

1 SAMUEL R. MAIZEL (Bar No. 189301)
samuel.maizel@dentons.com
2 JOHN A. MOE, II (Bar No. 066893)
john.moe@dentons.com
3 TANIA M. MOYRON (Bar No. 235736)
tania.moyron@dentons.com
4 DENTONS US LLP
601 South Figueroa Street, Suite 2500
5 Los Angeles, California 90017-5704
Tel: (213) 623-9300 / Fax: (213) 623-9924

6
7 Proposed Attorneys for the Chapter 11 Debtors and
Debtors In Possession

8 **UNITED STATES BANKRUPTCY COURT**
9 **CENTRAL DISTRICT OF CALIFORNIA - LOS ANGELES DIVISION**

10 In re
11 VERITY HEALTH SYSTEM OF
CALIFORNIA, INC., *et al.*,
12 Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

- 13 Affects All Debtors
14
15 Affects Verity Health System of California,
Inc.
16 Affects O'Connor Hospital
 Affects Saint Louise Regional Hospital
17 Affects St. Francis Medical Center
 Affects St. Vincent Medical Center
18 Affects Seton Medical Center
 Affects O'Connor Hospital Foundation
19 Affects Saint Louise Regional Hospital
Foundation
20 Affects St. Francis Medical Center of Lynwood
Foundation
21 Affects St. Vincent Foundation
 Affects St. Vincent Dialysis Center, Inc.
22 Affects Seton Medical Center Foundation
 Affects Verity Business Services
23 Affects Verity Medical Foundation
 Affects Verity Holdings, LLC
24 Affects De Paul Ventures, LLC
25 Affects De Paul Ventures - San Jose ASC,
LLC

- Jointly Administered With:
CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20171-ER

Chapter 11 Cases
Hon. Judge Ernest M. Robles

**DEBTORS' EMERGENCY MOTION FOR ENTRY
OF AN ORDER AUTHORIZING DEBTORS TO
HONOR PREPETITION OBLIGATIONS TO
CRITICAL VENDORS; MEMORANDUM OF
POINTS AND AUTHORITIES IN SUPPORT
THEREOF**

[Filed Pursuant to LBR 2081-1(a)(_) and 9075-1(a)]

[Declaration of Richard Adcock in Support of Debtors'
First-Day Motions filed concurrently herewith]

EMERGENCY HEARING:

Date: September 5, 2018
Time: 10:00 a.m.
Place: Courtroom 1568

26 Debtors and Debtors In Possession.

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300



TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Page

EMERGENCY MOTION 1

SUMMARY OF REQUESTED RELIEF 11

ADDITIONAL INFORMATION 12

RESERVATION OF RIGHTS 13

PRAYER 14

MEMORANDUM OF POINTS AND AUTHORITIES 15

I. INTRODUCTION 15

II. JURISDICTION AND VENUE 16

III. STATEMENT OF FACTS 16

 A. General Background 16

 B. Historical Challenges 18

 C. Critical Vendor Obligations 21

IV. RELIEF REQUESTED 30

V. DISCUSSION 34

VI. CONCLUSION 48

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

TABLE OF AUTHORITIES

	Page
Cases	
<i>American Suzuki Motor Corporation</i> , No. 8:12-bk-22808-SC (Bankr C.D. Cal. Nov. 7, 2012)	37
<i>Armstrong World Indus., Inc. v. James A. Phillips, Inc. (In re James A. Phillips, Inc.)</i> , 29 B.R. 391 (S.D.N.Y. 1983)	41
<i>Bank of Am. Nat’l Trust & Sav. Assoc. v. 203 N. LaSalle St. P’Ship</i> , 526 U.S. 434 (1999)	38, 48
<i>Burchinal v. Central Washington Bank (In re Adams Apple, Inc.)</i> , 829 F.2d 1484 (9th Cir. 1987).....	41
<i>California Coastal Communities, Inc.</i> , No. 8:09-bk-21712-TA (Bankr. C.D. Cal. Dec. 9, 2009)	37
<i>Comm. Of Asbestos-Related Litigants v. Johns-Manville Corp. (In re Johns-Manville Corp.)</i> , 60 B.R. 612 (Bankr. S.D.N.Y. 1986)	43
<i>Czyzewski v. Jevic Holding Corp.</i> , 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017)	36
<i>F.D.I.C. v. Faigin</i> , No. CV 12–03448-DDP, 2013 WL 3389490 (C.D. Cal. July 8, 2013)	43
<i>In re Appvion, Inc.</i> , No. 17-12082 (Bankr. D. Del. Oct. 30, 2017).....	48
<i>In re AWTR Liquidation Inc.</i> , 548 B.R. 300 (Bankr. C.D. Cal. 2016).....	43
<i>In re Brown & Cole Stores, LLC</i> , 375 B.R. 873 (B.A.P. 9th Cir. 2007).....	45
<i>In re CEI Roofing, Inc.</i> , 315 B.R. 50 (Bankr. N.D. Tex. 2004).....	43
<i>In re Chassix Holdings, Inc.</i> , Case No. 15-10578 (MEW) (Bankr. S.D.N.Y. Apr. 14, 2015).....	45
<i>In re Chassix Holdings, Inc.</i> , No. 15-10578 (Bankr. S.D.N.Y. Mar. 13, 2015)	39

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1	<i>In re Chrysler LLC,</i>	
2	No. 09-50002 (Bankr. S.D.N.Y. May 20, 2009).....	46
3	<i>In re Downey Regional Medical Center-Hosp., Inc.,</i>	
4	No. 209-BK-34714-BB (Bankr. C.D. Cal. Oct. 19, 2010).....	37
5	<i>In re Emas Chiyoda Subsea Ltd.,</i>	
6	No. 17-31146 (Bankr. S.D. Tex. Mar. 28, 2017).....	48
7	<i>In re Evergreen Oil, Inc.,</i>	
8	No. 8:13-bk-13163 (Bankr. C.D. Cal. Apr. 10, 2013).....	37
9	<i>In re Geokinetics Inc.,</i>	
10	No. 18-33410 (Bankr. S.D. Tex. July 16, 2018).....	48
11	<i>In re Goodrich Petroleum Corp.,</i>	
12	No. 16-31975 (Bankr. S.D. Tex. May 12, 2016).....	48
13	<i>In re The Great Atlantic & Pacific Tea Co., et al.,</i>	
14	No. 10-24549 (Bankr. S.D.N.Y. Dec. 14, 2010).....	38, 45
15	<i>In re The Great Atlantic & Pacific Tea Co., et al.,</i>	
16	No. 10-24549-RDD (Bankr. S.D.N.Y. Jan. 13, 2011).....	38, 46
17	<i>In re The Great Atlantic & Pacific Tea Co., et al.,</i>	
18	No. 15-23007 (Bankr. S.D.N.Y. July 20, 2015).....	47
19	<i>In re Green Fleet Systems, LLC,</i>	
20	No. 2:15-bk-11542-BR (Bankr. C.D. Cal. Mar. 16, 2015).....	38
21	<i>In re GST AutoLeather, Inc.,</i>	
22	No. 17-12100 (Bankr. D. Del. Nov. 13, 2017).....	48
23	<i>In re HDOS Enterprises,</i>	
24	No. 2:14-BK-12028-NB (Bankr. C.D. Cal. Feb. 6, 2014).....	37
25	<i>In re Hostess Brands, Inc.,</i>	
26	No. 12-22052 (Jan. 13, 2012).....	39
27	<i>In re Hostess Brands, Inc.,</i>	
28	No. 12-22052 (Jan. 27, 2012).....	39
	<i>In re Isis Foods, Inc.,</i>	
	37 B.R. 334 (W.D. Mo.), <i>appeal dismissed</i> , 738 F.2d 445 (8th Cir. 1984).....	47
	<i>In re Lear Corp.</i>	
	(Bankr. S.D.N.Y. July 31, 2009).....	46
	<i>In re Lear Corp.,</i>	
	No. 09-14326 (Bankr. S.D.N.Y. July 8, 2009).....	46

1 *In re M&G USA Corporation,*
2 No. 17-12307 (Bankr. D. Del. Nov. 30, 2017).....48

3 *In re Pomona Valley Med. Group, Inc.,*
4 476 F.3d 665 (9th Cir. 2007).....42, 43

5 *In re The Reader’s Digest Ass’n, Inc.,*
6 No. 09-23529 (Bankr. S.D.N.Y. Aug. 25, 2009)47

7 *In re The Readers Digest Ass’n, Inc.,*
8 No. 09-23529 (Bankr. S.D.N.Y. Sept. 17, 2009)40

9 *In re Structuralite Plastics Corp.,*
10 86 B.R. 922 (Bankr. S.D. Ohio 1988).....41

11 *In re Tops Holding II Corporation, et al.,*
12 No. 18-22279-RDD (Bankr. S.D.N.Y. Mar. 22, 2018).....38, 41

13 *In re True Religion Apparel, Inc.,*
14 No. 17-11460 (Bankr. D. Del. July 31, 2017).....48

15 *In re Victor Valley Community Hospital,*
16 No. 6:10-bk-39537-CB (Bankr. C.D. Cal. Sept. 17, 2010).....37

17 *Mann v. GTCR Golder Rauner, L.L.C.,*
18 483 F. Supp. 2d 884 (D. Ariz. 2007).....43

19 *Matter of B & W Enterprises, Inc.,*
20 713 F.2d 534 (9th Cir. 1983).....36

21 *Official Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re*
22 *Integrated Res., Inc.),*
23 147 B.R. 650, 656 (S.D.N.Y. 1992) *appeal dismissed*, 3 F.3d 49 (2d Cir. 1993)42, 43

24 *Unofficial Comm. of Equity Holders v. McManigle (In re Penick Pharm., Inc.),*
25 227 B.R. 229 (Bankr. S.D.N.Y. 1998)44

26

27

28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1	Statutes	
2	11 United States Code	
3	§ 105.....	16, 36, 37, 43
4	§ 105(a)	38, 43
5	§ 361.....	37
6	§ 362.....	37
7	§ 362(a)	24, 35, 44
8	§ 363.....	37, 40, 41
9	§ 363(b)	16
10	§ 363(c)(1).....	45
11	§ 364.....	37
12	§ 365.....	28
13	§ 503.....	40
14	§ 503(b)(9)	16, 45
15	§ 510.....	36
16	§ 549.....	40
17	§ 549(a)	33
18	§ 549(a)(2)(B)	16, 46
19	§ 1107.....	17
20	§ 1107(a)	43
21	§ 1108.....	17
22	§ 1129(a)(9)(A)	45
23	28 United States Code	
24	§ 157(b)(2)(A).....	17
25	§ 157(b)(2)(O).....	17
26	§ 1334.....	17
27	§ 1408(1)	17
28	§ 1408(2).....	17
29	California Business & Professions Code	
30	§§ 1200 <i>et. seq.</i>	22, 40
31	§§ 4000 <i>et. seq.</i>	22, 40
32	California Health & Safety Code	
33	§ 1206(l).....	18
34	§§ 1250 <i>et seq.</i>	22, 40, 42, 44
35	§§ 11000 <i>et. seq.</i>	22, 40
36	Rules and Regulations	
37	16 California Code of Regulations §§ 1700 <i>et. seq.</i>	22, 40
38	22 California Code of Regulations	
39	§ 51207.....	22, 40
40	§§ 70001, <i>et seq.</i>	22, 40, 42, 44
41	42 Code of Federal Regulations §§ 482 <i>et. seq.</i>	22, 40

1	Federal Rules of Bankruptcy Procedure	
	Rule 2002	37
2	Rule 4001	37
	Rule 6003(b)	16
3	Rule 6004(a).....	16
4	Rule 6004(h)	16
5	Local Bankruptcy Rules	
	Rule 2002-1	37
6	Rule 2081-1(a)(7).....	16
	Rule 4001-2.....	37
7	Rule 9075-1	16
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		
27		
28		

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

EMERGENCY MOTION

1
2 Pursuant to Rules 2081-1(a)(7) and 9075-1 of the Local Bankruptcy Rules of the United
3 States Bankruptcy Court for the Central District of California (the “LBR”), Rules 6003(b),
4 6004(a) and (h) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”), and
5 sections 105, 363(b), 503(b)(9), and/or 549(a)(2)(B) of title 11 of the United States Code, 11
6 U.S.C. §§ 101, *et seq.* (the “Bankruptcy Code”),¹ Verity Health System of California, Inc.
7 (“VHS”) and the above-referenced affiliated debtors, the debtors and debtors in possession in the
8 above-captioned chapter 11 bankruptcy case (collectively, the “Debtors”), hereby move, on an
9 emergency basis (the “Motion”), for the entry of an interim order authorizing, but not directing,
10 the Debtors to continue to pay and/or honor the prepetition claims (after an interim hearing, in an
11 interim amount of up to \$5 Million and only as needed to avoid immediate and irreparable harm),
12 and for the entry of a final order within thirty (30) days after filing the above-captioned chapter
13 11 bankruptcy case (the “Final Order”, together with the Interim Order, the “Critical Vendors
14 Order”) authorizing, but not directing, the Debtors to continue to pay and/or honor the prepetition
15 claims (after a final hearing, in an amount up to an additional \$15 Million, for a total of up to \$20
16 Million and only as needed to avoid immediate and irreparable harm), of their most critical
17 vendors in the Debtors’ discretion and in the ordinary course of the Debtors’ business, pursuant to
18 a carefully-designed Protocol (defined below) overseen by a core, centralized team consisting of
19 senior members of Debtors’ management and professional advisors, and subject to certain Terms
20 and Conditions (defined below). In support of the Motion, the Debtors have separately filed the
21 Declaration of Richard Adcock in Support of Debtors’ First-Day Motions (the “Adcock
22 Declaration”). The Debtors request that the relief sought herein be granted on an emergency basis
23 because they will suffer immediate and irreparable harm without the relief requested in this
24 Motion.

