlement with the DHCS. However, the Debtors obtained approval of the requisite settlement on December 9, 2019. *See* Doc. No. 3787. SGM attempts to distract attention from the Debtors' fulfillment of their obligations under § 8.7 by alleging that the Debtors improperly demanded that SGM close the sale before the documentation memorializing the DHCS settlement had been completed. This allegation is a red herring, given that SGM had ample time to close the SGM Sale after the DHCS settlement had been memorialized on December 9, 2019. SGM is not likely to prevail upon its allegation that the Debtors breached § 8.7 of the SGM APA.

Third, SGM alleges that the Debtors breached the SGM APA by failing to operate the hospitals in accordance with California law. SGM is unlikely to prevail upon this claim because the alleged operational issues would constitute a breach of the SGM APA only if they would have had a "material adverse effect" upon the transaction. The SGM APA is governed by California law, and California courts look with disfavor upon the enforcement of a "material adverse effect" clause. For example, in *1601 McCarthy Blvd., LLC v. GMAC Comm'l Mortg. Corp.*, 2005 WL 4859147 (Cal. Super. Ct. June 1, 2005), the court held that a loan servicer's invocation of a material

adverse effect clause to avoid its obligation to disburse funds to a borrower was an "unfair business practice or act," because the servicer "used the material adverse change clause as a lever against [the borrower] to retain control over the borrower's … funds." *McCarthy Blvd.*, 2005 WL 4859147 at *¶ 59. The court found:

> [L]enders rarely employ—and even less frequently invoke and enforce—this type of broad-based material adverse change clause in commercial real estate transactions…. And even when they are invoked, … lenders only use the clause as a tool to "bring the borrower to the table, use it as lever against the borrower, or ... a club against the borrower to modify the loan or change the loan." There is no evidence in the record that the material adverse change clause in the Deed of Trust benefits any side but the lender, or serves any other purpose than to threaten the borrower with dire consequences….
>
> The record supports Mr. Greenwald's opinion that broad-based material adverse change clauses are rarely used, and in those rare instances when they are, they are placed in deeds of trust purely for their in terrorem effect and not with any genuine intention to invoke them.

Id. at ¶¶ 59 and 68.

Although the SGM APA is governed by California law, Delaware cases interpreting material adverse effect clauses are helpful persuasive authority. A significant amount of the litigation over the enforcement of asset purchase agreements occurs before Delaware courts, and the Delaware caselaw interpreting material adverse effect clauses is well developed.

In *In re IBP, Inc. Shareholders Litigation*, the court rejected purchaser Tyson Foods' claim that it was not required to consummate a merger because of a material adverse effect. The court held:

> [A] buyer ought to have to make a strong showing to invoke a Material Adverse Effect exception to its obligation to close. Merger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not

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suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.

In re IBP, Inc. Shareholders Litig. (IBP, Inc. v. Tyson Foods, Inc.), 789 A.2d 14, 68 (Del. Ch. 2001).

In *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. 2008), the court reiterated that a "buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close."

In view of the difficult of showing a "material adverse effect," SGM is not likely to prevail upon its claim that the Debtors breached the SGM APA by failing to operate the hospitals in accordance with applicable law.

The Debtors have agreed to set aside the $30 million Deposit pending further order of the District Court. Given the Court's estimation of SGM's Admin Claim at $0, the reserve of the Deposit is more than sufficient. SGM's objection regarding the adequacy of the Administrative Claims Reserve is overruled.

At the hearing, SGM asserted that the Court had decided to estimate its administrative claim even though no party had requested such relief. It further argued that estimation would prejudice its ability to defend the Adversary Proceeding and would contravene the jurisdiction of the District Court. Neither contention is correct.

First, the Debtors requested that the Court estimate the SGM Admin Claim for the purpose of finding that the Administrative Claims Reserve was sufficient to satisfy the claim. *See* Doc. No. 5385 at 90–92 **[Note 5]** (arguing that the Court should estimate the SGM Admin Claim at between $8,640,120 and $17,280,240, based upon the litigation risk analysis formula set forth in *In re Lahijani*, 325 B.R. 282, 289–90 (BAP 9th Cir. 2005); Chadwick Decl. [Doc. No. 5385] at ¶ 37 (estimating the present value of the SGM Admin Claim at $8.6 million).

Further, the Court was left with no choice but to estimate the SGM Admin Claim in order to fulfill its statutory obligation under § 1129(a)(11) to determine the Plan's feasibility. SGM had offered to withdraw its objection, but only if the Debtors increased the amount reserved for its administrative claim from $30 million to $45.2 million. SGM's request was impossible for the Debtors to fulfill, because an Administrative Claims Reserve of the size demanded by SGM would have left insufficient cash for the Debtors to make the Effective Date payments that had been promised to other creditor constituencies to induce their support for the Plan. Thus, SGM's objection to the Plan's feasibility remained outstanding at the confirmation hearing. To rule upon that objection, the Court was required to estimate the SGM

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Admin Claim to determine whether the Administrative Claims Reserve was adequately funded. An insufficient Administrative Claims Reserve would have rendered the Plan unfeasible.

