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HON. WHITMAN L. HOLT

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In re: ASTRIA HEALTH, et.al. [1] Debtors in Possession,	Case No. 19-01189 WLH Chapter 11 Jointly Administered OBJECTION TO SECOND AMENDED PLAN

The United States Trustee for Region 18 objects to the debtors' jointly proposed Second Amended Plan for the following reasons:

1. "Deemed" Substantive Consolidation (or Any) is not Appropriate.

Substantive consolidation is an equitable doctrine designed to add benefits (ultimately distributions) to all creditors, not a subset of creditor(s), and designed

1 The Debtors, along with their case numbers, are as follows: Astria Health (19-01189), Glacier Canyon, LLC (19-01193), Kitchen and Bath Furnishings, LLC (19-01149), Oxbow Summit, LLC (19-01195), SHC Holdco, LLC (19-01196), SHC Medical Center-Toppenish (19-01190), SHC Medical Center-Yakima (19-01192), Sunnyside Community Hospital Association (19-01191), Sunnyside Community Hospital Home Medical Supply, LLC (19-01197), Sunnyside Home Health (19-001198), Sunnyside Professional Services, LLC (19-01199), Yakima Home Care Holdings, LLC (19-01201), and Yakima HMA Home Health, LLC (19-01200).

to enhance an estate and its equitable distribution, not remove assets. The various Circuit opinions including *In re Bonham*, 229 F.3d 750 (9th Cir. 2000) are abundantly clear: its function is to combine the assets and liabilities of separate and distinct—but related—legal entities into a single pool and treat them as though they belong to a single entity. Its sole purpose of substantive consolidation of debtors in bankruptcy is to ensure the equitable treatment of all creditors. *Bonham*, at p. 764.

This plan uses the doctrine as a sword to cleave off the operating enterprises with no consideration for the unsecured creditors. Oddly, the result of disenfranchising a set of creditors was the scenario that *Owens Corning* 418 F.3d 195 (3rd Cir. 2005) reversed. *Bonham* observed the reason for, and impact of, substantive consolidation is to benefit every creditor, saying:

> Commingling of assets and liabilities of debtor-entities justifies the substantive consolidation of their estates only when separately accounting for assets and liabilities of these distinct entities will reduce recovery of every creditor, i.e., when every creditor will benefit from the consolidation; moreover, this benefit should be from cost savings that make assets available, rather than from shifting of assets to benefit one group of creditors at another's expense.

The Ninth Circuit adopted the Second Circuit's rationale for this equitable doctrine. The second factor in that adopted rationale is "Consolidation under the second factor, entanglement of the debtor's affairs, is justified only where "the time

and expense necessary even to attempt to unscramble them [is] so substantial as to threaten the realization of any net assets for all the creditors" or where no accurate identification and allocation of assets is possible." Here, the corporate assets are identified for each debtor, are not scrambled and no debtor engaged in any nefarious "Ponzi" scheme. This doctrine is to be used sparingly and only when there is benefit to creditors as in *Bonham* where the benefit was the pursuit of avoidance actions under §§ 544(b) and 548 in the chapter 7 cases. Here, the debtors need to demonstrate how this approach meets Section 1129(a)(7) for each non-consenting (or not voting) member of the unsecured class vis-s-viz the debtor against whom it holds a claim.

2. Exculpation Provisions are Broader than Ninth Circuit Authority Allows.

Exculpation clauses are found in the Second Amended Plan and the two trusts. Each should be narrowed to fit the authority in the Ninth Circuit.

a. **Limited and Rare Exceptions**: The exception to the Ninth Circuit's interpretation of section 524(e) found in *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995), *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985) and *In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) is the *Blixeth v. Credit Suisse* 961 F.3d 1074 (9th Cir. 2020) in

which the narrow liability release limited to releasing parties from liability for "any act or omission in connection with, relating to or arising out of the Chapter 11 cases" or bankruptcy filing, applied only to negligence claims, not claims for willful misconduct or gross negligence, and covered only parties "closely involved" in drafting the plan, such as the lender. The release and exculpation clauses in this plan are more akin to *Lowenschuss's* global release than *Blixeth v Credit Suisse*'s very narrow release.

In *Blixeth,* the court had presided over much litigation in a highly contentious, long battled case and plan. The court seemed to impose an issue preclusion styled exculpation because of the long and tortured history of the case, i.e., "battle each other endlessly … oxes are gored." That factual background for exculpation is not like these Astria cases.