25 The Debtors operate a nonprofit safety-net health care system that provides medical care
26 for over 300,000 patients per year. The Debtor operates six general acute care hospitals and
27

28 ¹ All references to “§” and “section” herein are to sections of the Bankruptcy Code.

1 numerous outpatient medical clinics, including St. Francis Medical Center in Lynwood (a Level II
2 Trauma Center), St. Vincent Medical Center in Los Angeles, O'Connor Hospital in San Jose, St.
3 Louise Regional Hospital in Gilroy, Seton Medical Center in Daly City, and Seton Coastside in
4 Moss Beach. Collectively, the hospitals have 1,680 inpatient beds, six active emergency rooms,
5 dialysis services, imaging services, labor and delivery services and neonatal services, among
6 others. The Debtors employ more than 6,000 healthcare providers and administrative staff
7 statewide and contract with hundreds of physicians and medical groups to ensure critical medical
8 services are available to communities served by the hospitals.

9 The Debtors and the communities their hospitals serve are in a vulnerable position. The
10 availability of life-saving care and treatment could immediately stop if the Debtors are unable to
11 ensure the continual flow of the supplies and services that make their medical care possible,
12 including medical supplies, blood supplies, medical equipment, physicians, nurses, nurse
13 practitioners, physicians assistants, professional technicians such as, imaging technicians, surgical
14 technicians, sterile processing technicians and interim clinical/management staff, coders, and
15 information technology support. Debtors and their inpatients and outpatients ("Patients") face
16 irreparable harm without the granting of this Motion.

17 Additionally, local, state, and federal law requires Debtors ensure contracts with and
18 services from various healthcare providers, as well as adequate drugs, supplies and medical
19 equipment. For example, because the Debtors' hospitals are licensed by the California
20 Department of Public Health and certified to participate in the Medicare and Medicaid programs,
21 the Debtors must comply with all hospital licensing and certification requirements, including
22 those found in the Health and Safety Code and in Title 22 of the California Code of Regulations,
23 as well as the applicable Medicare conditions of participation and corresponding Medicaid (i.e.,
24 Medi-Cal) requirements. *See, e.g.*, Cal. Health & Safety Code §§ 1250 *et seq.*; 22 Cal. Code Regs
25 §§ 70001, *et seq.*; 22 Cal. Code Regs. § 51207; 42 C.F.R. §§ 482 *et seq.* In addition to complying
26 with these overarching requirements, the Debtors must monitor and comply with all of the other
27 licensing and operational requirements that apply to the different service lines and programs
28 offered by the hospitals, including, for example, those applicable to the hospital pharmacies and

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 laboratories. *See, e.g.*, Cal. Bus. & Prof. Code §§ 1200 *et. seq.*, Cal. Bus. & Prof. Code §§ 4000
2 *et. seq.*, Cal. Health & Safety Code §§ 11000 *et. seq.*, 16 Cal. Code Regs. §§ 1700 *et. seq.* These
3 extensive, comprehensive regulations and requirements can only be fulfilled through
4 uninterrupted access to essential goods and services. Thus, in order to ensure essential medical
5 care and treatment is available to the vulnerable communities served by the Debtors’ hospitals –
6 such as Debtor’s Level II Trauma Center that serves the inner city of Los Angeles – it is
7 imperative the Debtors are able to rely on a consistent, quality supply of essential services and
8 goods, including medical supplies, blood supplies, medical equipment, physicians, nurses, nurse
9 practitioners, physicians assistants, professional technicians such as, imaging technicians, surgical
10 technicians, sterile processing technicians and interim clinical/management staff, coders, and
11 information technology support and other medical suppliers and service providers that are
12 “critical” to Patient care and the Debtors’ businesses (the “Critical Vendors”).

13 The Debtors’ Critical Vendors include the following categories of providers:
14 (i) uncompensated care contract physicians and on-call coverage physicians (collectively, the
15 “Uncompensated Care and On-Call Coverage Physicians”); (ii) medical directors (the “Medical
16 Directors”); (iii) medical staff officers and leadership positions (“Medical Leadership”);
17 (iv) physicians providing teaching services (“Physician Educators”); (v) medical services
18 providers (the “Medical Services Providers”); (vi) medical supplies and medical equipment
19 providers (collectively, the “Medical Supplies and Equipment Providers”); (vii) medical staffing
20 agencies and hospital-based services providers (collectively, the “Clinical Staffing”); (viii) non-
21 medical services providers (the “Non-Medical Services Providers”); (ix) information technology
22 services providers (the “IT Services Providers”); and (x) various employee benefits providers (the
23 “Benefits Providers”).

24 The Debtors are mindful of their fiduciary obligations to seek to preserve and maximize
25 the value of their Estates. To that end, the Debtors and their advisors have engaged in an
26 extensive process of reviewing and analyzing the Debtors’ books and records, consulting
27 operations management and purchasing personnel, reviewing contracts and supply agreements,
28 and analyzing applicable laws, regulations, and historical practices to identify business

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 relationships—which, if lost, could materially harm the Debtors’ Patients, the Debtors’
2 businesses, reduce their enterprise value, and/or impair their restructuring process—all in an
3 effort to identify only those most critical vendors using their business judgment (the “Protocol”).
4 Such Protocol is on-going.

5 During the Protocol process, the Debtors have deemed certain vendors as critical because
6 each of these Critical Vendors meets the following criteria: (a) the vendor is essential to Patient
7 care, supports maintaining the Debtors’ business in full compliance with all of the numerous legal
8 requirements for operating general acute care hospitals in the state of California, including
9 California’s Title 22, and allows the Debtors to continue to provide essential and life-saving
10 patient care and services while maintaining their business postpetition until the reorganization
11 and/or sale of the Debtors’ assets for the benefit of creditors; (b) the vendor is indispensable for
12 providing vital goods or services (such as blood products or surgical implants), replacing said
13 vendor would be prohibitively expensive, or said vendor is otherwise critical to prevent the
14 diversion of management and key personnel (who would be nearly impossible to replace during
15 the extensive transitional period);² (c) the vendor holds an unpaid prepetition claim for the
16 provision of vital goods or services; (d) the Debtors believe the vendor will refuse to deliver vital
17 goods or services without payment of the prepetition claim and the automatic stay imposed by
18 § 362(a) will be inadequate to address the issue; (e) cash on delivery is unlikely to provide the
19 requisite incentive for the vendor to continue providing goods or services; (f) the Debtors lack a
20 long-term contractual relationship with the vendor that would oblige the vendor to continue the
21 prepetition relationship, and the Debtors are otherwise without adequate leverage to compel
22 performance on commercially reasonable terms; and (g) the Debtors will suffer immediate and
23 irreparable harm if the vendor is not specially incentivized to continue providing essential goods
24 or services. The Debtors’ will use commercially reasonable efforts to require the vendor to sign a
25 postpetition agreement with normalized terms and conditions that contractually bind the vendor to

26 _____
27 ² Additionally, the Debtors acknowledge that while some of these Critical Vendors are not the
28 only vendors in the area that provide these vital goods or services, switching to other providers at
this critical juncture will incur substantial time, energy, and unnecessary distraction during the
extensive transitional period.

1 continue providing essential goods and services postpetition (the “Critical Vendor Agreement”).

2 A brief description of each category of Critical Vendors follows.

3 **i. Uncompensated Care and On-Call Coverage Physicians**

4 The Debtors require the service of various physicians who provide care to patients who
5 lack the ability to compensate the Debtors for their medical treatment (“Uncompensated Care
6 Contract Physicians”) and the physicians who provide on-call services to cover the Debtors’ six
7 active emergency departments, one of which is an essential Level II Trauma Center (“On-Call
8 Coverage Physicians”). The Uncompensated Care Contract Physicians provide life-saving
9 medical care and treatment for Patients who would not otherwise be able to afford physician
10 services, including trauma patients needing emergency surgeries, infants in Debtor’s neonatal
11 intensive care unit and cardiac patients needing immediate STEMI services for serious
12 myocardial infarctions. Through the On-Call Coverage Physicians, Debtors ensure that specialty
13 physician services are available at all times for all Patients (regardless of ability to pay) for
14 emergency situations, such as trauma, cardiac arrest and labor and delivery. The On-Call
15 Coverage Physicians include a broad range of specialties, such as (i) urology; (ii) general surgery;
16 (iii) orthopedics; (iv) cardiology; (v) neurosurgery; (vi) thoracic surgery; (vii) cardiac surgery;
17 (viii) radiation oncology; (ix) neurology, (x) psychiatry; (xi) nephrology; (xii) gastroenterology;
18 (xiii) pediatric surgery; and (xiv) obstetrics. Due to the strong economy and the tight labor market
19 for professionals with expertise, Uncompensated Care and On-Call Coverage Physicians have a
20 vast array of working opportunities available to them, and to the extent the Debtors are unable to
21 ensure payment for prepetition claims, these Uncompensated Care and On-Call Coverage
22 Physicians will work at other hospitals, resulting in a devastating impact on the communities
23 served by the Debtors’ hospitals and irreparable harm to the smooth transition into chapter 11 and
24 preservation and maximization of value for the benefit of the Debtors’ creditors.

25 **ii. Medical Directors**

26 The Debtors require the services of various physicians who serve as Medical Directors. As
27 Medical Directors, it is their responsibility to ensure the hospital provides quality Patient care
28 efficiently and in compliance with state and federal laws, rules and regulations. These Medical

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 Directors supervise and coordinate the On-Call Coverage Physicians and provide vital operating
2 and administrative services, such as supervision of medical departments and programs, including
3 (i) the Long Term & Sub-Acute Unit; (ii) Advanced Wound Care; (iii) the Comprehensive Spine
4 Care Program; (iv) the Stroke Program; (v) Cardiac & Pulmonary Rehabilitation; (vi) Oncology;
5 (vii) Non-Invasive Cardiology; (viii) Radiation Therapy; (ix) the Intensive Care Unit and
6 Neonatal Intensive Care Unit; (x) the Antimicrobial Stewardship Program; (xi) Interventional
7 Neurology; (xii) the Bioethics Program; (xiii) the Catherization Laboratory; (xiv) the Skilled
8 Nursing Facility; (xv) the Stroke Program; (xvi) Thoracic Surgery; (xvii) the Dialysis Center; and
9 (xviii) Nuclear Medicine and Vascular Laboratory. The Medical Directors also are vital for
10 program quality, oversight, and risk management. There are approximately 60 physicians serving
11 as Medical Directors. Similar to the Uncompensated Care and On-Call Coverage Physicians, and
12 due to the strong economy and the tight labor market for professionals with expertise, Medical
13 Directors are in demand and have a vast array of working opportunities available to them. To the
14 extent the Debtors are unable to ensure payment for prepetition claims to Medical Directors, these
15 Medical Directors will work at other hospitals, resulting in a devastating impact on the
16 communities served by the Debtors' hospitals and irreparable harm to the smooth transition into
17 chapter 11 and preservation and maximization of value for the benefit of the Debtors' creditors.

18 **iii. Medical Leadership**

19 The Debtors require the services of various physicians who serve as medical staff officers
20 and in other leadership positions, as required by each Hospital's accreditation with The Joint
21 Commission (the "TJC"). Accreditation by the TJC is essential for each Hospital's certification
22 under the Medicare and Medi-Cal programs. Each Hospital's Medical Leadership includes a
23 Chief and Vice Chief of Staff and Department Chairs as required by Medical Staff Bylaws, by
24 TJC and by Title 22.

25 These medical staff leaders are essential to ensure quality medical services and risk
26 management. Without these physicians, who can easily find competitive opportunities elsewhere,
27 the quality of medical services may decline, and cause irreparable harm to the Debtors' chapter
28 11 Case.