Second, estimation of the SGM Admin Claim has no preclusive effect (or any other effect) on the Adversary Proceeding, as discussed previously. *See In re Bicoastal Corp*., 122 B.R. 771, 775 (Bankr. M.D. Fla. 1990) ("There is no question that the estimation of claims in bankruptcy does not establish a binding legal determination of the ultimate validity of a claim nor a binding determination of any issues."); *In re Adelphia Bus. Sols., Inc.*, 341 B.R. 415, 419 (Bankr. S.D.N.Y. 2003) (stating that the court's estimate of an administrative claim for plan feasibility purposes had no preclusive effect on the separate matter of the ultimate allowability of the administrative claim); *In re Ralph Lauren Womenswear, Inc.*, 197 B.R. 771, 775 (Bankr. S.D.N.Y. 1996) ("This being but an estimation hearing, my findings of fact will not have any preclusive effect upon the ultimate disposition of Kreisler's claim.").

2. SGM's Objection to Plan § 10.5(b) is Without Merit

SGM asserts that § 10.5(b) of the Plan purports to limit the amount of SGM's Admin Claim to the amount estimated by the Court. SGM misreads § 10.5(b).

Section 10.5(b) does not apply to administrative claims. That section addresses the "Estimation of Disputed Claims," and "Disputed" describes "Claims" that are either scheduled or with respect to which a proof of claim has been filed. Plan at § 1.58. The Plan does not incorporate the definition of "Claim" into its definition of "Administrative Claim"; instead, the Plan defines an "Administrative Claim" as a "[r]equest for Payment of an administrative expense of a kind specified in § 503(b) and entitled to priority pursuant to § 507(a)(2) …." *Id.* at § 1.13.

To be clear, the Court's estimation of the SGM Admin Claim is made only for the purposes of determining plan feasibility under § 1129(a)(9). The estimate does not prevent the SGM Admin Claim from being allowed at a higher amount in the future.

3. The Plan's Exculpation Clause is Appropriate

SGM asserts that the Exculpation Clause violates § 524(e) by providing a discharge to non-debtor parties. The Court disagrees.

In *Blixseth v. Credit Suisse*, the Ninth Circuit approved an exculpation clause providing that parties involved in the negotiation and implementation of the plan would not be liable for acts undertaken during the case. 961 F.3d 1074, 1078–79 (9th Cir. 2020). The court held that the bankruptcy court "had the authority to approve an

exculpation clause intended to trim subsequent litigation over acts taken during the bankruptcy proceedings and so render the Plan viable." *Blixseth*, 961 F.3d at 1084.

Here, the language of the Exculpation Clause is very similar to that of the clause approved in *Blixseth*. The Exculpation Clause applies only to those parties who have been heavily involved in these cases and in the negotiation of the Plan, and applies only with respect to acts taken during the cases. The Exculpation Clause was a necessary component of the compromise that resulted in the Plan. The Exculpation Clause is appropriate and does not run afoul of § 524(e).

4. The Plan's Treatment of Professional Claims is Appropriate

SGM argues that the Plan impermissibly prioritizes Professional Claims by limiting any recovery on the SGM Admin Claim to the Administrative Claims Reserve, and barring SGM from seeking the disgorgement of Professional Claims if the Administrative Claims Reserve proves inadequate. SGM is incorrect.

The cases cited by SGM are not on point, because they discuss disgorgement in the context of a Chapter 11 case that has been converted to Chapter 7. Even if the cases did apply, there is a split of authority as to whether disgorgement of professional fees may be ordered upon administrative insolvency. In the Court's view, the better-reasoned approach is that disgorgement is not permitted. As explained in *In re Home Loan Serv. Corp.*:

> There is nothing …. requiring, or even suggesting, disgorgement of earned and paid chapter 11 expenses solely in order to pay chapter 7 administrative expenses in full. One recent bankruptcy case held that disgorgement based solely on administrative insolvency is not permitted under § 726(b). *See In re Headlee Management Corp.*, 519 B.R. 452 (Bankr.S.D.N.Y.2014). In reaching this conclusion, the *Headlee* court noted that § 726 simply does not provide a remedy for the situation in which professional fees have been paid in a chapter 11 case prior to conversion. The *Headlee* court specifically declined to read a disgorgement remedy into the statute, particularly since sections 549 and 330 did not offer a disgorgement remedy in this situation. *Id.* at 458–59.

533 B.R. 302, 304–05 (Bankr. N.D. Cal. 2015).

The facts of *In re Montgomery Ward Holding Corp.*, 306 B.R. 489 (Bankr. D. Del. 2004) are more analogous to the present situation than the cases discussing disgorgement in the context of a Chapter 11 case that has been converted to Chapter 7.

In *Montgomery Ward*, the plan confirmed by the court provided that all administrative claims which became allowed after the plan's effective date would be paid only from assets revested in New Retailer, an entity created by the plan. *Id.* at 492–93. The assets held by New Retailer proved inadequate to satisfy the administrative claim of CenterPoint, a creditor whose administrative claim became allowed several years after the plan was confirmed. *Id.* The court held that CenterPoint's administrative claim could not be satisfied through either the disgorgement of previously-awarded professional fees or from a reserve that had been set aside to pay unsecured creditors. *Id.* at 492–95. The court reasoned that upon confirmation the plan became a legally-binding agreement, and that CenterPoint remained bound by its terms, notwithstanding the fact that its administrative claim would remain unsatisfied. *Id.*

