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Proposed Co-Counsel for the Official Committee of Unsecured Creditors

Honorable Frank L. Kurtz

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

IN RE: ASTRIA HEALTH, et al., Debtors.[1]	Lead Case No. 19-01189-11 Jointly Administered **OFFICIAL COMMITTEE OF UNSECURED CREDITORS' REPLY TO LAPIS SECURED PARTIES'**

[1] The Debtors, along with their case numbers, are as follows: Astria Health (19-01189-11), Glacier Canyon, LLC (19-01193-11), Kitchen and Bath Furnishings, LLC (19-01194-11), Oxbow Summit, LLC (19-01195-11), SHC Holdco, LLC (19-01196-11), SHC Medical Center-Toppenish (19-01190-11), SHC Medical Center-Yakima (19-01192-11), Sunnyside Community Hospital Association (19-01191-

OBJECTION TO DEBTORS' MOTION FOR FINAL ORDER AUTHORIZING POST-PETITION FINANCING, USE OF CASH COLLATERAL AND RELATED RELIEF

The Official Committee of Unsecured Creditors (the "Committee") in the chapter 11 cases of Astria Health (together with its affiliated debtors in possession, the "Debtors"), by and through its proposed undersigned counsel, hereby files this reply (the "Reply") to the Lapis Secured Parties' *Objection to Debtors' Motion for Final Order Authorizing Post-Petition Financing, Use of Cash Collateral and Related Relief* [Docket No. 226] (the "Lapis Objection").[2] In support of the Reply, the Committee respectfully represents as follows:

REPLY

As noted in the Committee's limited objection to the Debtors' DIP Financing Motion [as amended, Docket No. 233] (the "Committee Limited Objection"), the Committee objects to any adequate protection provisions or other requests by the Lapis Secured Parties beyond the adequate protection package provided in the

11), Sunnyside Community Hospital Home Medical Supply, LLC (19-01197-11), Sunnyside Home Health (19-01198-11), Sunnyside Professional Services, LLC (19-01199-11), Yakima Home Care Holdings, LLC (19-01201-11), and Yakima HMA Home Health, LLC (19-19-01200-11).

[2] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the DIP Financing Motion, the DIP Loan Documents, or the Committee Limited Objection, as applicable.

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Proposed Final Order. Any additional protections for the Lapis Secured Parties, which would strip all unsecured creditors of statutory rights (potentially exposing the Debtors' estates to administrative insolvency) and negativity impact the Debtors' ability to deliver the highest degree of patient care, are unnecessary in these chapter 11 cases. The risks to these estates inherent in granting the requests by the Lapis Secured Parties far exceed any potential benefits.

I. The Lapis Secured Parties Are Adequately Protected Under the Proposed Final Order

As set forth in greater detail in the Committee Limited Objection, the Lapis Secured Parties are already adequately protected in these cases pursuant to the terms of the Proposed Final Order. First, an equity cushion in the range of 80% to 100% exists in the Lapis Prepetition Collateral, which percentage could be increased when taking into account that (i) the Debtors, at this time, may not need to make an additional draw from the DIP Facility, eliminating up to $8 million in priming liens, (ii) the Lapis Senior Holdco Liens are not being primed and remain senior to the DIP Liens, and (iii) the Committee understands that the Debtors' financial performance appears to be better than projected. Lane Declaration, ¶ 55; Proposed Final Order, ¶ 12.

In fact, in the Lapis Objection the Lapis Secured Parties rely on the equity cushion to argue they are entitled to monthly adequate protection payments under section 506(b) of the Bankruptcy Code. Lapis Objection, page 24. However, as

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explained below, this is a mischaracterization of section 506(b), which does not entitle alleged secured creditors to payment of interest during the pendency of a case in the form of adequate protection. Instead, the Lapis Secured Parties will receive any distribution (including interest, if appropriate), pursuant to a plan after the Committee has had the opportunity to investigate the liens and claims of the Lapis Secured Parties. *See e.g., Countrywide Home Loans, Inc. v. Hoopai (In re Hoopai)*, 581 F.3d 1090, 1100 (9th Cir. 2009) ("[N]oting that '[a]n oversecured creditor . . . is entitled to receive postpetition interest as part of its claim at the time of confirmation of a plan.'") (emphasis added) (*citing Key Bank Nat'l Ass'n v. Milham (In re Milham)*, 141 F.3d 420, 423 (2d Cir. 1999).