1 **iv. Physician Educators**

2 The Debtors require the services of various physicians who provide teaching services in
3 the Debtors' graduate medical education (the "GME") program. The GME program trains
4 physicians – so-called, interns, residents, and fellows – and such physicians provide needed
5 staffing for Debtors' hospitals. Physician Educators are in high demand because they are so
6 highly skilled – these physicians must not only be experts in their fields but must also meet the
7 stringent qualifications under the government's GME requirements. Without the Physician
8 Educators, Debtor would lose its GME program. The GME Program is a required program for
9 the Level II Trauma Center that provides trauma services to the inner city of Los Angeles. To the
10 extent the Debtors are unable to ensure payment for prepetition claims to Physician Educators,
11 these in-demand Physician Educators will work at other hospitals, resulting in a devastating
12 impact on the Debtors' patients, and the community served by the Debtor's hospital and
13 irreparable harm to the smooth transition into chapter 11 and preservation and maximization of
14 value for the benefit of the Debtors' creditors.

15 **v. Medical Services Providers**

16 The Debtors require the services of various Medical Services Providers, including
17 providers of surgical anesthesia coverage, organ harvesting and organ matching services, medical
18 equipment sanitization, diagnostic interventional cardiology services, interventional
19 neuroradiology, imaging services, advanced wound care, pathology and laboratory services,
20 dialysis services, lithotripsy services, sterile compounding services, rehabilitation staffing and
21 management services, subacute management services, psychiatric management services,
22 hospitalist services, intensivist program services, medical screening services, and medical
23 instrument repair services. These services are vital to the Debtors' ability to continue offering
24 life-saving care and treatment at their hospitals. The Debtor and the communities served by the
25 Debtors' hospitals will suffer immediate irreparable harm should the Court deny the Debtors'
26 request to include the Medical Services Providers as Critical Vendors subject to payment on
27 prepetition claims.

28 **vi. Medical Supplies and Equipment Providers**

1 The Debtors require the use of various medical supplies and medical equipment,
2 including, blood and plasma, heart valves, coronary intervention products, defibrillators,
3 laparoscopic and minimally invasive surgical supplies, neurosurgical supplies and neurology
4 devices, other surgical medical products, bone substitute biologics, regenerative vascular grafts,
5 vaccinations and other pharmaceuticals, nuclear medicines, medical gases, anesthesia medical
6 equipment, laboratory medical supplies, radiation equipment, gastrointestinal supplies, cochlear
7 implants, orthopedic implants, spinal implants, intraocular lenses and ophthalmology supplies,
8 sterilization equipment and products, and fetal monitoring systems. Equipment includes
9 biomedical repair tools and equipment, patient beds and stretchers, vital sign monitoring, infusion
10 pumps, medication supply stations, gastro-intestinal lab equipment, cardiac catheterization lab
11 equipment, operating room equipment, imaging equipment, laboratory equipment, pharmacy
12 dispensing equipment, and transplant program equipment. The medical supplies and medical
13 equipment the Debtors receive from the Medical Supplies and Equipment Providers are vital to
14 the Debtors' ability to continue offering life-saving care and treatment at their hospitals. The
15 patients and the communities served by the Debtors' hospitals will suffer immediate irreparable
16 harm should the Court deny the Debtors' request to include the Medical Supplies and Equipment
17 Providers as Critical Vendors.

18 **vii. Clinical Staffing**

19 The Debtors require various medical staffing agencies to provide numerous personnel
20 essential to operating hospitals, including nurses, nurse practitioners, physicians assistants,
21 professional technicians such as, imaging technicians, surgical technicians, sterile processing
22 technicians and interim clinical/management staff, coders, and admission department staff. The
23 ability to access staffing agencies is particularly important for nursing services because Debtors
24 must comply with the California mandatory nurse-to-patient ratios; in other words, Debtors are
25 required to increase nurse staffing depending upon daily patient census. This is not always
26 possible to do solely through nurse-employees. Nurse staffing agencies are also important
27 because it is difficult to recruit experienced staff for short-term assignments (e.g., single day) or
28 during busier times (e.g., flu season).

1 Moreover, many of the Clinical Staffing who provide physicians, nurses, nurse
2 practitioners, physicians assistants, professional technicians such as, imaging technicians, surgical
3 technicians, sterile processing technicians and interim clinical/management staff, coders, and
4 admission department staff to the Debtors will not staff the Debtors' hospitals if there is any
5 interruption or delay in the payment of the amounts due to them. Given the Debtors' reliance on
6 the medical services provided by the Clinical Staffing to provide Patient care and otherwise fulfill
7 the Debtors' daily medical services needs, and the fact that the Clinical Staffing can simply shift
8 their services to another employer, it is crucial that the Debtors be authorized to pay any
9 prepetition amounts due to the Clinical Staffing as Critical Vendors in the ordinary course of
10 business.

11 **viii. Non-Medical Services Providers**

12 The Debtors require services of various non-medical service providers, including, but not
13 limited to, those who provide services such as payroll tax services, financial audit services, billing
14 services, cost reporting services, revenue cycle management services, consulting and education
15 services for various required national, state, and local accreditations and mandates, environmental
16 services, record retention services, building maintenance services, medical equipment
17 maintenance services, management services, and other similar services, as well as to seismic
18 contractors. Seismic contractors are designers, engineers, suppliers and constructors who are
19 engaged in the statutory work of retrofitting hospital structures to meet the SB1953 and
20 subsequent amendments that are required to be completed by December 31, 2019. Delay of the
21 projects will cause the Debtors to miss the regulated deadlines risking California Department of
22 Public Health license and suspension of such. These non-medical services are vital to the
23 Debtors' day-to-day operations — including patient care — and the Debtors' ability to comply
24 with regulatory requirements set by the State of California legislature, and the Debtors will suffer
25 immediate irreparable harm should the Court not grant the Debtors' request to include the Non-
26 Medical Services Providers as Critical Vendors.

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 **ix. IT Services Providers**

2 The Debtors require use of various information technology services, including, but not
3 limited to, those who provide services such as diagnostic technology, interoperability between
4 devices, risk management and software services, revenue cycle management billing software and
5 services, teleradiology services, customer relationship management, networking solutions
6 services, multi-function copiers, voice over internet protocol system services, hosting services for
7 applications, and point of care data management system services. Critical patient care systems
8 such as electronic health record systems and enterprise resource planning systems must be
9 maintained to ensure continuity of patient care. These information technology services are vital to
10 the quality of patient care and the Debtors' day-to-day operations, and the Debtor will suffer
11 immediate irreparable harm should the Court not grant the Debtors' request to include the IT
12 Services Providers as Critical Vendors subject to payment on prepetition claims.

13 **x. Benefits Providers**

14 The Debtors have incentivized their employees to continue working through the
15 continuation of company-subsidized benefits, such as workers compensation, medical, dental,
16 vision, short term and long term care, leave of absence, and life insurance. If the Debtors are not
17 permitted to pay any prepetition premium amounts due to these Benefits Providers, the
18 employees' insurance coverage will be jeopardized and the employees will likely seek
19 employment elsewhere. Specifically, any disruption to payment of the employee benefits in the
20 ordinary course (and in the Debtors' discretion), would adversely affect the Debtors' goals in this
21 Case because such events are likely to cause some employees to terminate their employment with
22 the Debtors, will cause all employees to be distracted from their duties to care for the Patients and
23 the operations of the Hospitals, and will inevitably hurt employee morale at a particularly
24 sensitive time for all employees, resulting in severe repercussions on the Debtors' ability to
25 provide Patient care, and to preserve their assets and administer the Estates, to the detriment of all
26 constituencies. Since the Debtors do not have the ability to quickly or cost-effectively replace
27 their employees who provide vital medical and non-medical services on a daily basis, it is critical
28 that the Debtors be allowed to continue these benefits in order to retain their employees and

1 maintain their business operations to preserve the full value of their assets for the benefit of their
2 creditors. Therefore, the Court should include Benefits Providers as Critical Vendors.

3 **SUMMARY OF REQUESTED RELIEF**

4 By this Motion, the Debtors seek authority to continue to pay and/or honor the prepetition
5 claims of the Uncompensated Care and On-Call Coverage Physicians, the Medical Directors, the
6 Medical Leadership, Physician Educators, the Medical Services Providers, the Medical Supplies
7 and Equipment Providers, the Clinical Staffing, the Non-Medical Services Providers, the IT
8 Services Providers, and the Benefits Providers as Critical Vendors, up to \$20 Million (the
9 “Critical Vendor Cap”), with (i) an interim amount of up to \$5 Million and only as needed to
10 avoid immediate and irreparable harm; and (ii) an additional amount of up to \$15 Million and
11 only as needed to avoid immediate and irreparable harm, as set forth in the Declaration of Richard
12 Adcock in Support of the Emergency Motions filed concurrently herewith (the “Adcock
13 Declaration”), and in the Debtors’ discretion and in the ordinary course of the Debtors’ business,
14 and pursuant to the Protocol. The amounts proposed to be paid to the Critical Vendors are already
15 provided for in the Debtors’ operating budget (the “Budget”) submitted in connection with the
16 Debtors’ motion for authority to use cash collateral and to obtain debtors in possession financing
17 from the Debtors’ senior secured lender (the “Cash Collateral Motion”) which is supported by the
18 Declaration of Anita M. Chou (the “Chou Declaration”) filed concurrently herewith.

19 As a safeguard to the Debtors’ Patients, other creditors, and the Estates, the Debtors
20 propose certain terms and conditions (the “Terms and Conditions”) of the payment to the Critical
21 Vendors if a Critical Vendor, after signing the Critical Vendor Agreement, thereafter refuses to
22 supply the critical goods or services to the Debtor throughout the course of the bankruptcy
23 proceeding, as provided under the Critical Vendor Agreement (the “Defaulting Vendor”). These
24 Terms and Conditions allow the Debtors: (i) to deem such payment to the Defaulting Vendor as a
25 voidable postpetition transfer pursuant to § 549(a); and (ii) to demand the immediate return of any
26 and all payments made to the Defaulting Vendor pursuant to this Motion, to the extent that the
27 aggregate amount of such payments exceeds the postpetition obligations then outstanding without
28 giving effect to alleged setoff rights, recoupment rights, adjustments, or setoffs of any type

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 whatsoever, and the Defaulting Vendor's prepetition claim shall be reinstated in such an amount
2 as to restore the Debtors and the Defaulting Vendor to their original positions, as if the Critical
3 Vendor Agreement had never been entered into and the payment of the Defaulting Vendor's
4 prepetition claim had not been made. In short, the Debtors will return the parties to their positions
5 immediately prior to the entry of the order approving the relief sought herein.

6 The Debtors also request that all applicable banks and other financial institutions be
7 authorized to receive, process, honor, and pay all checks presented for payment of, and to honor
8 all fund transfer requests made by the Debtors related to, the claims that the Debtors request
9 authority to pay in this Motion, regardless of whether the checks were presented or fund transfer
10 requests were submitted before or after the Petition Date, provided, however, that: (i) funds are
11 available in the Debtors' accounts to cover the checks and fund transfers; and (ii) all of the banks
12 and other financial institutions are authorized to rely on the Debtors' designation of any particular
13 check as approved by the attached proposed order.

14 The Debtors respectfully submit that the relief requested herein is necessary and
15 appropriate to ensure a smooth transition into chapter 11, to normalize and maintain existing
16 relationships with the Debtors' Critical Vendors during the turbulent early stages of this
17 bankruptcy case, and to preserve and maximize value for the benefit of the Debtors' creditors.
18 One of the keys to the Debtors' successful reorganization will be maintaining harmonious
19 relationships with their employees, medical services providers, most critical vendors, and
20 customers, and preserving the going-concern value of the Debtors' business. As set forth in the
21 attached Memorandum of Points and Authorities, the relief requested in this Motion is essential to
22 those objectives.

23 **ADDITIONAL INFORMATION**

24 This Motion is based upon LBR 2081-1(a)(7) and 9075-1, Bankruptcy Rules 6003(b),
25 6004(a) and (h), and §§ 105, 363(b), 503(b)(9), and 549(a)(2)(B), the attached Memorandum of
26 Points and Authorities, and Adcock Declaration filed concurrently herewith, the arguments and
27 statements of counsel to be made at the hearing on the Motion, and other admissible evidence
28 properly brought before the Court.

1 Counsel to the Debtors will serve this Motion, the attached Memorandum of Points and
2 Authorities, the Adcock Declaration and the Notice of First-Day Motions on: (i) the Office of the
3 United States Trustee; (ii) the Secured Creditors and DIP Lenders; (iii) the 50 largest general
4 unsecured creditors appearing on the list filed in accordance with Bankruptcy Rule 1007(d); (iv)
5 the United States of America, and the State of California; and (v) parties that file with the Court
6 and serve upon the Debtors requests for notice of all matters in accordance with Bankruptcy Rule
7 2002(i). To the extent necessary, the Debtors request that the Court waive compliance with LBR
8 9075-1(a)(6) and approve service (in addition to the means of services set forth in such LBR) by
9 overnight delivery. Among other things, the Notice of Emergency Motions will provide that any
10 opposition or objection to the Motion may be presented at any time before or at the hearing
11 regarding the Motion, but that failure to timely object may be deemed by the Court to constitute
12 consent to the relief requested herein.