As discussed above, it is exceptionally unlikely that SGM will be able to establish that it is entitled to an administrative claim, and even less likely that SGM will be able to show entitlement to an administrative claim of $45.2 million. The small chance that SGM will prevail upon the SGM Counterclaim does not render impermissible the Plan's provisions limiting satisfaction of the SGM Admin Claim to the Administrative Claims Reserve and barring SGM from seeking disgorgement from other estate professionals in the event the Administrative Claims Reserve proves insufficient. To obtain confirmation, the Debtor is required only to show that the Plan "offers a reasonable prospect of success and is workable…. The prospect of financial uncertainty does not defeat plan confirmation on feasibility grounds since a guarantee of the future is not required…. The mere potential for failure of the plan is insufficient to disprove feasibility." *Mutual Life Ins. Co. of N.Y. v. Patrician St. Joseph Partners Ltd. P'ship (In re Patrician St. Joseph Partners Ltd. P'ship)*, 169 B.R. 669, 674 (D. Ariz. 1994). The Debtors have easily surpassed the threshold of showing that the Plan is feasible. The remote possibility that the Administrative Claims Reserve could prove inadequate cannot defeat confirmation. There always exists some possibility that the assets reserved to pay claims will prove insufficient, as was the case in *Montgomery Ward*.

5. SGM's Objection to the Plan's Setoff and Recoupment Provisions is Overruled

SGM asserts that § 13.6 of the Plan improperly eliminates the setoff and recoupment rights of creditors. SGM fears that § 13.6 will prejudice its ability to defend itself in the Adversary Proceeding and prosecute the SGM Counterclaim.

SGM's fear is unfounded and is based upon a misreading of the Plan. The provision to which SGM objects prohibits "Persons that have held, currently hold or

may hold a Claim against the Debtors" from "asserting any setoff, right of subrogation or recoupment of any kind, directly or indirectly, against any debt, liability or obligation due to the Debtors, the Post-Effective Date Debtors or the Liquidating Trust *with respect to a Claim* …." (emphasis added). As discussed in Section II.A.2, above, the term "Claim" does not encompass the SGM Admin Claim. The Plan's setoff and recoupment provisions will therefore have no effect upon SGM's ability to defend itself in the Adversary Proceeding or prosecute the SGM Counterclaim. SGM's objection to these provisions is overruled.

B. The Toyon Objection is Overruled

Toyon contends that the Plan is not feasible because the Administrative Claims Reserve is not sufficient to satisfy its administrative claim, which Toyon asserts is in excess of $12.5 million (the "Toyon Admin Claim").

Toyon has been retained as an ordinary course professional (an "OCP") to pursue on behalf of the Debtors appeals intended to increase the Medicare reimbursements owed to the Debtors. In the declaration it filed in support of its application for retention as an OCP (the "Retention Application"), Toyon stated:

> For the Appeal Services described above, the Firm is paid a contingency of the total additional reimbursement paid to the hospital resulting from the successful pursuit of appeal issues. With respect to appeals, no fees or expenses are paid to Toyon unless the appeal or reopening results in additional reimbursement to the hospital.

Doc. No. 900 at ¶ 6.

In connection with stipulations necessary to facilitate the sale of certain of the Debtors' hospitals, the Debtors withdrew many of the appeals that Toyon had been pursuing. Notwithstanding the fact that these withdrawn appeals did not yield an infusion of cash into the estates, Toyon asserts that the appeals nonetheless provided value because they enhanced the Debtors' bargaining leverage, thereby increasing the proceeds that the estates received from the disposition of these assets.

The Debtors have set aside $250,000 in the Administrative Claims Reserve for the Toyon Admin Claim. As discussed in Section II.A.1, above, the Court may estimate the value of the Toyon Admin Claim for plan feasibility purposes. The Court estimates the Toyon Admin Claim at no more than $250,000. The amount reserved by the Debtors for Toyon's claim is sufficient.

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In arriving at this estimate, the Court relies upon the Declaration of Peter C. Chadwick, the Debtors' Chief Financial Officer and a managing director at Berkeley Research Group. Toyon objects to Chadwick's testimony on the ground that it offers an opinion on an ultimate issue of law (the amount which Toyon will recover on account of its administrative claim) and on the ground that it lacks foundation. Toyon's objections are overruled. As the Debtors' CFO, Chadwick is qualified to testify as to his estimate of the amount of the Toyon Admin Claim that will ultimately be allowed. Such testimony does not constitute an opinion as to an ultimate issue of law. Instead, the testimony is an estimate regarding the monetary amount of the estate's litigation exposure, which falls within the scope of Chadwick's expertise as CFO.

The Court has also assessed the arguments asserted by Toyon in concluding that the Toyon Admin Claim has an estimated value of $250,000. A substantial portion of the administrative claim to which Toyon asserts it is entitled is based upon work performed in connection with appeals which were withdrawn (the "Withdrawn Appeals"). Toyon contends it is entitled to $3,829,235.85 for Withdrawn Appeals pertaining to OCH and SLRH, $5,912,340.60 for Withdrawn Appeals pertaining to Seton, and $2,273,553.45 for Withdrawn Appeals pertaining to SFMC.