Next, even if no equity cushion exists, the replacement liens provided in the Proposed Final Order provide adequate protection to the Lapis Secured Parties. Here, despite the Lapis Secured Parties' claim that the replacement liens are illusory, the replacement liens provide significant value in the form of liens on, among other things, post-petition accounts receivable of the Debtors' operating hospitals, and the proceeds thereof—assets on which the Lapis Secured Parties did not previously have a lien. *See* 11 U.S.C. § 552(a) and (b); *In re Skagit Pac. Corp.* 316 B.R. 330, 336 (B.A.P. 9th Cir. 2004) ("Proceeds of post-petition accounts receivable do not fall within the § 552(b) proceeds exception. Therefore, a creditor's security interest only encompasses the cash collected on existing pre-petition accounts.").

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Third, the Lapis Secured Parties are adequately protected by the 507(b) administrative expense superpriority claims in an amount equal to the diminution in value of the Lapis Prepetition Collateral from and after the Petition Date, if any, for any reasons provided under the Bankruptcy Code, subject and subordinate only to the Carve-Out and DIP Superpriority Claims, with recourse to the DIP Collateral (excluding the Commercial Tort Claims and Excluded Avoidance Actions). In addition to pre-petition collateral, and excluding the Commercial Tort Claims and Excluded Avoidance Actions, the DIP Collateral includes post-petition real and personal property of the Debtors. As such, this is another significant source of adequate protection and, together with the equity cushion and replacement liens, is more than sufficient to protect the interests of the Lapis Secured Parties with respect to the diminution in value, if any, of their interests in the Lapis Prepetition Collateral.

II. Any Additional Adequate Protection Requests by the Lapis Secured Parties Are Unnecessary and Potentially Detrimental to the Debtors' Unsecured Creditors and Patients of the Hospitals

As set forth in the Committee Limited Objection, the additional adequate protection terms requested by the Lapis Secured Parties will harm the Debtors' estates at the expense of the unsecured creditors and patients of the hospitals. Further, many of the requested forms of adequate protection are the result of the Lapis Secured Parties seeking to augment their rights by conflating their position as

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a pre-petition creditor with that of a post-petition lender and otherwise ignoring certain provisions in the DIP Loan Agreement.

First, in the Lapis Objection, the Lapis Secured Parties state that an "'all options' strategy is necessary to adequately protect the [Lapis Secured Parties] and relief on the Financing Motion should be conditioned on an obligation to proceed in that manner." Lapis Objection, pages 19-20. However, the DIP Loan Agreement does not set the Debtors down an exclusive path to proceed as a standalone hospital without allowing for the pursuit of an alternative transaction. For example, section 8.1 of the DIP Loan Agreement provides that the following events, among others, shall constitute an Event of Default:

> (p) Following one hundred and twenty (120) days from the Petition Date, the failure of the Borrowers to have (i) filed an Acceptable Plan or (ii) presented an alternative going forward strategy for resolving the Chapter 11 Cases that is acceptable to the Lender, in its sole discretion; or
>
> (q) Following one hundred and eighty (180) days from the Petition Date, the failure of the Borrowers to have (i) effectuated an Acceptable Plan or (ii) obtained final court approval of an alternative transaction acceptable to the Lender, in its sole discretion.

DIP Loan Agreement, section 8.1(p) and (q) (emphasis added).

The Proposed Final Order further accommodates the Debtors' ability to pursue an alternative transaction, delaying payment of the Stated Maturity Date Fee in the event that, among other things, the Debtors have obtained final court approval of an alternative transaction that has not closed due to the process of obtaining

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requisite governmental approvals. Proposed Final Order, ¶ 1. As such, the Debtors are not being forced down a path to continue as a standalone hospital without the opportunity to simultaneously explore an alternative transaction. Further, to the extent any deadlines or termination provisions are ultimately tied to dates for an alternative transaction, the Lapis Secured Parties should not have exclusive control over the alternative transaction process—the Committee should receive the same rights as the Lapis Secured Parties with respect thereto.

Next, the Lapis Secured Parties argue they are entitled to "adequate protection that is customary in hospital chapter 11 cases," and provide a list of such types of adequate protection. Lapis Objection, pages 23-24. However, this request suggests that the facts of all hospital chapter 11 cases are similar and ignores the replacement liens and superpriority claims they are already receiving as adequate protection, as well as the equity cushion that exists in these cases.

First, the Lapis Secured Parties request superpriority claims on the Excluded Avoidance Actions and Commercial Tort Claims. As set forth in the Committee Limited Objection, this is not a "customary" form of adequate protection, as these unencumbered assets and the proceeds thereof should remain available for distribution to unsecured creditors whose only recourse may be against such assets. *See e.g.*, *Buncher Co. v. Official Comm. of Unsecured Creditors of GenFarm Ltd. Pshp. IV*, 229 F.3d 245, 250 (3d Cir. 2000); *In re Sweetwater*, 884 F.2d 1323, 1328 (10th Cir. 1989).