13 In the event that the Court grants the relief requested by the Motion, the Debtors shall
14 provide notice of the entry of the order granting such relief upon each of the foregoing parties and
15 any other parties in interest as the Court directs. The Debtors submit that such notice is sufficient
16 and that no other or further notice be given.

17 **RESERVATION OF RIGHTS**

18 Nothing contained herein is intended or shall be construed as: (i) an admission as to the
19 validity of any claim against the Debtors; (ii) a waiver of the Debtors' or any appropriate party in
20 interest's rights to dispute the amount of, basis for, or validity of any claim against the Debtors;
21 (iii) a waiver of any claims or causes of action which may exist against any creditor or interest
22 holder; or (iv) an approval, assumption, adoption, or rejection of any agreement, contract, lease,
23 program, or policy between the Debtors and any third party under § 365. Likewise, if the Court
24 grants the relief sought herein, any payment made pursuant to the Court's order is not intended to
25 be and should not be construed as an admission to the validity of any claim or a waiver of the
26 Debtors' rights to dispute such claim subsequently.

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

PRAYER

WHEREFORE, the Debtors respectfully request that this Court hold an emergency hearing on the Motion and issue an Interim Order:

- (1) affirming the adequacy of the notice given;
 - (2) granting the Motion in the interim;
 - (3) authorizing, but not directing, the Debtors to continue to pay and/or honor the prepetition claims (up to \$5 Million) of the Critical Vendors, in the ordinary course of the Debtors' business, in the Debtors' discretion, and in accordance with the Protocol and the Budget;
- and

(4) granting such other and further relief as the Court deems just and proper under the circumstances.

WHEREFORE, the Debtors also respectfully request that this Court hold a final hearing on the Motion and issue a Final Order:

- (1) affirming the adequacy of the notice given;
- (2) granting the Motion in its entirety;
- (3) authorizing, but not directing, the Debtors to continue to pay and/or honor the prepetition claims (up to a total of \$20 Million) of the Critical Vendors, in the ordinary course of the Debtors' business, in the Debtors' discretion, and in accordance with the Protocol and the Budget; and

(4) granting such other and further relief as the Court deems just and proper under the circumstances.

Dated: August 31, 2018

DENTONS US LLP
SAMUEL R. MAIZEL
JOHN A. MOE, II
TANIA M. MOYRON

By /s/ Tania M. Moyron
Tania M. Moyron

Proposed Attorneys for the Chapter 11 Debtors
and Debtors In Possession

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Pursuant to Rules 2081-1(a)(7) and 9075-1 of the Local Bankruptcy Rules of the United States Bankruptcy Court for the Central District of California (the “LBR”), Rules 6003(b), 6004(a) and (h) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”), and sections 105, 363(b), 503(b)(9), and/or 549(a)(2)(B) of title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.* (the “Bankruptcy Code”),³ Verity Health System of California, Inc. (“VHS”) and the above-referenced affiliated debtors, the debtors and debtors in possession in the above-captioned chapter 11 bankruptcy case (collectively, the “Debtors”), hereby move, on an emergency basis (the “Motion”), for the entry of an interim order (substantially in the form attached hereto as **Exhibit “A”**, the “Interim Order”) authorizing, but not directing, the Debtors to continue to pay and/or honor the prepetition claims (after an interim hearing, in an interim amount of up to \$5 Million and only as needed to avoid immediate and irreparable harm), and for the entry of a final order within 30 days after filing the above-captioned chapter 11 bankruptcy case (the “Final Order”, together with the Interim Order, the “Critical Vendors Order”) authorizing, but not directing, the Debtors to continue to pay and/or honor the prepetition claims (after a final hearing, in an amount up to an additional \$15 Million, for a total of up to \$20 Million and only as needed to avoid immediate and irreparable harm), of their most critical vendors in the Debtors’ discretion and in the ordinary course of the Debtors’ business, pursuant to a carefully-designed Protocol (defined below) overseen by a core, centralized team consisting of senior members of Debtors’ management and professional advisors, and subject to certain Terms and Conditions (defined below). In support of the Motion, the Debtors have separately filed the Declaration of Richard Adcock in Support of Debtors’ First-Day Motions (the “Adcock Declaration”). The Debtors request that the relief sought herein be granted on an emergency basis because they will suffer immediate and irreparable harm without the relief requested in this Motion.

³ All references to “§” and “section” herein are to sections of the Bankruptcy Code.

1 **II. JURISDICTION AND VENUE**

2 1. This Court has jurisdiction over these cases pursuant to 28 U.S.C. § 1334. This is a
3 core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O).

4 2. Venue of the Debtors' chapter 11 cases is proper pursuant to 28 U.S.C. § 1408(1)
5 and (2).

6 **III. STATEMENT OF FACTS**

7 **A. General Background**

8 1. On August 31, 2018 ("Petition Date"), the Debtors each filed a voluntary petition
9 for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Since
10 the commencement of their cases, the Debtors have been operating their businesses as debtors in
11 possession pursuant to §§ 1107 and 1108.

12 2. Debtor VHS, a California nonprofit public benefit corporation, is the sole
13 corporate member of the following five Debtor California nonprofit public benefit corporations
14 that operate six acute care hospitals, O'Connor Hospital, Saint Louise Regional Hospital, St.
15 Francis Medical Center, St. Vincent Medical Center, Seton Medical Center, and Seton Medical
16 Center Coastside (collectively, the "Hospitals") and other facilities in the state of California.
17 Seton Medical Center and Seton Medical Center Coastside operate under one consolidated acute
18 care license.

19 3. VHS, the Hospitals, and their affiliated entities (collectively, "Verity Health
20 System") operate as a nonprofit health care system, with approximately 1,680 inpatient beds, six
21 active emergency rooms, a trauma center, eleven medical office buildings, and a host of medical
22 specialties, including tertiary and quaternary care.

23 4. The VHS affiliated entities, including the Debtors and non-debtor entities, are as
24 follows:

- 25 • O'Connor Hospital
- 26 • Saint Louise Regional Hospital
- 27 • St. Francis Medical Center
- 28 • St. Vincent Medical Center
- Seton Medical Center, including

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

- 1 • Seton Medical Center Coastside campus
- 2 • Verity Business Services
- 3 • Marillac Insurance Company, Ltd.
- 4 • O'Connor Hospital Foundation
- 5 • Saint Louise Regional Hospital Foundation
- 6 • St. Francis of Lynwood Medical Center Foundation
- 7 • St. Vincent Medical Center Foundation
- 8 • Seton Medical Center Foundation
- 9 • St. Vincent de Paul Ethics Corporation
- 10 • St. Vincent Dialysis Center
- 11 • De Paul Ventures, LLC
- 12 • De Paul Ventures - San Jose Dialysis, LLC
- 13 • De Paul Ventures - San Jose ASC, LLC
- 14 • Verity Medical Foundation
- 15 • Verity Holdings, LLC

16 5. Verity Medical Foundation (“VMF”), incorporated in 2011, is a medical
17 foundation, exempt from licensure under California Health & Safety Code § 1206(l). VMF
18 contracts with physicians and other healthcare professionals to provide high quality,
19 compassionate, patient-centered care to individuals and families throughout California. With
20 more than 100 primary care and specialty physicians, VMF offers medical, surgical and related
21 healthcare services for people of all ages at community-based, multi-specialty clinics
22 conveniently located in areas served by the Debtor Hospitals. VMF holds long-term
23 professional services agreements with the following medical groups: (a) Verity Medical Group;
24 (b) All Care Medical Group, Inc.; (c) CFL Children’s Medical Associates, Inc.; (d) Hunt Spine
25 Institute, Inc.; (e) San Jose Medical Clinic, Inc., D/B/A San Jose Medical Group; and (f) Sports,
26 Orthopedic and Rehabilitation Associates.

27 6. Verity Holdings, LLC (“Holdings”) is a direct subsidiary of its sole member VHS
28 and was created in 2016 to hold and finance VHS’ interests in four medical office buildings
whose tenants are primarily physicians, medical groups, healthcare providers, and certain of the
VHS Hospitals. Holdings’ real estate portfolio includes more than 15 properties. Holdings is
the borrower on approximately \$66.2 Million of non-recourse financing secured by separate

1 deeds of trust and revenue and accounts pledges, including the rents on each medical office
2 building.

3 7. O'Connor Hospital Foundation, Saint Louise Regional Hospital Foundation, St.
4 Francis of Lynwood Medical Center Foundation, St. Vincent Medical Center Foundation, and
5 Seton Medical Center Foundation handle fundraising and grant-making programs for each of
6 their respective Debtor Hospitals.

7 8. As of August 31, 2018, the Debtors have approximately 7,385 employees, of
8 whom 4,733 are full-time employees. Approximately 74% of these employees are represented by
9 collective bargaining units. A majority of the employees are represented by either the Service
10 Employees International Union (approximately 39% of employees) or California Nurses
11 Associations (approximately 22% of employees).

12 9. Each of the Debtors is exempt from federal income taxation as an organization
13 described in Section 501(c)(3) of the Internal Revenue Code of 1986, except for Verity
14 Holdings, LLC, DePaul Ventures, LLC, and DePaul Ventures - San Jose Dialysis, LLC.

15 10. To date, no official committee or examiner has been appointed by the Office of
16 the United States Trustee in these chapter 11 Cases.

17 **B. Historical Challenges**

18 1. The Hospitals and VMF were originally owned and operated by the Daughters of
19 Charity of St. Vincent de Paul, Province of the West (the "Daughters of Charity"), to support the
20 mission of the Catholic Church through a commitment to the sick and poor. The Daughters of
21 Charity began their healthcare mission in California in 1858 and they ministered to ill, poverty-
22 stricken individuals for more than 150 years. In March 1995, the Daughters of Charity merged
23 with Catholic Healthcare West ("CHW"). In June 2001, Daughters of Charity Health System
24 ("DCHS") was formed, and in October 2001, the Daughters of Charity withdrew from CHW. In
25 2002, DCHS commenced operations and was the sole corporate member of the Hospitals, which
26 at that time were California nonprofit religious corporations.
27
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 2. Between 1995 and 2015, the Daughters of Charity and DCHS struggled to find a
2 solution to continuing operating losses, either through a sale of some or all of the hospitals or a
3 merger with a more financially sound partner. All these efforts failed. During these efforts,
4 however, the health system’s losses continued to mount, and the health system borrowed more
5 than \$500 Million—including through a 2008 bond issuance (the “2008 Bonds”)—to fund
6 operations, acquire assets, fund needed capital improvements and/or refinance existing debt.

7 3. Despite continuous efforts to improve operations, operating losses continued to
8 plague the health system due to, among other things, mounting labor costs, low reimbursement
9 rates and the ever-changing healthcare landscape. In 2013, DCHS actively solicited offers for
10 O’Connor Hospital, St. Louise Regional Hospital, Seton Medical Center and Seton Medical
11 Center Coastside. In 2013, to avoid failing debt covenants, the Daughters of Charity Foundation,
12 an organization separate and distinct from DCHS, donated \$130 Million to DCHS to allow it to
13 retire the 2008 Bonds in the total amount of \$143.7 Million.

14 4. In early 2014, DCHS announced that they were beginning a process to evaluate
15 strategic alternatives for the health system. Throughout 2014, DCHS explored offers to sell their
16 hospital system and, in October of 2014, they entered into an agreement with Prime Healthcare
17 Services and Prime Healthcare Foundation (collectively, “Prime”) to sell the health system.
18 However, to keep the hospitals open, DCHS needed to borrow another \$125 Million to mitigate
19 immediate cash needs during the sales process; in other words, to allow DCHS to continue to
20 operate until the sale could be consummated. In early 2015, the California Attorney General
21 consented to the sale to Prime, subject to conditions on that sale that were so onerous that Prime
22 terminated the transaction.

23 5. In 2015, DCHS again marketed their health system for sale, and, again, focused
24 on offers that maintained the health system as a whole, and assumed all the obligations. In July
25 2015, the DCHS Board of Directors selected BlueMountain Capital Management LLC
26 (“BlueMountain”), a private investment firm, to recapitalize its operations and transition
27
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 leadership of the health system to the new Verity Health System (the “BlueMountain
2 Transaction”).