As set forth above, Toyon recognized in the Retention Application that it would not be paid unless its appeals resulted in additional reimbursement to the hospitals. Therefore, it is not likely that Toyon will be able to show that it is entitled to an administrative claim for work performed in connection with the Withdrawn Appeals. Recognizing this impediment, Toyon alleges that the Withdrawn Appeals nonetheless provided value by enhancing the Debtors' bargaining leverage in connection with the sales. This argument is not likely to be successful because purchasers, recognizing that Medicare appeals are time-consuming and frequently unsuccessful, attribute little to no value to pending appeals when bidding for hospitals. *See* Chadwick Decl. [Doc. No. 5385] at ¶ 31 ("The Debtors in the exercise of their business judgment have not attributed any material value to the appeals pursued by Toyon Associates resulting from denials of claims by the Medicare program because the Medicare appeals program is long, cumbersome and unlikely to be successful…. For these reasons, the Debtors, like most hospitals, write off amounts that might be recovered on these appeals and put no value on them during appeal. Even buyers who purchase accounts receivable are most likely to attribute no value to amounts that might someday be recovered on a pending appeal. Thus, these appeals were not considered a valuable asset by the Debtors when negotiating the sales of their hospitals and this assessment

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is further supported by the fact that the express terms of the stipulations make clear that no value was attributed between the Debtors and CMS to the waiver of any pending appeals.").

At the hearing, Toyon argued there was not sufficient evidence before the Court to permit a ruling on the Toyon Objection, and that Toyon was entitled to a further evidentiary hearing in order to establish that the Administrative Claims Reserve was inadequate to satisfy its claim. Toyon is mistaken.

In overruling the Toyon Objection, the Court has considered the *Declaration of Thomas P. Knight* [Doc. No. 5281] (the "Knight Declaration"), which sets forth the reasons for Toyon's assertion that it is entitled to an administrative claim in excess of $12.5 million; the exhibits filed in support of the Knight Declaration; the *Request for Allowance of Administrative Claim* [Doc. No. 3286] and *Second Request for Allowance of Administrative Claim* [Doc. No. 5242] filed by Toyon; and the briefing and evidence submitted by the Debtors in support of the adequacy of the Administrative Claims Reserve [Doc. Nos. 5385 and 5468, Ex. D]. The record is sufficient for the Court to rule upon Toyon's objection to the adequacy of the Administrative Claims Reserve.

The Court finds that the $250,000 reserved for the Toyon Admin Claim is sufficient for plan feasibility purposes. The Toyon Objection is overruled.

C. The HealthNet Objection is Overruled

HealthNet asserts that the Plan is not feasible because the Debtors do not intend to assume and assign to Prime a Medi-Cal services agreement between SFMC and HealthNet (the "HealthNet Agreement"). HealthNet contends that assignment of the HealthNet Agreement is one of the conditions imposed by the Attorney General on the Prime Sale; that the Prime Sale cannot close because Prime intends to reject the HealthNet Agreement in violation of the Attorney General's conditions; and that accordingly the Plan is not feasible since the proceeds of the SFMC Sale are necessary to fund the Plan.

HealthNet's assertion that assignment of the HealthNet Agreement is among the conditions imposed by the Attorney General is not correct. The relevant condition provides:

> For ten years from the closing date of the Asset Purchase Agreement, Prime Healthcare Services, Inc. shall … [m]aintain and have Medi-Cal Managed Care contracts with the below-listed Medi-Cal Managed Care Plans to provide

> the same types and levels of emergency and non-emergency services at St. Francis Medical Center to Medi-Cal beneficiaries … as required in these Conditions, on the same terms and conditions as other similarly situated hospitals offering substantially the same services, without any loss, interruption of service or diminution in quality, or gap in contracted hospital coverage, unless the contract is terminated for cause or not extended or renewed by the Medi-Cal Managed Care Plan: …
>
> > (ii) Commercial Plan: Health Net Community Solutions, Inc. or its successor.

Conditions to the Sale of St. Francis Medical Center [Doc. No. 5199, Ex. B] at § IX.

This condition requires only that Prime enter into an agreement with HealthNet on the same terms and conditions as other similarly situated hospitals; it does not require that Prime retain the existing HealthNet Agreement. Prime is in discussions with HealthNet regarding a new agreement. Adcock Decl. at ¶ 7. Contrary to HealthNet's contention, Prime's rejection of the *existing* HealthNet Agreement does not run afoul of the Attorney General's conditions, because Prime intends to have in place a *new* agreement with HealthNet prior to the closing of the sale.

D. The Premier Objection is Overruled

Premier questions whether the Plan adequately provides for the payments Premier is owed under the Premier Settlement. The Debtors have included an additional $200,000 in the Administrative Claims Reserve for "Ordinary Course Creditors" on account of Premier. The Court finds that this amount is sufficient to satisfy the Debtors' obligations under the Premier Settlement.

Next, Premier asserts that the Plan does not specify the duration of the Post-Effective Date Debtors. Premier is incorrect. The Disclosure Statement sets forth the duration of the Post-Effective Date Debtors as follows:

> The Sale-Leaseback Debtors, SVMC, St. Vincent Dialysis, the SCC Debtors, and VHS (together, the "Post-Effective Date Debtors") shall continue to exist after the Effective Date of the Plan (i) with the Sale-Leaseback Debtors existing until the expiration of the Interim Agreements so that they may engage in the transition tasks set forth in Section 5.8 of the Plan, and (ii) with the SCC Debtors existing until all Quality Assurance Payments are collected.

The primary transaction task (i) for the Sale-Leaseback Debtors involves the Interim Agreements, and (ii) for the SCC Debtors involves remitting Quality Assurance Payments received after the Effective Date to the Liquidating Trust.

Disclosure Statement at 80.

Finally, Premier objects to the Plan's general releases. For the reasons discussed in Section II.A.3, above, the Plan's releases are appropriate, and Premier's objection to the releases is overruled.

