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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: BORREGO COMMUNITY HEALTH FOUNDATION, Debtor-in-Possession.	Case No.: 22-02384-LT11 ACTING UNITED STATES TRUSTEE'S OBJECTION TO CONFIRMATION OF THE FIRST AMENDED JOINT COMBINED DISCLOSURE STATEMENT AND CHAPTER 11 PLAN OF LIQUIDATION Date: January 17, 2024 Time: 10:00 a.m. Dept.: Three (3) Room: 129 Judge: Hon. Laura S. Taylor

Tiffany L. Carroll, the Acting United States Trustee ("UST"), files this Opposition ("Objection") to Confirmation of the First Amended Joint Combined Disclosure Statement and Chapter 11 Plan of Liquidation ("Plan") filed as Docket No. 1168 by Borrego Community Health Foundation ("Debtor") and the Official Committee of Unsecured Creditors ("OCC"). With the Plan, Debtor and OCC also filed Notice of Plan Supplement ("Plan Supplement") to the Plan as Docket No. 1182.

Proponents of the Plan bear the burden of proof in showing that the Plan satisfies the requirements of the Bankruptcy Code. *Everett v. Perez (In re Perez)*, 30 F.3d 1209, 1214 fn 5 (9th Cir. 1994)(stating that "[t]he burden of proposing a

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plan that satisfies the requirement of the Code always falls on the party proposing it, but it falls particularly heavily on the debtor-in-possession since they stand in a fiduciary relationship to the estate's creditor"). There are several issues with confirming the Plan: (1) the Plan does not contain any default provision; (2) the Plan includes impermissible Third Party Release; (3) the Plan includes permanent injunction that operates as *de facto* discharge in a liquidating plan; and (4) the Plan fails to consistently treat the Liquidating Trustee[1] and Co-Liquidating Trustee as fiduciary.

1. Default Provision

The Plan and the Liquidating Trust Agreement ("Agreement") filed as Exhibit G to the Plan Supplement do not contain any explicit default provisions. Initial Distribution Date is defined as "the Effective Date, or as soon as practicable thereafter when the initial Distribution of Cash shall be made to the Holders of Allowed Claims." Lacking explicit default provision leaves ambiguity on when creditors may be paid, and years may pass before creditors could potentially move to dismiss or convert the case for the Plan's failure. *See e.g. In re Consolidated Pioneer Mortg. Entities*, 264 F.3d 803, 804-806 (9th Cir. 2001)(detailing how a liquidating plan confirmed in 1992 was eventually converted to chapter 7 in 1998 based on the liquidating corporation's failure to provide financial information justifying reduced rate of return for investors than what was presented at the confirmation of the liquidating joint plan).

2. Impermissible Third Party Release

The Plan includes Third Party Release under Section 17.2(b). This Third Party Release is impermissible for two reasons. First, it violates § 524(e) by not limiting the scope or time. Second, it binds creditors who did not affirmatively consent to the release.

[1] Capitalized terms that are not otherwise defined in this Objection shall have the same meaning as defined in the Plan and/or Plan Supplement.

The Third Party Release clause states, in part (emphasis added):

> …the Released Parties shall be forever released (the "Third Party Release") from any and all **claims, obligations, … debts**,… and liabilities throughout the world under any law or court … (including all claims … that existed … **prior to the Effective Date** …) which the Debtor, its estate, Creditors, or other persons … may have against any of them in any way related to this Chapter 11 Case …or other occurrence taking place **on and before the Petition Date** and related to the Debtor (or its predecessors), its business and/or its assets …

The Ninth Circuit Court of Appeals have long held that §524(e)[2] precludes bankruptcy courts from discharging the liabilities of non-debtors. *See In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (holding that global release provision in plan was "contrary to § 524(e)"); *In re American Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) (permanent injunction that protected a non-debtor violated § 524(e)); *see also Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020) ("We have interpreted [Section 524(e)] generally to prohibit a bankruptcy court from discharging the debt of a non-debtor."). Recently, the Ninth Circuit clarified that § 524(e) prevents bankruptcy courts extinguishing creditors' claims against non-debtors over the very same debt being discharged through the bankruptcy. *Blixseth*, 961 F.3d, 1082. The discharge merely releases the debtor from personal liability but does not extinguish the debt. *Id.* Therefore, the Ninth Circuit explained that the liability release in *Blixseth* was permissible because it was limited to "actions that occurred during the bankruptcy proceeding, not before." *Id.* at 1081.

The Third Party Release included in the Plan, however, explicitly includes debts that arose prior to the bankruptcy proceeding. It includes all claims, obligations, liabilities prior to the Effective Date, including any occurrence before the Petition Date. This is not the liability release that is "narrow in both scope and

[2] Unless otherwise indicated, all section references are to 11 U.S.C. §§ 101-1530, and all rule references are to the Federal Rules of Bankruptcy Procedure 1001-9037.

time" allowed by *Blixseth*. *See id.* at 1081.