3 6. In connection with the BlueMountain Transaction, BlueMountain agreed to make
4 a capital infusion of \$100 Million to the health system, arrange loans for another \$160 Million to
5 the health system, and manage operations of the health system, with an option to buy the health
6 system at a future time. In addition, the parties entered into a System Restructuring and Support
7 Agreement (the “Restructuring Agreement”), DCHS’s name was changed to Verity Health
8 System, and Integrity Healthcare, LLC (“Integrity”) was formed to carry out the management
9 services under a new management agreement.

10 7. On December 3, 2015, the California Attorney General approved the
11 BlueMountain Transaction, subject to conditions. Despite BlueMountain’s infusion of cash and
12 retention of various consultants and experts to assist in improving cash flow and operations, the
13 health system did not prosper.

14 8. In July 2017, NantWorks, LLC (“NantWorks”) acquired a controlling stake in
15 Integrity. NantWorks brought in a new CEO, CFO, and COO. NantWorks loaned another \$148
16 Million to the Debtors.

17 9. Despite the infusion of capital and new management, it became apparent that the
18 problems facing the Verity Health System were too large to solve without a formal court
19 supervised restructuring. Thus, despite VHS’ great efforts to revitalize its Hospitals and
20 improvements in performance and cash flow, the legacy burden of more than a billion dollars of
21 bond debt and unfunded pension liabilities, an inability to renegotiate collective bargaining
22 agreements or payor contracts, the continuing need for significant capital expenditures for
23 seismic obligations and aging infrastructure, and the general headwinds facing the hospital
24 industry, make success impossible. Losses continue to amount to approximately \$175 Million
25 annually on a cash flow basis.
26
27
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 10. Additional background facts on the Debtors, including an overview of the
2 Debtors' business, information on the Debtors' capital structure and additional events leading up
3 to these chapter 11 cases, are contained in the Declaration of Richard G. Adcock.

4 **C. Critical Vendor Obligations**

5 As life-saving medical service providers, the Debtors are situated in a vulnerable position.
6 Their entire mission could immediately unravel, irreparably harming the Debtors and their
7 patients (the "Patients") absent the continual flow of vital medical services, medical supplies,
8 medical equipment, physicians, nurses, nurse practitioners, physicians assistants, professional
9 technicians such as, imaging technicians, surgical technicians, sterile processing technicians and
10 interim clinical/management staff, coders, admission department staff, as well as non-medical
11 services and information technology support.

12 Additionally, local, state, and federal law places certain compliance requirements on the
13 Debtors. For example, as the operator of hospitals licensed under California state law and
14 certified to participate in the Medicare and Medicaid programs, the Debtors must comply with all
15 hospital licensing and certification requirements, including those found in the Health and Safety
16 Code and in Title 22 of the California Code of Regulations, as well as the applicable Medicare
17 conditions of participation and corresponding Medicaid requirements. *See, e.g.,* Cal. Health &
18 Safety Code §§ 1250 *et seq.*; 22 Cal. Code Regs §§ 70001, *et seq.*; 22 Cal. Code Regs. § 51207;
19 42 C.F.R. §§ 482 *et seq.* In addition to complying with these overarching requirements, the
20 Debtors must monitor and comply with all of the other licensing and operational requirements
21 that apply to the different service lines and programs offered by the hospitals, including, for
22 example, those applicable to the hospital pharmacies and laboratories. *See, e.g.,* Cal. Bus. & Prof.
23 Code §§ 1200 *et seq.*, Cal. Bus. & Prof. Code §§ 4000 *et seq.*, Cal. Health & Safety Code
24 §§ 11000 *et seq.*, 16 Cal. Code Regs. §§ 1700 *et seq.* These extensive, comprehensive
25 regulations and requirements can only be fulfilled through continued, uninterrupted access to
26 essential goods and services. Thus, in order to ensure the timely and proper care of the Patients
27 and maintain ongoing business operations, it is imperative the Debtors are able to rely on a
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 consistent, quality supply of various physicians, nurses, nurse practitioners, physicians assistants,
2 professional technicians such as, imaging technicians, surgical technicians, sterile processing
3 technicians and interim clinical/management staff, coders, admission department staff, as well as
4 certain medical supplies, medical equipment, and services provided by vendors, suppliers and/or
5 service-providers that are “critical” to Patient care and the Debtors’ businesses (the “Critical
6 Vendors”).

7 The Debtors’ Critical Vendors include the following categories of providers:
8 (i) uncompensated care contract physicians and on-call coverage physicians (collectively, the
9 “Uncompensated Care and On-Call Coverage Physicians”); (ii) medical directors (the “Medical
10 Directors”); (iii) medical staff officers and leadership positions (“Medical Leadership”);
11 (iv) physicians providing teaching services (“Physician Educators”); (v) medical services
12 providers (the “Medical Services Providers”); (vi) medical supplies and medical equipment
13 providers (collectively, the “Medical Supplies and Equipment Providers”); (vii) medical staffing
14 agencies and hospital-based services providers (collectively, the “Clinical Staffing”); (viii) non-
15 medical services providers (the “Non-Medical Services Providers”); (ix) information technology
16 services providers (the “IT Services Providers”); and (x) various employee benefits providers (the
17 “Benefits Providers”).

18 The Debtors are mindful of their fiduciary obligations to seek to preserve and maximize
19 the value of their Estates. To that end, the Debtors and their advisors have engaged in an
20 extensive process of reviewing and analyzing the Debtors’ books and records, consulting
21 operations management and purchasing personnel, reviewing contracts and supply agreements,
22 and analyzing applicable laws, regulations, and historical practices to identify business
23 relationships—which, if lost, could materially harm the Debtors’ Patients, the Debtors’
24 businesses, reduce their enterprise value, and/or impair their restructuring process—all in an
25 effort to identify only those most critical vendors using their business judgment (the “Protocol”).
26 Such Protocol is on-going.

1 During the Protocol process, the Debtors have deemed certain vendors as critical because
2 each of these Critical Vendors meets the following criteria: (a) the vendor is essential to Patient
3 care, supports maintaining the Debtors' business in full compliance with California's Title XII
4 requirements for operating general acute care hospitals in the state of California, and allows the
5 Debtors to continue to provide needed patient care and services and maintain their business
6 postpetition until reorganization and/or sale of the Debtors' assets for the benefit of creditors;
7 (b) the vendor is indispensable for providing vital goods or services (such as blood products or
8 surgical implants), replacing said vendor would be prohibitively expensive, or said vendor is
9 otherwise critical to prevent the diversion of management and key personnel to solicit other
10 vendors to provide comparable goods or services and to prevent other unnecessary distraction
11 during the extensive transitional period;⁴ (c) the vendor holds an unpaid prepetition claim for the
12 provision of goods or services; (d) the Debtors believe the vendor will refuse to deliver goods or
13 provide services without payment of the prepetition claim and the automatic stay imposed by
14 § 362(a) will be inadequate to address the issue; (e) cash on delivery is unlikely to provide the
15 requisite incentive for the vendor to continue providing goods or services; (f) the Debtors lack a
16 long-term contractual relationship with the vendor that would oblige the vendor to continue the
17 prepetition relationship, and the Debtors are otherwise without adequate leverage to compel
18 performance on commercially reasonable terms; and (g) the Debtors will suffer immediate and
19 irreparable harm if the vendor is not specially incentivized to continue providing essential goods
20 or services. The Debtors' will use commercially reasonable efforts to require the vendor to sign a
21 postpetition agreement with normalized terms and conditions that contractually bind the vendor to
22
23
24
25

26 ⁴ Additionally, the Debtors acknowledge that while some of these Critical Vendors are not the
27 only vendors in the area that provide these vital goods or services, switching to other providers at
28 this critical juncture will incur substantial time, energy, and unnecessary distraction during the
extensive transitional period.

1 continue providing essential goods and services postpetition (the “Critical Vendor Agreement”).
2 A brief description of each category of Critical Vendors follows.

3
4 **i. Uncompensated Care and On-Call Coverage Physicians**

5 The Debtors require the service of various physicians who provide care to patients who
6 lack the ability to compensate the Debtors for their medical treatment (individually,
7 “Uncompensated Care Contract Physicians”) and the physicians who provide on-call services to
8 cover the Debtors’ six active emergency departments, one of which is an essential Level II
9 Trauma (individually, “On-Call Coverage Physicians”). The Uncompensated Care Contract
10 Physicians routinely provide the following vital Patient services: (i) Emergency Room coverage;
11 (ii) surgical procedures for any Patient who is uninsured or underinsured; (iii) psychiatry; and
12 (iv) cardiac services. The On-Call Coverage Physicians make themselves available to the Debtors
13 for certain periods of time to ensure that a specialist is available at all times for emergency
14 situations, including such emergent conditions as cardiac arrest and immediate trauma. The On-
15 Call Coverage Physicians routinely provide the following areas of expertise: (i) urology;
16 (ii) general surgery; (iii) orthopedics; (iv) cardiology; (v) neurosurgery; (vi) thoracic surgery;
17 (vii) cardiac surgery; (viii) radiation oncology; (ix) neurology, (x) psychiatry; (xi) nephrology;
18 (xii) gastroenterology; (xiii) pediatric surgery; and (xiv) obstetrics. Due to the strong economy
19 and the tight labor market for professionals with expertise, Uncompensated Care and On-Call
20 Coverage Physicians have a vast array of working opportunities available to them, and to the
21 extent the Debtors are unable to ensure payment for prepetition claims, these Uncompensated
22 Care and On-Call Coverage Physicians will work at other hospitals, resulting in a devastating
23 impact on Patient care and irreparable harm to the smooth transition into chapter 11 and
24 preservation and maximization of value for the benefit of the Debtors’ creditors.

25 **ii. Medical Directors**

26 The Debtors require the services of various physicians who serve as Medical Directors. As
27 Medical Directors, it is their responsibility to ensure the hospital provides quality Patient care
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 efficiently and according to local, state, and federal mandates in order to ensure Patient care.
2 These Medical Directors supervise and coordinate the On-Call Coverage Physicians, provide vital
3 operating and administrative services, such as supervision of certain departments or programs,
4 including but not limited to, (i) the Long Term & Sub-Acute Unit; (ii) Advanced Wound Care;
5 (iii) the Comprehensive Spine Care Program; (iv) the Stroke Program; (v) Cardiac & Pulmonary
6 Rehabilitation; (vi) Oncology; (vii) Non-Invasive Cardiology; (viii) Radiation Therapy; (ix) the
7 Intensive Care Unit and Neonatal Intensive Care Unit; (x) the Antimicrobial Stewardship
8 Program; (xi) Interventional Neurology; (xii) the Bioethics Program; (xiii) the Catherization
9 Laboratory; (xiv) the Skilled Nursing Facility, the Stroke Program; (xv) Thoracic Surgery; (xvi)
10 the Dialysis Center; and (xvii) Nuclear Medicine and Vascular Laboratory. They also are vital for
11 program quality, oversight, and risk management. There are approximately 60 physicians serving
12 as Medical Directors. Similar to the Uncompensated Care and On-Call Coverage Physicians, and
13 due to the strong economy and the tight labor market for professionals with expertise, Medical
14 Directors are in demand and have a vast array of working opportunities available to them. To the
15 extent the Debtors are unable to ensure payment for prepetition claims to Medical Directors, these
16 Medical Directors will work at other hospitals, resulting in a devastating impact on Patient care
17 and irreparable harm to the smooth transition into chapter 11 and preservation and maximization
18 of value for the benefit of the Debtors' creditors.

19 **iii. Medical Leadership**

20 The Debtors require the services of various physicians who serve as medical staff officers
21 and in other leadership positions, as required by each Hospital's accreditation with The Joint
22 Commission (the "TJC"). Medical Leadership includes the Chiefs of Staff and all Department
23 Chairs required by each of the Debtors' Medical Staff Bylaws, and by Title 22, including
24 physician oversight for cardiology, pulmonary, laboratory, stroke, and ST-elevation myocardial
25 infarction departments. The Chief Medical Officers are essential to ensure quality and risk
26 oversight. Without these physicians, who can easily find competitive opportunities elsewhere, the
27 Debtors' will suffer irreparable harm to the Debtors' chapter 11 Case.
28

1 **iv. Physician Educators**

2 The Debtors require the services of various physicians who provide teaching services in
3 the Debtors' graduate medical education (the "GME") program, a legal requirement with which
4 the Debtors must comply. The GME program simultaneously provides: (i) training for interns,
5 residents, and fellows until they become independent and licensed physicians; and (ii) access to
6 healthcare for elderly and impoverished Patients. Physician Educators are in high demand
7 because the State of California mandates that every teaching hospital support the efforts to
8 provide access to high quality healthcare to its most vulnerable population. To maintain Level II
9 Trauma status, the Debtors must maintain the GME program. Therefore, Physician Educators are
10 vital to maintaining the Debtors' teaching hospital status and affording access to healthcare, both
11 of which are key to the Debtors' Patient care and ongoing operations and/or potential sale of its
12 assets for the benefit of its creditors and the Estates.