E. The LBMMC Objection is Overruled

LBMMC's objection consists primarily of requests for clarification regarding certain Plan provisions. The Debtors have sufficiently responded to these requests for clarification in their reply to the LBMMC Objection.

LBMMC also objects to the Plan's general releases. For the reasons discussed in Section II.A.3, above, the Plan's releases are appropriate, and Premier's objection to the releases is overruled.

F. The Remaining Objections Are Moot or Have Been Resolved

The Court finds that objections asserted by UnitedHealthcare Ins. Co., SCAN Health Plan, Blue Shield, and Humana have been resolved by the Debtors' agreement to include additional language in the Confirmation Order. *See* Doc. No. 5455.

The objection asserted by Aetna Life Insurance Company has been resolved by a stipulation [Doc. No. 5338] that has been approved by the Court [Doc. No. 5350]. The objection asserted by the Cigna Entities [Doc. No. 5231] has been resolved by the filing of the *Notice Re Irrevocable Designation Concerning Assumption and Assignment of Cigna Contracts* [Doc. No. 5370]. *See* Doc. No. 5396 (Cigna's notice stating that its objection has been resolved).

The Reservation of Rights asserted by Seoul Medical Group, Inc. ("Seoul") [Doc. No. 5268] is moot given the concurrently-issued ruling to approve the settlement agreement to which Seoul is a party.

The objection of GRM Information Management Services, Inc. ("GRM") to the adequacy of the Administrative Claims Reserve has been resolved by the Debtors' agreement to set aside $2 million in the reserve on account of GRM's administrative claim. *See* Doc. No. 5425.

The Attorney General objects to the Debtors' failure to stipulate to include the following provision in the Confirmation Order:

> The California Attorney General and the Debtors reserve all rights, arguments and defenses concerning the California Attorney General's authority, if any, to review the sale under California Corporations Code §§ 5914-5924 and California Code of Regulations on Nonprofit Hospital Transactions-Title 11, Chapter 15, § 999.5, and any conditions issued thereto. Notwithstanding any provision to the contrary in [the Plan or any confirmation order], nothing in the [Plan or any confirmation order] shall limit or be construed as a waiver of the Attorney General's statutory or regulatory authority or other rights or defenses, or a waiver of the Debtors' statutory or other rights or defenses.

Doc. No. 5294.

In a concurrently issued ruling, the Court has found that the Debtors are authorized to sell St. Francis free and clear of the regulatory obligations that the Attorney General asserts he has the authority to impose under Cal. Corp. Code §§ 5914 *et seq.* This ruling moots the Attorney General's request for a provision in the Confirmation Order that would reserve rights that the Court has found the Attorney General does not possess.

G. The Deemed Substantive Consolidation Contemplated by the Plan is Approved

The Plan provides for the deemed substantive consolidation of the Debtors' estates. Upon entry of a substantive consolidation order, the "consolidated assets create a single fund from which all claims against the consolidated debtors are satisfied; duplicate and inter-company claims are extinguished; and, the creditors of the consolidated entities are combined for purposes of voting on reorganization plans." *Alexander v. Compton (In re Bonham)*, 229 F.3d 750, 764 (9th Cir. 2000).

"Deemed consolidation" is a court-developed alternative to substantive consolidation. Unlike substantive consolidation, deemed consolidation does "not result in the merger of or the transfer or commingling of any assets of the Debtors … [which] will continue to be owned by the respective Debtors." *In re Owens Corning*, 419 F.3d 195, 202 (3d Cir. 2005). In other words, substantive consolidation actually combines the debtors' assets and liabilities into a single entity, whereas deemed consolidation merely treats the assets and liabilities as if they were pooled for the purpose of creditor distributions without actually merging the debtor entities.

Deemed substantive consolidation is appropriate where (1) creditors dealt with the

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entities as a single economic unit and did not rely on their separate identity in extending credit or where (2) the affairs of the debtors are so entangled that consolidation would benefit all creditors. *Bonham*, 229 F.3d at 764. "The presence of either factor is a sufficient basis to order substantive consolidation." *Id.* at 766.

Here, both factors are satisfied. With respect to the first factor, the Debtors' secured lenders dealt with the Debtors as a single economic unit. A substantial amount of the Debtors' prepetition secured debt relates to loan and bond obligations on which multiple debtors are obligated. Specifically, VHS, SFMC, SVMC, SMC, and SLRH (collectively, the "Obligated Group Members") are all obligated on the 2005 Series A, G and H Revenue Bonds, the 2015 Revenue Notes, and the 2017 Revenue Notes (collectively, the "Obligated Bonds").

The Obligated Bonds imposed joint and several liability on the Obligated Group Members, and the terms of the Obligated Bonds only addressed the rights and obligations of the Obligated Group Members collectively, rather than on a hospital-by-hospital basis. Further, the Master Trust covenants for the Obligated Bond borrowings are Obligated Group-oriented and are not hospital-specific.

With respect to the second factor, the Debtors' affairs are so entangled that consolidation will benefit all creditors. The Debtors engaged in complex, prepetition intercompany transfers, which were not always booked as such, and would prove difficult and costly to unwind or reconcile. For example, VMF was historically supported by near-weekly funding from other Debtors, but these transfers were booked as direct net asset contributions rather than intercompany loans. Members of the Obligated Group transferred real estate collateral to Holdings, a non-Obligated Group member, to be used as collateral for the MOB Financing, but this transaction was not booked as an intercompany transfer.