Further, the case instructs us that the clause must be necessary to render the plan viable. Noting in this case indicates the Exculpation Clauses are necessary to make this plan viable.

Much like the observation by Judge Wiles in *In re Aegean Marine Petroleum Network, Inc.* 599 B.R. 717 (Bank. S.D.N.Y. 2019), releases and exculpations are not a "merit badge" or "participation trophy" or "gold star" for doing a good job or making a positive contribution to a case. Instead, they are rare,

only in the extraordinary case, and which are limited to the "claims against the exculpated parties based upon the negotiation, execution and implementation of agreements and transactions that were approved by the Court."

b. **The scope of the exculpated acts or omissions is too broad**. The *Blixeth* exception refers to the actions narrowly focused within and during the bankruptcy proceedings "closely involved" in drafting the Plan which were supervised by the court. The Ninth Circuit stated that "§ 524(e) does not bar a narrow exculpation clause of the kind here at issue – that is, one focused on actions of various participants in the Plan approval process and relating only to that process." *Blixeth*, p. 1082. Astria proposes to improperly include:

> "**any prepetition** or post-petition act taken or omitted to be taken in connection with the Chapter 11 Cases, or related to formulating, negotiating, soliciting, preparing, disseminating, confirming, or **implementing the Plan or consummating the Plan**, the Disclosure Statement, or **any contract**, instrument, release, or other agreement or document created or entered into **in connection with the Plan**, or any other **prepetition** or **post-petition act** taken or omitted to be taken **in connection with or in contemplation of the restructuring** of the Reorganized Debtors, **liquidation of the Liquidating Debtors, or administration of the GUC Distribution Trust**.

Prepetition acts or omissions in connection with the Chapter 11 Cases are not within the *Blixeth* exception. Pre-petition acts or omissions are not supervised nor approved by the court. *Blixeth* itself refers to the lower court's finding that "it exculpates actions that occurred during the bankruptcy proceeding, not before."

961 F.2d p. 1081.

Acts or omissions in implementing or consummating the plan are not within the *Blixeth* exception. Many of those acts (or omissions) will occur after confirmation or the effective date of the plan and most will not be supervised by the court. If there is some separation between acts or omissions before the Effective Date but after confirmation, they should not be included unless specifically reviewed and approved by the court.

The scope of "any contract… created or entered into in connection with the Plan" is too broad and not identified. Those contracts are undefined and may extend far after the confirmation of effective date of the plan. For example, it could potentially include management agreements and ordinary course of business contracts entered by the debtors.

Prepetition and postpetition acts taken in connection with or in contemplation of the restructuring of the Reorganized Debtors could include significant acts not supervised by the court or about which the court might never know. It may include decisions by the Board Trustees, management agreements and ordinary course of business contracts entered by the debtors.

The inclusion of the trusts and the GUC Distribution Trust's POC (definition 1.122 in the Plan, paragraphs 3.2 and 4.1 of the GUC Distribution Trust, and

paragraphs 6.7(j), 7.1(c), and 7.4 if the Liquidation Trust) to provide exculpation of all that they might do before any acts are undertaken by the trustee, the trust or the related parties simply is not within the scope of permissible releases or exculpations in the Ninth Circuit. Predicting any future acts or omissions is speculative at best and how one would prejudge those acts or omissions is difficult to conceive. Additionally, the Liquidation Trust's exculpation provision does not have any exception for gross negligence by the trustee as contrasted to the Plan's Exculpation Clause. Those trustees and trust entities will need to defend themselves if they are ever attacked. This includes the professionals the respective trustees or the POC might employ. Indeed, both trusts state in their respective provisions that Washington is the governing law, and should any disputes arise, that law may determine the issues. These same arguments apply to Section VII.I of the Plan – Limitation on Liability of GUC Distribution Trustee if it is intended as a separate independent authority to provide the same result as exculpation.