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Second, the Lapis Secured Parties request rights with respect to the Budget, but such rights are "customarily" reserved for the DIP lender who is providing the post-petition financing—the Lapis Secured Parties are not the DIP lender in these cases.

Third, as set forth in the Committee Limited Objection, the Committee does not dispute that it may be appropriate to establish an investigation and challenge period and related budget with respect solely to the validity, extent, perfection, priority and/or amount of the liens and claims of the Lapis Secured Parties under the Lapis 2017 Loan Documents and the Lapis 2019 Loan Documents (the "Lapis Lien Challenge"). However, any such investigation, challenge period and budget for the Lapis Lien Challenge must be reasonable to allow the Committee to fulfill its investigatory duties in these complex cases for the benefit of the Debtors' unsecured creditors. *See* 11 U.S.C. § 1103(c)(2) (empowering the committee to "investigate the acts, conduct, assets, liabilities, and financial condition of the debtor . . . and any other matter relevant to the formulation of the plan"). Further, any claims or causes of action that the Debtors' estates may have against the Lapis Secured Parties not related to Lapis Lien Challenge should not be subject to any challenge deadlines or budget. All such claims and causes of action should be pursued consistent with the deadlines imposed by Congress or applicable state law rather than an arbitrary deadline imposed by an alleged junior secured creditor.

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Consistent therewith, the Lapis Secured Parties should not be entitled to a broad release from the Debtors.

Fourth, the Lapis Secured Parties request waivers of the Debtors' and Committee's rights under sections 506(c) and 552(b) of the Bankruptcy Code. In support of such requests, the Lapis Secured Parties claim they have already been "surcharged" by the DIP Loan and the Carve-Out. This is incorrect. Certain of their liens have been primed pursuant to section 364(d) of the Bankruptcy Code. Section 364(d) does not entitle a prepetition secured lender to a waiver of the Debtors' and/or Committee's rights under sections 506(c) or 552(b)—it only requires the prepetition secured lender receive adequate protection to the extent the collateral is declining in value, nothing more. Here the Lapis Secured Parties are receiving adequate protection. Similarly, the Carve-Out is for professional fees and expenses—not any trailing expenses in these chapter 11 cases—and thus is not in exchange for any rights under sections 506(c) or 552(b) of the Bankruptcy Code, which rights are designed to protect the Debtors' estates in the event of administrative insolvency. If the Lapis Secured Parties agree to fund all trailing expenses, the Committee will support a section 506(c) surcharge waiver as to the Lapis Secured Parties.

In further support of the requested waivers, the Lapis Secured Parties state that they "should not be subjected to still further raids on their collateral." Lapis Objection, page 24. This too mischaracterizes sections 506(c) and 552(b) of the

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Bankruptcy Code. To surcharge a lender's collateral under 506(c) or avoid pre-petition liens from attaching to post-petition proceeds under section 552(b), the Debtors or Committee, as appropriate, must establish that circumstances warrant such relief pursuant to the requirements in the Bankruptcy Code. With respect to section 506(c), a debtor can recover the "reasonable, necessary costs and expenses of preserving, or disposing of, [secured property] to the extent of any benefit to the holder of such claim[.]" 11 U.S.C. § 506(c). With respect to section 552(b), courts can disregard a post-petition lien on "proceeds, products, offspring, or profits" of collateral based on the "equities of the case." 11 U.S.C. § 552(b). Thus, neither provision allows a debtor or committee to "raid" collateral.

Further, such waivers are inappropriate in these cases. Section 506(c) was carefully designed to protect against the risk of a debtor's administrative insolvency and to ensure secured creditors do not use the chapter 11 process to fund their own foreclosure proceedings. *See Comerica Bank-California v. GTI Capital Holdings, L.L.C. (In re GTI Capital Holdings, L.L.C.)*, 2007 Bankr. LEXIS 4853, at *43 (B.A.P. 9th Cir. Mar. 29, 2007) (*citing Silver State Sav. & Loan Ass'n v. Young*, 252 F.2d 236, 238-39 (9th Cir. 1958)). The concern of administrative insolvency is particularly acute in hospital bankruptcy cases, such as these, where patients' lives are at stake. Thus, here, the Debtors should not be left without a vehicle to surcharge the Lapis Prepetition Collateral. With respect to section 552(b)—which is "relevant in chapter 11 to prevent a secured creditor from reaping benefits from

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collateral that has appreciated in value as a result of the trustee's/debtor-in-possession's use of other assets of the estate"—it is not appropriate at the outset of these cases "to waive prospectively an argument that other parties in interest may make." *In re Sine*, 2018 Bankr. LEXIS 2553, at *25 (Bankr. W.D. Wash. Aug. 24, 2018); *In re Metaldyne Corp.*, 2009 Bankr. LEXIS 1533, at *20 (Bankr. S.D.N.Y. June 23, 2009). As such, any waiver of rights under sections 506(c) and 552(b) is not appropriate at this stage of these cases and could be detrimental to the Debtors' estates and the communities served by the Debtors.