H. The Plan Settlement is Approved

The Plan Proponents request that entry of the Confirmation Order constitute the Bankruptcy Court's approval, as of the Effective Date, of the Plan Settlement by and between the Debtors, the Prepetition Secured Creditors, and the Committee, pursuant to Bankruptcy Rule 9019 (the "Settlement Agreement").

The Court approves the Settlement Agreement pursuant to Bankruptcy Rule 9019. "In determining the fairness, reasonableness and adequacy of a proposed settlement agreement, the court must consider: (a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily

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attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises." *Martin v. Kane (In re A&C Properties)*, 784 F.2d 1377, 1381 (9th Cir. 1986). "[C]ompromises are favored in bankruptcy, and the decision of the bankruptcy judge to approve or disapprove the compromise of the parties rests in the sound discretion of the bankruptcy judge." *In re Sassalos*, 160 B.R. 646, 653 (D. Ore. 1993). In approving a settlement agreement, the Court must "canvass the issues and see whether the settlement 'falls below the lowest point in the range of reasonableness.'" *Cosoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir. 1983). Applying the *A&C Properties* factors, the Court finds that the Settlement Agreement is adequate, fair, and reasonable, and is in the best interests of the estate and creditors.

Probability of Success on the Merits and Complexity of the Litigation

These factors weigh in favor of approving the Settlement Agreement. The settlement resolves both active claims (the litigation brought by the Committee on the Debtors' behalf challenging the validity of the liens asserted by the Prepetition Secured Creditors) and potential claims (the claims settled through the settlement's waiver and mutual release provisions). Given the complex nature of the parties' claims, rights, and theories, quantifying the overall probability of success is difficult. That reality supports approval of the Settlement Agreement, which enables confirmation of a Plan that will distribute funds to creditors.

Absent approval of the Settlement Agreement, the Plan would no longer work as filed. The Debtors would be required to file and solicit votes upon a completely new Plan, which would cost the estates significant time and money.

Paramount Interests of Creditors

This factor weighs strongly in favor of approving the Settlement Agreement. The Settlement Agreement is supported by both the Prepetition Secured Creditors and the Committee, which together comprise the overwhelming majority of the creditor body in these cases.

Difficulties to be Encountered in the Matter of Collection

This factor does not apply.

I. The Plan Satisfies the Requirements of § 1129

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SECTION 1129(A)(1)

Section 1129(a)(1) requires that the "plan compl[y] with the applicable provisions of this title." According to the leading treatise, the "legislative history suggests that the applicable provisions are those governing the plan's internal structure and drafting: 'Paragraph (1) requires that the plan comply with the applicable provisions of chapter 11, such as section 1122 and 1123, governing classification and contents of a plan.'" *Collier on Bankruptcy* ¶ 1129.01[1] (16th rev'd ed.) (citing S. Rep. No. 989, 95th Cong., 2d Sess. 126 (1978)).

1. Section 1122(a)

Section 1122(a) provides that "a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class." "A claim that is substantially similar to other claims may be classified separately from those claims, even though section 1122(a) does not say so expressly." *In re Rexford Props., LLC*, 558 B.R. 352, 361 (Bankr. C.D. Cal. 2016).

The Plan's classification structure complies with § 1122(a). Claims and Interests are placed in thirteen different classes based upon differences in the legal or factual nature of those Claims and Interests, and each of the Claims and Interests in a particular Class is substantially similar to the other Claims and Interests in that Class.

2. Section 1122(b)

Section 1122(b) provides that "a plan may designate a separate class of claims consisting only of ever unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience."

The Plan does not contain any convenience classes. Section 1122(b) does not apply.

3. Section 1123(a)(1)

Section 1123(a)(1) requires that a plan "designate … classes of claims, other than claims of a kind specified in section 507(a)(2) [administrative expense claims], 507(a)(3) [claims arising during the gap period in an involuntary case], or 507(a)(8) [priority tax claims], and classes of interest." There are no involuntary gap claims because this is a voluntary chapter 11 case. The Plan appropriately classifies administrative expense claims and priority tax claims. The Plan satisfies § 1123(a)(1).

4. Section 1123(a)(2)

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Section 1123(a)(2) requires that the Plan "specify any class of claims or interests that is not impaired under the Plan." The Plan specifies that Classes 1A and 1B are not impaired. The Plan satisfies § 1123(a)(2).

5. Section 1123(a)(3)

Section 1123(a)(3) requires that the Plan "specify the treatment of any class of claims or interests that is impaired under the Plan." The Plan specifies the treatment of the impaired classes. The Plan satisfies § 1123(a)(3).

6. Section 1123(a)(4)

Section 1123(a)(4) requires that the Plan "provide the same treatment for each claim or interest of a particular class unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest." The Plan provides the same treatment to claims and interests of the same class. The Plan satisfies § 1123(a)(4).

7. Section 1123(a)(5)

Section 1123(a)(5) requires that the Plan "provide adequate means for the plan's implementation." The Plan will be funded by the Debtors' remaining cash on hand and proceeds from the sale of SFMC and Seton. The Plan provides for the establishment of a Liquidating Trust to make distributions to creditors. The Plan satisfies § 1123(a)(5).

8. Section 1123(a)(6)

Section 1123(a)(6) provides: "[A] plan shall provide for the inclusion in the charter of the debtor, if the debtor is a corporation …, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends."

Because no securities are being issued under the Plan, § 1123(a)(6) does not apply.

9. Section 1123(a)(7)

Section 1123(a)(7) requires that the Plan's provisions with respect to the selection

of officers and directors be consistent with public policy and the interests of creditors and equity security holders.