The Plan's Exculpation Clause continues with a limitation:

> that the foregoing "Exculpation" shall have no effect on the liability of any Entity for liability **solely** to the extent resulting from any such act or omission taken after the Effective Date or of any Entity solely to the extent resulting from any act or omission that is determined in a final order to have constituted gross negligence or willful misconduct"…

The use of the word "solely to the extent resulting from any such act or omission taken after the Effective Date" is the concern. First, this is not limited to the "focus[ed] on actions of various participants in the Plan approval process and relating only to that process." *Blixeth*, p. 1082. Second, if the act, omission or breach of some contract involved in an allegation of liability is not "solely" taken after the Effective Date --meaning it or a portion of the act or omission can be traced to some act, omission or breach before the Effective Date, it is potentially barred and may involve parties (post-petition and during the case) not receiving notice of this Exculpation Clause.

c. **Parties included are too broad**. The Exculpation Clause provides a limited release for parties who are not estate fiduciaries and for all their lawyers. The Board Trustees, Lapis Parties, Professionals, and the governing persons of the two trusts are not estate fiduciaries. Some of the Lapis Parties have a portion of their new credit transaction before the court, but they do not have a fiduciary duty to this estate. Indeed, they have a duty to collect on the debt owed by the debtors as evidenced by the two Plan Supplement exhibits of both the new credit agreement and the forbearance.

The host of Professionals, as defined in § 1.127 of the Plan's definitions, in this case have not been shown to be "participants in the Plan approval process and

relating only to that process" as is contemplated by the *Blixeth* case. Again, the scope is too broad.

The case law in the Ninth Circuit before *Blixeth* was also cautionary. A professional seeking the protection of such provisions generally bears the burden of establishing that they are reasonable in the context of the case. *In re Metricom, Inc.*, 275 B.R. 364, 371 (Bankr. N.D. Cal. 2002). As the court observed in *WCI Cable Inc*.:

> Different liability standards may be appropriate and/or applicable under the Bankruptcy Code to these different entities and individuals in various circumstances in performing their respective functions post-petition in bankruptcy, and the lines separating actions protected by immunity from actionable conduct are neither clearly nor easily drawn.
> 282 B.R. 457, 478 (Bankr. D. Or. 2002).

The court's evaluation of indemnification and exculpation clauses is fact intensive and based upon the unique circumstances and posture of each case. *See id*. at 479; *DJS Props., L.P. v. Simplot*, 397 B.R. 493, 506 (D. Idaho 2008). Courts have been skeptical of such protective provisions being extended to professionals:

> The court would rather presume that [the] professional possesses sufficient expertise and sophistication that it will not be negligent in the performance of its duties; if there is any doubt about that, it would be inappropriate for the estate to be prohibited from seeking compensation if it suffers as a result of such negligence.

In re Metricom, Inc., 275 B.R. at 371 quoting *In re Pacific Gas & Electric Co.,*

Case No. 01–30923 (Bankr. N.D. Cal., Jul. 6, 2001) (unpublished tentative decision at dkt. # 1407); *see also In re Allegheny Int'l, Inc.*, 100 B.R. 244, 247 (Bankr. W.D. Pa. 1989) ("holding a fiduciary harmless for its own negligence is shockingly inconsistent with the strict standard of conduct for fiduciaries."); *In re WCI Cable, Inc.*, 282 B.R. at 479 (acknowledging that cases reach inconsistent results but "decisions in the Ninth Circuit appear not to favor exculpation or indemnification provisions that limit liability for negligence or breach of fiduciary duty.").

Further, lawyers in Washington may not waive prospective claims of misconduct. RPC 1.8(h) provides:

> A lawyer shall not:
> (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented by a lawyer in making the agreement.

Hence, the lawyers may not ask for, without the independently informed consent of their clients, any agreement limiting their liability.

To be permitted within this Plan, these exculpation provisions in the Second Amended Plan and the trusts created by the Second Amended Plan need to be significantly narrowed.

3. GUC Distribution Trust Limits Notice in the "Conflicts Trustee" Aspect.

In paragraph 3.3 of the GUC Distribution Trust, entitled GUC Distribution Trustee Conflicts of Interest, the provision provides that in the event the GUC Distribution Trustee has a conflict on any discrete matter, a "conflicts trustee" may be selected to handle the discrete matter with only notice to the U.S. Trustee. This notice is too narrow. First, if the case is closed, notice to the U.S. Trustee would be ineffective. Second, other parties in interest may have a broader knowledge of the circumstances of any conflict and be better suited to participate. Third, post-petition participation in the Reorganized Debtor-creditor relationship is best suited for those parties with an economic interest in the case and its results. The U.S. Trustee is not and should not be a substitute for those parties.

Dated: December 4, 2020

Respectfully submitted,

GREGORY M. GARVIN
ACTING UNITED STATES TRUSTEE

/s/ Gary W. Dyer
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Assistant US Trustee