13 **v. Medical Services Providers**

14 The Debtors require the services of various Medical Services Providers, including, but not
15 limited to, those who provide services such as surgical anesthesia coverage, organ harvesting and
16 organ matching services, medical equipment sanitization, diagnostic interventional cardiology
17 services, interventional neuroradiology, imaging services, advanced wound care, pathology and
18 laboratory services, dialysis services, lithotripsy services, sterile compounding services,
19 rehabilitation staffing and management services, subacute management services, psychiatric
20 management services, hospitalist services, intensivist program services, medical screening
21 services, and medical instrument repair services. These services are vital to the Debtors. The
22 Debtor will suffer immediate irreparable harm should the Court deny the Debtors' request to
23 include the Medical Services Providers as Critical Vendors subject to payment on prepetition
24 claims.

25 **vi. Medical Supplies and Equipment Providers**

26 The Debtors require the use of various medical supplies and medical equipment,
27 including, but not limited to, blood and plasma, heart valves, coronary intervention products,
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 defibrillators, laparoscopic and minimally invasive surgical supplies, neurosurgical supplies and
2 neurology devices, other surgical medical products, bone substitute biologics, regenerative
3 vascular grafts, vaccinations and other pharmaceuticals, nuclear medicines, medical gases,
4 anesthesia medical equipment, laboratory medical supplies, radiation equipment, gastrointestinal
5 supplies, cochlear implants, orthopedic implants, spinal implants, intraocular lenses and
6 ophthalmology supplies, sterilization equipment and products, and fetal monitoring systems.
7 Equipment includes medical equipment rentals, biomedical repair tools and equipment, patient
8 beds and stretchers, vital sign monitoring, infusion pumps, medication supply stations, gastro-
9 intestinal lab equipment, cardiac catheterization lab equipment, operating room equipment, imaging
10 equipment, laboratory equipment, pharmacy dispensing equipment, and transplant program
11 equipment. The medical supplies and medical equipment the Debtors receive from the Medical
12 Supplies and Equipment Providers are vital to the Debtors. The Debtors will suffer immediate
13 irreparable harm should the Court not grant the Debtors' request to include the Medical Supplies
14 and Equipment Providers as Critical Vendors subject to payment on prepetition claims.

15 **vii. Clinical Staffing**

16 The Debtors require various medical staffing agencies and other hospital-based services
17 providers to provide nurses, nurse practitioners, physicians assistants, professional technicians
18 such as, imaging technicians, surgical technicians, sterile processing technicians and interim
19 clinical/management staff, coders, and admission department staff.

20 Additionally, regarding the provision of nurses, the staffing supplementation is essential
21 because: (1) California has a mandatory statutory nurse to patient ratio, and so the Debtors are
22 required by law to meet certain ratios in order to operate on a daily basis; and (2) it is difficult to
23 recruit experienced staff—as opposed to recent graduates—for short-term assignments. Indeed,
24 these staffing agencies provide the requisite “registry” nurses who take short single-day
25 assignments and “traveler” nurses who take longer-term assignments to fill in during busier
26 seasons—*e.g.*, flu season—and understaffed periods—*e.g.*, during nurses strikes of represented
27
28

1 nurses—where the Debtors may not otherwise have sufficient numbers of nurses between their
2 core and per diem nurses.

3 Moreover, many of the Clinical Staffing who provide physicians, nurses, nurse
4 practitioners, physicians assistants, professional technicians such as, imaging technicians, surgical
5 technicians, sterile processing technicians and interim clinical/management staff, coders, and
6 admission department staff to the Debtors will not staff the Debtors' business if there is any
7 interruption or delay in the payment of the amounts due to them. Given the Debtors' reliance on
8 the medical services provided by the Clinical Staffing to provide Patient care and otherwise fulfill
9 the Debtors' daily medical services needs, and the fact that the Clinical Staffing can simply shift
10 their services to a medical services company, it is crucial that the Debtors be authorized to pay
11 any prepetition amounts due to the Clinical Staffing as Critical Vendors in the ordinary course of
12 business.

13 **viii. Non-Medical Services Providers**

14 The Debtors require services of various non-medical service providers, including, but not
15 limited to, those who provide services such as payroll tax services, financial audit services, billing
16 services, cost reporting services, revenue cycle management services, consulting and education
17 services for various required national, state, and local accreditations and mandates, environmental
18 services, record retention services, building maintenance services, medical equipment
19 maintenance services, management services, and other similar services, as well as to seismic
20 contractors. Seismic contractors are designers, engineers, suppliers and constructors who are
21 engaged in the statutory work of retrofitting hospital structures to meet the SB1953 and
22 subsequent amendments that are required to be completed by December 31, 2019. Delay of the
23 projects will cause the Debtors to miss the regulated deadlines risking California Department of
24 Public Health license and suspension of such. These non-medical services are vital to the
25 Debtors' day-to-day operations and the Debtors' ability to comply with regulatory requirements
26 set by the State of California legislature, and the Debtors will suffer immediate irreparable harm
27
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 should the Court not grant the Debtors' request to include the Non-Medical Services Providers as
2 Critical Vendors.

3 **ix. IT Services Providers**

4 The Debtors require use of various information technology services, including, but not
5 limited to, those who provide services such as diagnostic technology, interoperability between
6 devices, risk management and software services, revenue cycle management billing software and
7 services, teleradiology services, customer relationship management, networking solutions
8 services, multi-function copiers, voice over internet protocol system services, hosting services for
9 applications, and point of care data management system services. Critical patient care systems
10 such as electronic health record systems and enterprise resource planning systems must be
11 maintained to ensure continuity of patient care. These information technology services are vital to
12 the Debtors' day-to-day operations, and the Debtor will suffer immediate irreparable harm should
13 the Court not grant the Debtors' request to include the IT Services Providers as Critical Vendors
14 subject to payment on prepetition claims.

15 **x. Benefits Providers**

16 The Debtors have incentivized their employees to continue working through the
17 continuation of company-subsidized benefits, such as workers compensation, medical, dental,
18 vision, short term and long term care, leave of absence, and life insurance. If the Debtors are not
19 permitted to pay any prepetition premium amounts due to these Benefits Providers, the
20 employees' insurance coverage will be jeopardized and the employees will likely seek
21 employment elsewhere. Specifically, any disruption to payment of the employee benefits in the
22 ordinary course (and in the Debtors' discretion), would adversely affect the Debtors' goals in this
23 Case because such events are likely to cause some employees to terminate their employment with
24 the Debtors, will cause all employees to be distracted from their duties to care for the Patients and
25 the operations of the Hospitals, and will inevitably hurt employee morale at a particularly
26 sensitive time for all employees, resulting in severe repercussions on the Debtors' ability to
27 provide Patient care, and to preserve their assets and administer the Estates, to the detriment of all
28

1 constituencies. Since the Debtors do not have the ability to quickly or cost-effectively replace
2 their employees who provide vital medical and non-medical services on a daily basis, it is critical
3 that the Debtors be allowed to continue these benefits in order to retain their employees and
4 maintain their business operations to preserve the full value of their assets for the benefit of their
5 creditors. Therefore, the Court should include Benefits Providers as Critical Vendors.

6 **IV. RELIEF REQUESTED**

7 By this Motion, the Debtors seek authority to continue to pay and/or honor the prepetition
8 claims of the Uncompensated Care and On-Call Coverage Physicians, the Medical Directors, the
9 Medical Leadership, the Physician Educators, the Medical Services Providers, the Medical
10 Supplies and Equipment Providers, the Clinical Staffing, the Non-Medical Services Providers, the
11 IT Services Providers, and the Benefits Providers as Critical Vendors, up to \$20 Million (the
12 “Critical Vendor Cap”), with (i) an interim amount of up to \$5 Million and only as needed to
13 avoid immediate and irreparable harm; and (ii) an additional amount of up to \$15 Million and
14 only as needed to avoid immediate and irreparable harm—as mentioned in the Declaration of
15 Richard Adcock in Support of the Emergency Motions filed concurrently herewith (the “Adcock
16 Declaration”), and in the Debtors’ discretion and in the ordinary course of the Debtors’ business,
17 and pursuant to a carefully-designed Protocol overseen by a core, centralized team consisting of
18 senior members of Debtors’ management and professional advisors. Specifically, the Debtors
19 seek entry of an interim order (substantially in the form attached hereto as Exhibit “A”, the
20 “Interim Order”) authorizing, but not directing, the Debtors to continue to pay and/or honor the
21 prepetition claims (after an interim hearing, in an interim amount of up to \$5 Million and only as
22 needed to avoid immediate and irreparable harm), and entry of a final order within thirty (30)
23 days after filing the above-captioned chapter 11 bankruptcy cases (the “Final Order”, together
24 with the Interim Order, the “Critical Vendors Order”) authorizing, but not directing, the Debtors
25 to continue to pay and/or honor the prepetition claims (after a final hearing, in an amount up to an
26 additional \$15 Million, for a total of up to \$20 Million and only as needed to avoid immediate and
27 irreparable harm), of their Critical Vendors. The amounts proposed to be paid to the Critical
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 Vendors are already provided for in the Debtors' operating budget (the "Budget") submitted in
2 connection with the Debtors' motion for authority to use cash collateral and to obtain debtors in
3 possession financing from the Debtors' senior secured lender (the "Cash Collateral Motion")
4 which is supported by the Declaration of Anita M. Chou (the "Chou Declaration") filed
5 concurrently herewith.

6 Regarding the Protocol, there shall be a Critical Vendor Cap of \$20 Million, which will be
7 the most the Debtors may pay to the Critical Vendors. The Debtors, at their discretion, using their
8 business judgment, and pursuant to the Protocol, shall pay the Critical Vendors, subject to certain
9 accountability requirements (the "Accountability Requirements"). The Accountability
10 Requirements shall include: (i) filing under seal a report on a monthly basis that details the
11 Critical Vendor payments (the "Interim Critical Vendors Report"), with a final report filed under
12 seal once the cap has been met (the "Final Critical Vendors Report"), with viewing privileges
13 only for the Debtors, the Official Committee of Unsecured Creditors, and the United States
14 Trustee, to include: (a) a list of the Critical Vendors; (b) the amount paid to each individual
15 Critical Vendor; (c) a description of the supplies or services provided to the Debtors; and (d) an
16 explanation for how each payment was determined by the carefully-designed Protocol overseen
17 by a core, centralized team consisting of senior members of Debtors' management and
18 professional advisors;⁵ (ii) an *in camera* hearing during which the Court may review the
19 foregoing information in the presence of the Debtors, the Official Committee of Unsecured
20 Creditors, and the United States Trustee; and (iii) if there is an objection to any payment by any
21 party in interest, such objection may be heard by this Court at a hearing in open court.
22 Furthermore, to ensure timely payment to Critical Vendors, the Debtors propose that the Interim
23 Order be issued, subject to final approval by the Court in the Final Order, each of which provides
24 authorization for the Debtors to make rolling payment of (i) an interim amount of up to \$5

25 _____
26 ⁵ Due to the sensitive nature of certain confidential proprietary data, this material will be filed
27 under seal. Furthermore, the Debtors believe that keeping the identity of potential Critical
28 Vendors confidential may assist in reducing the number of prepetition claims that must be paid in
order to continue receiving critical goods and services. Accordingly, a schedule of Critical
Vendors will not be made publicly available.

1 Million; and (ii) an additional final amount of up to \$15 Million, towards the prepetition claims
2 (up to the Critical Vendor Cap) to Critical Vendors.

3 As a safeguard to the Debtors' Patients, other creditors, and the Estates, the Debtors
4 propose certain terms and conditions (the "Terms and Conditions") of the payment to the Critical
5 Vendors if a Critical Vendor, after signing the Critical Vendor Agreement, thereafter refuses to
6 supply the critical goods or services to the Debtor throughout the course of the bankruptcy
7 proceeding, as provided under the Critical Vendor Agreement (the "Defaulting Vendor"). These
8 Terms and Conditions allow the Debtors: (i) to deem such payment to the Defaulting Vendor as a
9 voidable postpetition transfer pursuant to § 549(a); and (ii) to demand the immediate return of any
10 and all payments made to the Defaulting Vendor pursuant to this Motion, to the extent that the
11 aggregate amount of such payments exceeds the postpetition obligations then outstanding without
12 giving effect to alleged setoff rights, recoupment rights, adjustments, or setoffs of any type
13 whatsoever, and the Defaulting Vendor's prepetition claim shall be reinstated in such an amount
14 as to restore the Debtors and the Defaulting Vendor to their original positions, as if the Critical
15 Vendor Agreement had never been entered into and the payment of the Defaulting Vendor's
16 prepetition claim had not been made. In short, the Debtors will return the parties to their positions
17 immediately prior to the entry of the order approving the relief sought herein.