The members of the Post-Effective Date Committee are the California Nurses Association, Medline Industries, Inc., and the Pension Benefit Guaranty Corporation. *See* Doc. No. 5443. The Plan provides that the identity of the Liquidating Trustee and the identity of the directors serving on the Post-Effective Date Board of Directors will be disclosed in one or more Plan Supplements to be filed prior to the Effective Date. Because the Plan Supplement(s) must be acceptable to the Committee and the Prepetition Secured Creditors, the Plan's provisions pertaining to the selection of officers and directors are consistent with the interests of creditors.

Because the Debtor is a non-profit and no equity security interests will be issued under the Plan, the Debtor is not required to satisfy § 1123(a)(7) with respect to equity security holders. *See St. Mary's Hosp., Passaic, N.J.*, 2010 WL 5126151, at *4 (Bankr. D.N.J. Feb. 2, 2010).

10. Section 1123(b)

Section 1123(b) sets forth provisions that are permitted, but not required, in a plan. The Plan contains certain of § 1123(b)'s optional provisions. The Plan is consistent with § 1123(b).

SECTION 1129(A)(2)

Section 1129(a)(2) requires that the "proponent of the plan compl[y] with the applicable provisions of this title." The Plan Proponents have obtained approval of a Disclosure Statement in accordance with § 1125; have obtained approval of the employment of professional persons; and have solicited votes on the Plan in accordance with procedures approved by the Court. The Plan Proponents have satisfied the requirements of § 1129(a)(2).

SECTION 1129(A)(3)

Section 1129(a)(3) requires that the "plan has been proposed in good faith and not by any means forbidden by law." As one court has explained:

> The term 'good faith' in the context of 11 U.S.C. § 1129(a)(3) is not statutorily defined but has been interpreted by case law as referring to a plan that 'achieves a result consistent with the objectives and purposes of the Code.' 'The requisite good faith determination is based on the

totality of the circumstances.'

In re Melcher, 329 B.R. 865, 876 (Bankr. N.D. Cal. 2005) (internal citations omitted).

Good faith may be found where the Plan is supported by the major constituencies in the case. *In re Chemtura Corp.*, 439 B.R. 561, 608–09 (Bankr. S.D.N.Y. 2010) (finding good faith where the Debtor "negotiated honestly and at an arm's length … in an effort to create a confirmable plan that would satisfy all parties"). Here, the Plan was proposed jointly by the Debtors, the Committee, and the Prepetition Secured Creditors, after extensive negotiations at arm's length. Section 1129(a)(3) is satisfied.

SECTION 1129(A)(4)

Section 1129(a)(4) requires that "[a]ny payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable." The Plan provides that all professional fees are subject to review by the Court. The plan satisfies § 1129(a)(4).

SECTION 1129(A)(5)

Section 1129(a)(5) requires that the Plan disclose "the identity and affiliations of any individual proposed to serve, after confirmation of the Plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint Plan with the debtor, or a successor to the debtor under the Plan." Section 1129(a)(5)(A)(ii) requires that the appointment to or continuation in office of an director or officer be consistent with the interests of creditors, equity security holders, and public policy. Section 1129(a)(5)(B) requires the Plan proponent to disclose the identity of any insider to be employed by the reorganized debtor.

The Plan Proponents have disclosed that the members of the Post-Effective Date Committee will be the California Nurses Association, Medline Industries, Inc., and the Pension Benefit Guaranty Corporation. *See* Doc. No. 5443. The identities of the Post-Effective Date Board of Directors and Liquidating Trustee will be disclosed in a Plan Supplement to be filed prior to the Effective Date. To satisfy § 1129(a)(5), the Debtors are required to disclose the identities of only those officers and directors that have already been selected. *See In re Charter Commc'ns*, 419 B.R. 221, 260 (Bankr. S.D.N.Y. 2009) ("To the extent the Plan's satisfaction of 11 U.S.C. § 1129(a)(5)

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remains at issue, the Court concludes that this confirmation standard is satisfied. It is undisputed that two out of the eleven seats on the Debtors' board of directors remain vacant. Although section 1129(a)(5) requires the plan to identify all directors of the reorganized entity, that provision is satisfied by the Debtors' disclosure at this time of the identities of the *known* directors.").

The Plan satisfies § 1129(a)(5).

SECTION 1129(A)(6)

Section 1129(a)(6), which requires that a governmental regulatory commission with jurisdiction over rates charged by a debtor approve any rate changes provided for in the plan, does not apply.

SECTION 1129(A)(7)

Section 1129(a)(7), known as the "best interests of creditors test," provides in relevant part: "With respect to each impaired class of claims or interests, each holder of a claim or interest of such class has accepted the plan; or will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date."

All impaired classes that are entitled to vote have accepted the Plan. Section 1129(a)(7) is satisfied.

SECTION 1129(A)(8)

Section 1129(a)(8) requires each class to accept the Plan, unless the class is not impaired. All impaired classes entitled to vote have accepted the Plan.

The only two classes deemed to reject the Plan—Class 11 (Subordinated General Unsecured Claims) and Class 12 (Interests)—are "vacant" classes that are not considered for purposes of § 1129(a)(8), pursuant to § 3.5 of the Plan:

> [a]ny Class of Claims, as of the commencement of the Confirmation Hearing, that does not have at least one (1) Holder of a Claim in an amount greater than zero for voting purposes shall be considered vacant, deemed eliminated from the Plan for purposes of voting to accept or reject the Plan, and disregarded for purposes of determining whether the Plan satisfies § 1129(a)(8) with respect to that Class.