Then, the Third Party Release states further, in part:

> …the foregoing releases are granted only by (a) Creditors who returned a Ballot; and (b) Creditors who were sent a Solicitation Package or a Release Opt-Out Election Form, but either (i) did not vote; or (ii) did not return a Release Opt-Out Election Form

Here, the Plan appears to describe the Third Party Release as being "consensual." This description may be accurate for creditors who submit a valid ballot and affirmatively consent to the release. However, the Plan's clause on Third Party Releases provides that releases are granted by creditors who **did not vote** (*i.e.*, did not submit a ballot) **or did not return a Release Opt-Out Election Form**. Further, the Plan's definition of a "Releasing Party" includes creditors that do not affirmatively **opt-out** of the Third Party Release pursuant to the Release Opt-Out Election Form.

The Third Party Release effectively binds these creditors without their affirmative consent. This improperly shifts the burden of action to creditors. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011). As one court stated "the opt out mechanism is not sufficient to support the third party releases …, particularly with respect to parties who do not return a ballot … Failing to return a ballot is not a sufficient manifestation of consent to a third party release." *Id; see also in re Chassix Holdings, Inc.*, 533 B.R. 64, 80 (Bankr. S.D.N.Y. 2015) (holding that "as to creditors who were entitled to vote, but who chose to take no action at all: under the circumstances of this case it would be inappropriate to treat such inaction as a 'consent' to third party releases."). Affirmative opt-in procedure by non-debtor parties to release their claims would be proper, consensual third party release in the Ninth Circuit. *See In re PG & E Corp.*, 617 B.R. 671, 683 (Bankr. N.D. Cal. 2020) (stating that "as releases in Section 10.9(b) are consensual and require an affirmative opt-in by the affected creditor, the court determines that such releases do not violate section 524(e),

which prohibits only nonconsensual third-party releases."). *Cf. In re Long M. Arabians*, 103 B.R. 211, 215 (B.A.P. 9th Cir. 1989) (holding that "the failure or inability of a creditor to vote on confirmation of a plan is not equivalent to acceptance of the plan.").

For these reasons, the Third Party Release is impermissible and fails to meet the requirement of § 1129(a)(1).

3. De Facto Discharge

Section 16.3 of the Plan expressly provides that the Debtor will not receive a discharge pursuant to § 1141(d). However, the Plan also includes Section 17.3(a) which permanently enjoins creditors from taking any action in furtherance of their claims. Because the Plan's permanent injunction is not subject to an any temporal limit (such as the duration the Plan), it appears to amount to a *de facto* discharge of claims. *Cf. In re S. Edge LLC*, 478 B.R. 403, 408, 417 (D. Nev. 2012) (post-confirmation injunction that prevented satellite litigation only until all estate assets had been administered was not a de facto improper discharge). Because Section 17.3(a) of the Plan is a *de facto* discharge of claims and discharge cannot be entered in a liquidating plan, it should be stricken. *See generally In re Dominguez*, 51 F.3d 1502, 1508 (9th Cir. 1995) ("Liquidating corporations … are automatically precluded from discharge.").

4. Liquidating Trustee and Co-Liquidating Trustee's Fiduciary Duties

The Plan and Agreement are inconsistent in defining that the Liquidating Trustee and Co-Liquidating Trustee owe fiduciaries duties. Section 15.8(a) of the Plan states that "the Liquidating Trustee shall be deemed the Estate's representative in accordance with § 1123 and shall have … the powers of a trustee under §§ 704 and 1106 and Bankruptcy Rule 2004." However, Section 17.5 states that "[t]he obligations under this Plan of the Debtor's Estate shall (i) be contractual only and shall not create any fiduciary relationship…" According to the Ninth Circuit Court of Appeals, however, Liquidating Trustee and Co-Liquidating

Trustee should be deemed fiduciary. *See In re Consolidated Pioneer Mortg. Entities*, 264 F.3d 803, 808 (9th Cir. 2001)(holding that liquidating corporation created under a joint chapter 11 plan had a fiduciary duty to the investors and citing *Holywell Corp. v. Smith,* 503 U.S. 47, 52 (1992) for the proposition that trustee appointed to liquidate and distribute debtor's property under chapter 11 plan had fiduciary duties). The Plan and Agreement should clearly set forth that beyond contractual obligations, the extant Ninth Circuit case law requires the Liquidating Trustee and Co-Liquidating Trustee be deemed to owe fiduciary duties.[3]

Based on all of the above reasons, the UST respectfully objects to the confirmation of the Plan and requests that the Court deny confirmation or strike impermissible provisions.

Respectfully submitted,

TIFFANY L. CARROLL
UNITED STATES TRUSTEE

Dated: January 2, 2024

By: /s/ Haeji Hong
Haeji Hong,
Attorney for the United States Trustee

[3] There are various limitation of liability clauses in the Plan and Agreement for the Liquidating Trustee and the Co-Liquidating Trustee. Indemnification, exculpation, and/or limitation of liability provisions carve out grossly negligent, fraudulent or willful misconduct. Because they are fiduciaries, it may be reasonable to include breach of fiduciary duties in such carve-outs.