18 The Debtors also request that all applicable banks and other financial institutions be
19 authorized to receive, process, honor, and pay all checks presented for payment of, and to honor
20 all fund transfer requests made by the Debtors related to, the claims that the Debtors request
21 authority to pay in this Motion, regardless of whether the checks were presented or fund transfer
22 requests were submitted before or after the Petition Date, provided, however, that: (i) funds are
23 available in the Debtors' accounts to cover the checks and fund transfers; and (ii) all of the banks
24 and other financial institutions are authorized to rely on the Debtors' designation of any particular
25 check as approved by the attached proposed Interim Order.

26 The Debtors respectfully submit that the relief requested herein is necessary and
27 appropriate to ensure a smooth transition into chapter 11 and maintain high-quality patient care,
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 to normalize and maintain existing relationships with the Debtors' Critical Vendors during the
2 turbulent early stages of this bankruptcy case, and to preserve and maximize value for the benefit
3 of the Debtors' creditors. One of the keys to the Debtors' successful sales or reorganization will
4 be maintaining harmonious relationships with their employees, medical services providers, most
5 critical vendors, and customers, and preserving the quality of patient care and ultimately the
6 going-concern value of the Debtors' business. The Debtors rely heavily upon these supplies and
7 services provided by the Critical Vendors to fulfill the Debtors' daily medical services needs.

8 Failure to make payment to the Critical Vendors on their prepetition claims will result in
9 harm to the Debtors' Patients, as well as the Debtors being unable to fulfill their medical services
10 needs, resulting in a substantial loss of revenue. Accordingly, it is crucial that the Debtors be
11 authorized to continue to pay and/or honor the prepetition claims—in (i) an interim amount of up
12 to \$5 Million; and (ii) an additional final amount of up to \$15 Million, for a total amount of \$20
13 Million—to the Critical Vendors, in the ordinary course of the Debtors' business and at the
14 Debtors' discretion, pursuant to the Protocol, and pursuant to the Interim Order and the Final
15 Order.

16 As noted in the Adcock Declaration, the Debtors intend to market and sell some or all of
17 their assets, therefore, the Debtors need to maintain their business operations and preserve the
18 value of their assets, which in turn, requires the Debtors to preserve their existing relationships
19 with their Critical Vendors and to retain their employees.

20 Additionally, the Debtors anticipate that the mere filing of their bankruptcy cases will
21 raise concerns among the Debtors' Patients, vendors, employees, and other parties in interest
22 within the medical services industry. The Debtors' vendors will understandably be concerned that
23 the Debtors will not be able to continue paying the amounts due to them, and the Debtors'
24 Patients will be concerned that the Debtors will not be able to fulfill their medical services, due to
25 the Debtors' financial condition. The Debtors' vendors and Patients may therefore look to shift
26 their business elsewhere, and the automatic stay imposed by § 362(a) will be inadequate to
27 address the issue. The Debtors believe that the most effective way to counter these perceptions
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 and concerns within their industry is to continue to make payments to their most critical vendors,
2 in the ordinary course of their business, in accordance with the Debtors' Protocol, the Interim
3 Order, and the Budget submitted with the Cash Collateral Motion filed concurrently herewith, at
4 least in the immediate term.⁶

5 The Debtors' Budget already includes the proposed payments to the Critical Vendors,
6 which payments are set forth in **Exhibit "2"** to the Chou Declaration. The Debtors' goals in these
7 chapter 11 cases are to facilitate an orderly administration of their bankruptcy cases and to
8 maintain efficient and seamless operations for the benefit of the Patients who seek medical care in
9 the hospitals, medical centers, and clinics operated by the Debtors in order to maximize the value
10 of their assets for the benefit of all stakeholders. Accordingly, it is imperative to the
11 accomplishment of the Debtors' goals in these cases that the Debtors minimize any adverse
12 impact of the chapter 11 filing on the Debtors' workforce, on the Patients, on the operations of the
13 Hospitals, and on the orderly administration of these Cases.

14 Accordingly, the Debtors respectfully request that the Court grant the Motion.

15 **V. DISCUSSION**

16 By this Motion, the Debtors seek to protect their Patients and preserve and maintain their
17 relationships with their Critical Vendors, employees, physicians, nurses, nurse practitioners,
18 physicians assistants, professional technicians such as, imaging technicians, surgical technicians,
19 sterile processing technicians and interim clinical/management staff, coders, and admission
20 department staff during the turbulent early stages of their bankruptcy case in order to preserve the
21 reputation of the Debtors' business and the value of the Debtors' assets. Such action has been
22 recognized as a legitimate practice in bankruptcy proceedings by the Supreme Court. *Czyzewski v.*
23 *Jevic Holding Corp.*, 137 S. Ct. 973, 985, 197 L. Ed. 2d 398 (2017) (listing critical vendor orders
24 that allow payment of essential supplier prepetition invoices as legitimate exceptions to the
25

26
27 _____
28 ⁶ A true and correct copy of the Budget is attached as an exhibit to the Debtors' Cash Collateral
Motion filed concurrently herewith.

1 common priority scheme).⁷ Indeed, the Supreme Court reasoned that critical vendor orders
2 supported “significant Code-related objectives.” *Id.* In *Jevic*, the Supreme Court offered several
3 appropriate considerations for courts in determining whether to grant motions for payment of
4 critical vendors: (a) preserve the debtor as a going concern; (b) make the disfavored creditors
5 better off; (c) promote the possibility of a confirmable plan; (d) restore the status quo *ante*; or (e)
6 protect reliance interests. *Id.*⁸ Granting the Debtors’ Motion will meet these objectives, and is
7 authorized pursuant to the Court’s powers under § 105(a). 11 U.S.C. § 105 (“The court may issue
8 any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the
9 Bankruptcy Code].”).

10 Furthermore, bankruptcy judges in this district have routinely granted similar critical
11 vendors motions. *See, e.g.*, Order (A) Authorizing the Debtor to Pay Prepetition Claims of
12 Emergency Room Doctors, Medical Director Doctors, and Nursing Registries who are Critical
13 Service Providers and (B) Directing the Applicable Bank to Pay All Checks and Electronic
14 Payment Requests Made by the Debtor Relating to the Foregoing, *In re Victor Valley Community*
15 *Hospital*, No. 6:10-bk-39537-CB (Bankr. C.D. Cal. Sept. 17, 2010) (No. 34); Final DIP Order (A)
16 Authorizing Debtor to Obtain Postpetition Financing; (B) Granting Superpriority Expense Claims
17 and Security Interests; and (C) Granting Other Relief Under 11 U.S.C. §§ 105, 361, 362, 363 and
18 364, F.R.B.P. 2002 and 4001; and LBRs 2002-1 and 4001-2 at 14, 33, *In re Downey Regional*
19 *Medical Center-Hosp., Inc.*, No. 2009-BK-34714-BB (Bankr. C.D. Cal. Oct. 19, 2009) (No. 148)
20 (J. Bluebond) (allowing for process to pay “critical vendor claims”); Order Authorizing The
21 Debtor To Pay Prepetition Claims Of Critical Vendors, at 2, *American Suzuki Motor Corporation*,
22 No. 8:12-bk-22808-SC (Bankr C.D. Cal. Nov. 7, 2012) (No. 69) (J. Clarkson) (“The Debtor is
23 authorized, but not directed, to pay in its sole discretion the prepetition claims of Critical Vendors

24 _____
25 ⁷ Some have misconstrued *Matter of B & W Enterprises, Inc.*, 713 F.2d 534 (9th Cir. 1983) as
26 prohibiting Critical Vendors Motions altogether. Such notions are contrary to the Supreme
27 Court’s analysis in *Jevic*. Instead, *B & W Enterprises, Inc.* should be narrowly construed: the
28 debtor may not use 11 U.S.C. § 510 to subvert the Bankruptcy Code’s priority scheme without
evidence of misconduct by the creditor not receiving payment on prepetition expenses. *Matter of*
B & W Enterprises, Inc., 713 F.2d at 537.

⁸ This list is non-exhaustive.

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 in the ordinary course of the Debtor’s business relating to undisputed prepetition claims that the
2 Debtor, in its business judgment, determines is necessary and appropriate for the operation of its
3 business); Final Order Authorizing: 1) the Debtors to Pay Prepetition Lien Claimants; and 2)
4 Certain Financing Institutions to Honor All Related Checks and Electronic Payment Request at 2,
5 *California Coastal Communities, Inc.*, No. 8:09-bk-21712-TA (Bankr. C.D. Cal. Dec. 9, 2009)
6 (No. 87) (J. Albert) (granting “critical vendor” motion and authorizing vendors “to continue
7 supplying goods and services to the Debtors on the same trade terms given to them prior to the
8 Petition Date or upon such other agreed trade terms as the Debtor may recommend”); Order
9 Granting Evergreen Oil, Inc.’s Emergency Motion For Entry Of An Order Authorizing Debtor To
10 Honor Pre-Petition Obligations To Critical Vendors And To Continue Vendor Programs at 2, *In*
11 *re Evergreen Oil, Inc.*, No. 8:13-bk-13163 (Bankr. C.D. Cal. Apr. 10, 2013) (No. 32) (J.
12 Clarkson) (granting critical vendors motion); Order Granting Debtor’s Emergency First Day
13 Motion for an Order Authorizing Debtor to Pay Pre-Petition Claims of Certain Critical Vendors at
14 2, *In re HDOS Enterprises*, No. 2:14-BK-12028-NB (Bankr. C.D. Cal. Feb. 6, 2014) (No. 66) (J.
15 Bason) (granting critical vendors motion); Order Granting Motion For Entry Of An Order
16 Authorizing Debtor To Honor Pre-Petition Obligations To Critical Vendors, *In re Green Fleet*
17 *Systems, LLC*, No. 2:15-bk-11542-BR (Bankr. C.D. Cal. Mar. 16, 2015) (No. 81) (J. Russell)
18 (granting critical vendors motion).

19 Allowing a debtor to honor prepetition obligations under §105(a) authority is appropriate
20 where, as here, doing so is consistent with the “two recognized policies” of chapter 11 of the
21 Bankruptcy Code—preserving going concern value and maximizing property available to satisfy
22 creditors. *See Bank of Am. Nat’l Trust & Sav. Assoc. v. 203 N. LaSalle St. P’Ship*, 526 U.S. 434,
23 453 (1999).

24 Moreover, the amount of the Critical Vendor Cap is reasonable—up to \$20 Million. In
25 other cases of similar magnitude but with much less at stake than the lives of Patients, such as for
26 grocery chains like *In re The Great Atlantic & Pacific Tea Co., et. al* and *In re Tops Holding II*
27 *Corporation, et. al.*, courts have allowed significantly higher amounts. See Final Order
28

1 Authorizing Debtors to Pay Certain Prepetition Claims of Critical Vendors and Section 503(b)(9)
2 Claims, Approving Related Procedures, and Granting Related Relief, *In re The Great Atlantic &*
3 *Pacific Tea Co., et al.*, No. 10-24549-RDD (Bankr. S.D.N.Y. Jan. 13, 2011) (No. 504)
4 (authorizing payment of up to \$62 Million to critical vendors); Order signed Authorizing Debtors
5 to Pay Certain Prepetition Obligations to Critical Vendors, Approving Related Procedures and
6 Granting Related Relief at 3, *In re Tops Holding II Corporation, et al.*, No. 18-22279-RDD
7 (Bankr. S.D.N.Y. Mar. 22, 2018) (No. 181) (authorizing payment of up to \$36 Million to critical
8 vendor cap).