Plan § 3.5.

Section 1129(a)(8) is satisfied.

SECTION 1129(A)(9)

Section 1129(a)(9) requires that holders of certain administrative and priority claims receive cash equal to the allowed claim amount of their claims on the effective date of the plan, unless the claimant agrees to different treatment.

The Plan provides for the payment of all allowed administrative claims on the Effective Date. For the reasons discussed in Sections II.A–B, above, the objections of SGM and Toyon—whose administrative claims have not yet been allowed—to the adequacy of the Administrative Claims Reserve are overruled. The Plan satisfies § 1129(a)(9).

SECTION 1129(A)(10)

Section 1129(a)(10) requires that "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider." All impaired classes entitled to vote have accepted the Plan. Section 1129(a)(10) is satisfied.

SECTION 1129(A)(11)

Section 1129(a)(11), known as the "feasibility requirement," requires the Court to find that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan."

The Debtors will have sufficient cash on hand to pay the amounts that are due on the Effective Date. As discussed in Sections II.A–B, above, the Debtors are not required to fund the Administrative Claims Reserve such that it provides for the full face amount of all alleged administrative claims that have not yet been allowed. The Court has estimated the amounts of administrative claims not yet allowed and finds the Administrative Claims Reserve to be adequate. The plan is feasible and satisfied § 1129(a)(11).

SECTION 1129(A)(12)

Section 1129(a)(12) requires that the Debtor pay all United States Trustee fees

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prior to confirmation or provide for payment of those fees on the effective date. The Plan provides for the payment in cash of all UST fees at the time of confirmation. Section 1129(a)(12) is satisfied.

SECTION 1129(A)(13)

Section 1129(a)(13), which contains requirements pertaining to the payment of retirement benefits, does not apply.

SECTION 1129(A)(14)

Section 1129(a)(14), which contains requirements pertaining to the payment of domestic support obligations, does not apply.

SECTION 1129(A)(15)

Section 1129(a)(15), which imposes certain requirements upon individual debtors, does not apply.

SECTION 1129(A)(16)

Section 1129(a)(16) provides: "All transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust."

The Plan does not provide for the transfer of any property in contravention of applicable nonbankruptcy law. The Plan satisfies § 1129(a)(16).

SECTION 1129(D)

Section 1129(d) provides: "Notwithstanding any other provisions of this section, on request of a party in interest that is a governmental unit, the court may not confirm a Plan if the principal purpose of the Plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933." No governmental unit has requested that the court not confirm the Plan on the grounds that the Plan's purpose is the avoidance of taxes. No securities are issued under the Plan. The Plan satisfies § 1129(d).

III. Conclusion

For the reasons set forth above, all unresolved objections to the Plan are **OVERRULED** and the Plan is **CONFIRMED**. The Debtors shall submit an order

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incorporating this tentative ruling by reference within seven days of the hearing.

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Carlos Nevarez or Daniel Koontz at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Note 1

The Debtors are as follows:
1) Verity Health System of California, Inc. ("VHS");
2) O'Connor Hospital ("OCH");
3) Saint Louise Regional Hospital ("SLRH");
4) St. Francis Medical Center ("SFMC");
5) St. Vincent Medical Center ("SVMC")
6) Seton Medical Center ("Seton");
7) Verity Business Services ("VBS");
8) O'Connor Hospital Foundation (the "OCH Foundation");
9) Saint Louise Regional Hospital Foundation (the "SLRH Foundation);
10) St. Francis Medical Center of Lynwood Foundation (the "SFMC Foundation");
11) St. Vincent Medical Center Foundation (the "SVMC Foundation");
12) Verity Medication Foundation ("VMF");
13) Verity Holdings, LLC ("Holdings");
14) De Paul Ventures, LLC ("DePaul");
15) De Paul Ventures—San Jose Dialysis, LLC; and St. Vincent Dialysis Center.

Note 2

The Prepetition Secured Creditors are UMB Bank, N.A., as Master Trustee, Wells Fargo Bank, National Association, as 2005 Revenue Bonds Trustee, U.S. Bank, National Association as 2015 Notes Trustee and 2017 Notes Trustee, Verity MOB Financing LLC and Verity MOB Financing II, LLC.

United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Wednesday, August 12, 2020 **Hearing Room 1568**

10:00 AM

CONT... Verity Health System of California, Inc. **Chapter 11**

Note 3

Objections that have been resolved or are now moot are not discussed herein.

Note 4

The Court declines the Debtors' request to strike the sur-reply that SGM filed on August 10, 2020 [Doc. No. 5448]. The Debtors are not prejudiced by the Court's consideration of the sur-reply since the Court has also considered the Debtors' arguments in opposition to the sur-reply contained in the *Debtors' (I) Request to Strike or, in the Alternative, Overrule Strategic Global Management, Inc.'s Unauthorized "Surreply" in Support of SGM's Confirmation Objection and (II) Response to Toyon Associates, Inc.'s Evidentiary Objections to the Declaration of Peter C. Chadwick in Support of the Confirmation Brief* [Doc. No. 5456].

Note 5

All page citations are to the page numbers that are automatically affixed to the top of each page by the Electronic Case Filing (ECF) system upon filing, rather than to the pagination used by the document's preparer.