Fifth, the Lapis Secured Parties request other rights provided to the DIP Lender, who, unlike the Lapis Secured Parties, is providing the Debtors' estates with new money under the DIP Loan Agreement. For example, the Lapis Secured Parties request the right to credit bid all of their alleged claims (of which most are junior to the claims of the DIP Lender) in any sale of the Debtors' assets. However, it is not "customary" or appropriate to provide an alleged junior creditor the right to credit bid, especially when, in these cases, the Committee intends to conduct an investigation of the liens and claims of the Lapis Secured Parties. *See* 11 U.S.C. § 363(k) ("At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale . . . .") (emphasis added); *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55, 61 (Bankr. D. Del. 2014) ("The law leaves no

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doubt that the holder of a lien the validity of which has not been determined, as here, may not bid its lien.").

Finally, the Lapis Secured Parties request adequate protection payments in the amount of monthly interest accrued on the principal amount of the Bonds and Working Capital Loan at non-default rates. Lapis Objection, page 24. As explained above, they rely on the equity cushion in their collateral in making the argument they are entitled to post-petition interest. However, this too is a misinterpretation of the Bankruptcy Code. Even if the court ultimately determines that the Lapis Secured Parties are oversecured and thus entitled to post-petition interest, such post-petition interest will be paid pursuant to a plan, not in the form of immediate adequate protection payments during the pendency of the chapter 11 cases. *See e.g., In re Hoopai*, 581 F.3d at 1100 (9th Cir. 2009) ("[N]oting that '[a]n oversecured creditor . . . is entitled to receive postpetition interest as part of its claim at the time of confirmation of a plan.'") (emphasis added) (*citing Key Bank Nat'l Ass'n v. Milham (In re Milham)*, 141 F.3d 420, 423 (2d Cir. 1999)); *Telfair v. First Union Mortg. Corp.*, 216 F.3d 1333, 1339 (11th Cir. 2000) ("[T]he purpose of section 506(b) [is to] allow[] oversecured creditors to include post-petition interest and certain fees as part of the secured claim they will receive upon confirmation of the plan") (emphasis added); *In re Milham*, 141 F.3d at 423 ("On the date of confirmation, the allowed claim of an oversecured creditor is augmented by the inclusion of section 506(b) pendency interest.") (emphasis added).

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It would be illogical to establish the existence of an equity cushion in collateral, which precludes the need for further adequate protection, while simultaneously requiring adequate protection interest payments as a result of that equity cushion. Further, the Committee intends to investigate the liens and claims of the Lapis Secured Parties and thus it is premature to make payments based on the status of the Lapis Secured Parties' asserted liens and claims.

Additionally, requiring the Debtors to make adequate protection interest payments in these cases could be the sole reason the Debtors would need to draw additional funds from the DIP Facility or could impair the Debtors' ability to utilize such funds for the provision of patient care. A second draw on the DIP Facility will be extremely costly to the Debtors' estates, as such additional draw carries with it high fees and expenses, including, among others, (i) non-default interest at a rate of 12% per annum on the Daily Balance; (ii) default interest at a rate of 17% per annum on the Daily Balance; and (iii) a funding fee at a rate of 1.5% of each Advance payable upon funding such Advance. Thus, making adequate protection interest payments would be costly to the Debtors' estates without providing any necessary protection to the already adequately protected Lapis Secured Parties. Further, the Committee submits that the Debtors' capital in these cases should be used to provide patient care rather than diverting such funds to creditors asserting security interests in the Debtors' property.

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RESERVATION OF RIGHTS

The Committee expressly reserves and preserves all rights, claims, arguments, defenses and remedies with respect to the DIP Financing Motion, the Lapis Objection, or any other issues in these chapter 11 cases, and to supplement, modify and amend this Reply, to seek discovery, and to raise additional objections in writing or orally at the final hearing on the DIP Financing Motion.

WHEREFORE, for the foregoing reasons, the Committee respectfully requests that this Court deny any adequate protection requests by the Lapis Secured Parties in the Lapis Objection beyond what it is included in the Proposed Final Order, and grant such other and further relief as this Court deems just and proper.

Dated: June 11, 2019.

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