9 Recognizing that, as here, payment of certain prepetition claims may be required to
10 achieve legislative goals of preserving going concern value and maximizing the property
11 available to satisfy creditors, bankruptcy courts have granted relief consistent with the relief
12 requested herein for similarly-situated debtors. *See, e.g.*, Interim Order Authorizing Debtors to
13 Pay Certain Prepetition Claims of Critical Vendors and Section 503(b)(9) Claims, Approving
14 Related Procedures, and Granting Related Relief, *In re The Great Atlantic & Pacific Tea Co., et*
15 *al.*, (Bankr. S.D.N.Y. Dec. 14, 2010) (No. 55) (interim and final orders authorizing payment of up
16 to \$62 Million on account of claims held by critical vendors); Interim Order Pursuant to 11
17 U.S.C. §§ 105(a), 363(b) And 503(b)(9) (i) Authorizing, But Not Directing, Debtors to Pay
18 Prepetition Obligations of Critical Vendors, and (ii) Authorizing and Directing Financial
19 Institutions to Honor and Process Related Checks and Transfers and Order Pursuant to 11 U.S.C.
20 §§ 503(b)(9) And 105(a) (i) Approving Procedures for the Assertion, Resolution, and Satisfaction
21 of Claims Asserted Pursuant to 11 U.S.C. § 503(b)(9) and (ii) Prohibiting Vendors from Pursuing
22 Such Claims Outside the Procedures at 4, *In re Chassix Holdings, Inc.*, No. 15-10578 (Bankr.
23 S.D.N.Y. Mar. 13, 2015) (No. 85) (interim order authorizing payment of up to \$5 Million on
24 account of claims held by critical vendors); Order Approving Procedures for the Assertion,
25 Resolution, and Satisfaction of Claims Asserted and Prohibiting Vendors from Pursuing Such
26 Claims Outside the Procedures, *In re Chassix Holdings, Inc.*, No. 15-10578 (Bankr. S.D.N.Y.
27 Apr. 14, 2015) (No. 275) (final order authorizing payment of up to \$40 Million on account of
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 claims held by critical vendors) (citing Motion of Debtors Pursuant to 11 U.S.C. §§ 105(a),
2 363(b) and 503(b)(9) for Entry of Order (I) Authorizing, But Not Directing, Debtors to Pay
3 Prepetition Obligations of Critical Vendors, and (II) Authorizing and Directing Financial
4 Institutions to Honor and Process Related Checks and Transfers at 12, *id.* (Bankr. S.D.N.Y. Mar.
5 12, 2015) (No. 24)); Interim Order Authorizing the Debtors to Pay the Pre-petition Claims of
6 Certain Essential Suppliers and Service Providers and Granting Certain Related Relief; *In re*
7 *Hostess Brands, Inc.*, No. 12-22052 (Jan. 13, 2012) (No. 76) (interim and final orders authorizing
8 payment of up to \$14 Million on account of claims held by critical vendors); Order Granting
9 Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b) and 503(b)(9)
10 of the Bankruptcy Code, for Interim and Final Orders Authorizing Them to Pay the Prepetition
11 Claims of Certain Essential Suppliers and Service Providers and Granting Certain Related Relief,
12 *In re Hostess Brands, Inc.*, No. 12-22052 (Jan. 27, 2012) (No. 196) (interim and final orders
13 authorizing payment of up to \$14 Million on account of claims held by critical vendors); Final
14 Orders Authorizing Debtors to Pay Certain Prepetition Claims of Critical Vendors and Lien
15 Claimants, Approving Related Procedures and Authorizing and Directing All Financial
16 Institutions to Honor All Related Payment Requests at 3, *In re The Readers Digest Ass'n, Inc.*,
17 No. 09-23529 (Bankr. S.D.N.Y. Sept. 17, 2009) (No. 91) (authorizing payment of up to \$25
18 Million to critical vendors).

19 The Debtors also move under §§ 363, 503, and/or 549, as more fully discussed below.

20 Moreover, local, state, and federal law places certain compliance requirements on the
21 Debtors, which can only be fulfilled through continued, uninterrupted access to various goods and
22 services these Critical Vendors provide. More specifically, as outlined above, as the operator of
23 hospitals licensed under California state law and certified to participate in the Medicare and
24 Medicaid programs, the Debtors must comply with all hospital licensing and certification
25 requirements, including those found in the Health and Safety Code and in Title 22 of the
26 California Code of Regulations, as well as the applicable Medicare conditions of participation and
27 corresponding Medicaid requirements. *See, e.g.*, Cal. Health & Safety Code §§ 1250 *et seq.*; 22
28

1 Cal. Code Regs §§ 70001, *et seq.*; 22 Cal. Code Regs. § 51207; 42 C.F.R. §§ 482 *et. seq.* In
2 addition to complying with these overarching requirements, the Debtors must monitor and
3 comply with all of the other licensing and operational requirements that apply to the different
4 service lines and programs offered by the hospitals, including, for example, those applicable to
5 the hospital pharmacies and laboratories. *See, e.g.*, Cal. Bus. & Prof. Code §§ 1200 *et. seq.*, Cal.
6 Bus. & Prof. Code §§ 4000 *et. seq.*, Cal. Health & Safety Code §§ 11000 *et. seq.*, 16 Cal. Code
7 Regs. §§ 1700 *et. seq.* These extensive, comprehensive requirements must be met in order to
8 ensure that the Hospitals can continue to operate in a compliant fashion, delivering quality health
9 care to the patients and communities they service. The Debtors require the assistance of its
10 Critical Vendors in order to do so. It is imperative the Debtors are able to rely on a consistent,
11 quality supply of the Critical Vendors.

12 **i. Section 363 Allows the Debtors to Honor Critical Vendor’s Prepetition**
13 **Claims Under the Business Judgment Rule**

14 Section 363, which permits a debtor in possession to use, sell, or lease estate property,
15 provides authority for the Debtors to continue to pay and/or honor the prepetition claims (up to
16 the Critical Vendor Cap)—with (i) an interim amount of up to \$5 Million; and (ii) an additional
17 amount of up to \$15 Million, for a total of \$20 Million—of the Critical Vendors, in the amounts
18 set forth in the Budget attached to the Chou Declaration, in the ordinary course of the Debtors’
19 business and in the Debtors’ discretion, and pursuant to the Protocol. Under § 363 a court may
20 authorize a debtor in possession to expend funds outside the ordinary course of business where, in
21 the debtor’s judgment, the expenditure is in the best interest of the bankruptcy estate. *See e.g.*,
22 Order signed Authorizing Debtors to Pay Certain Prepetition Obligations to Critical Vendors,
23 Approving Related Procedures and Granting Related Relief at 3, *In re Tops Holding II*
24 *Corporation, et al.*, (Bankr. S.D.N.Y. Mar. 22, 2018) (No. 181) (authorizing the debtors under §
25 363 to use their sole reasonable business judgment to pay critical vendors up to a \$36 Million
26 critical vendor cap).

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 Other courts have reached similar conclusions in other factual scenarios related to
2 prepetition debts. For example, the Ninth Circuit Court of Appeals has permitted the payment of
3 prepetition debts when necessary for rehabilitation. *See Burchinal v. Central Washington Bank*
4 (*In re Adams Apple, Inc.*), 829 F.2d 1484, 1490 (9th Cir. 1987) (“Cases have permitted unequal
5 treatment of pre-petition debts when necessary for rehabilitation, in such contexts as (i) pre-
6 petition wages to key employees; (ii) hospital malpractice premiums incurred prior to filing; (iii)
7 debts to providers of unique and irreplaceable supplies; and (iv) peripheral benefits under labor
8 contracts.”). Similarly, in *In re Structuralite Plastics Corp.*, 86 B.R. 922, 932 (Bankr. S.D. Ohio
9 1988), the court found that payment of prepetition claims was justified where otherwise the
10 Debtors’ rehabilitative effort would have been immediately aborted. *See also Armstrong World*
11 *Indus., Inc. v. James A. Phillips, Inc. (In re James A. Phillips, Inc.)*, 29 B.R. 391, 397 (S.D.N.Y.
12 1983) (relying on § 363 to allow contractor to pay prepetition claims for suppliers).

13 The Debtors have determined, in the exercise of their business judgment, that continuing
14 to pay and/or honor the prepetition claims (up to the Critical Vendor Cap) of the Critical Vendors
15 in the amounts set forth in the Budget attached to the Chou Declaration, in the Debtors’ discretion
16 and pursuant to the Protocol, is in the overwhelming best interests of their Estates. Granting the
17 Debtors the authority to pay and/or honor such prepetition claims (up to the Critical Vendor Cap)
18 greatly benefits the Estates by preserving the Debtors’ relationships with their most critical
19 vendors and employees, without whom the Debtors cannot adequately provide medical services
20 or comply with statutory requirements necessary for certification, and by maintaining the value of
21 the company, so that the Debtors can continue business operations while they continue upon a
22 marketing and sale process for their business.

23 Simply put, if the Debtors are not permitted to continue making and/or honoring the
24 prepetition claims of the Critical Vendors, the Debtors will not be able to provide medical
25 services or meet the requirements of local, state, and federal law, such as the federal Medicare
26 program, California’s Title XII requirements, or 22 Cal. Code Regs §§ 70001, *et seq.*, Cal. Health
27 & Safety Code §§ 1250 *et seq.*, and the Debtors will be unable to generate sufficient revenue to
28

1 continue their business operations. This, in turn, will drastically and negatively impact the value
2 of the Debtors' business as a going-concern (and correspondingly, the value of the Debtors'
3 assets), jeopardize the Debtors' ability to sell their business and assets, and potentially eliminate
4 the Debtors' ability to successfully reorganize in this case.

5 The decision to pay Critical Vendors is a valid exercise of the Debtors' business
6 judgment. The business judgment rule is satisfied where "the directors of a corporation acted on
7 an informed basis, in good faith and in the honest belief that the action taken was in the best
8 interests of the company." *See, e.g., Official Comm. of Subordinated Bondholders v. Integrated*
9 *Res., Inc. (In re Integrated Res., Inc.)*, 147 B.R. 650, 656 (S.D.N.Y. 1992) (quoting *Smith v. Van*
10 *Gorkom*, 488 A.2d 858, 872 (Del. 1985)), *appeal dismissed*, 3 F.3d 49 (2d Cir. 1993); *accord In*
11 *re Pomona Valley Med. Group, Inc.*, 476 F.3d 665, 670 (9th Cir. 2007) ("in evaluating the
12 [business] decision, the bankruptcy court should presume that the debtor-in-possession acted
13 prudently, on an informed basis, in good faith, and in the honest belief that the action taken was in
14 the best interests of the bankruptcy estate.").

15 Moreover, if "the debtor articulates a reasonable basis for its business decisions (as
16 distinct from a decision made arbitrarily or capriciously), courts will generally not entertain
17 objections to the debtor's conduct." *Comm. Of Asbestos-Related Litigants v. Johns-Manville*
18 *Corp. (In re Johns-Manville Corp.)*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986) (citation omitted);
19 *F.D.I.C. v. Faigin*, No. CV 12-03448-DDP, 2013 WL 3389490, at *5 (C.D. Cal. July 8, 2013)
20 ("The California business judgment rule . . . establishes a presumption that directors' decisions
21 are based on sound business judgment, and it prohibits courts from interfering in business
22 decisions made by the directors in good faith and in the absence of a conflict of interest.")
23 (citations omitted). Courts should decline to interfere with corporate decisions absent a showing
24 of bad faith, self-interest, or gross negligence, and have upheld a board's decisions as long as
25 such decisions are attributable to any "rational business purpose." *Integrated*, 147 B.R. at 656
26 (quoting *CRTF Corp. v. Federated Dep't Stores*, 683 F. Supp. 422, 436 (S.D.N.Y. 1988)); *In re*
27 *Pomona Valley Med. Group, Inc.*, 476 F.3d 665; *In re AWTR Liquidation Inc.*, 548 B.R. 300, 314
28

1 (Bankr. C.D. Cal. 2016) (“The effect of the business judgment rule is to raise the burden of proof
2 from ordinary negligence to gross negligence—“i.e., failure to exercise even slight care.”); *Mann*
3 *v. GTCR Golder Rauner, L.L.C.*, 483 F. Supp. 2d 884, 902 (D. Ariz. 2007) (“because the business
4 judgment rule is a powerful presumption, it can only be rebutted in those rare cases where the
5 decision under attack is so far beyond the bounds of reasonable judgment that it seems essentially
6 inexplicable on any ground other than bad faith.”) (citations omitted).

7 **ii. Section 105 Empowers the Court to Grant Critical Vendor Relief**

8 Section 105 relief is necessary here for the Debtors to carry out their fiduciary duties
9 under § 1107(a). Section 105(a) empowers bankruptcy courts to “issue any order, process, or
10 judgment that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. §
11 105. Section 1107(a) “contains an implied duty of the debtor-in-possession” to “protect and
12 preserve the estate, including an operating business’ going-concern value,” on behalf of a debtor’s
13 creditors and other parties in interest. *In re CEI Roofing, Inc.*, 315 B.R. 50, 59 (Bankr. N.D. Tex.
14 2004) (quoting *In re CoServ, L.L.C.*, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002)); *see also*
15 *Unofficial Comm. of Equity Holders v. McManigle (In re Penick Pharm., Inc.)*, 227 B.R. 229,
16 232–33 (Bankr. S.D.N.Y. 1998) (“[U]pon filing its petition, the Debtor became debtor in
17 possession and, through its management . . . was burdened with the duties and responsibilities of
18 a bankruptcy trustee.”).

19 As life-saving medical service providers, the Debtors are in a vulnerable
20 position—without the continual flow of vital medical services, medical supplies, medical
21 equipment, physicians, nurses, nurse practitioners, physicians assistants, professional technicians
22 such as, imaging technicians, surgical technicians, sterile processing technicians and interim
23 clinical/management staff, coders, admission department staff, as well as non-medical services,
24 information technology support, and/or benefits, the entire mission of the Debtors’ business
25 would immediately unravel, irreparably harming the Debtors and their Patients.

26 Additionally, failure to grant the relief requested by this Motion could result in the
27 Debtors’ inability to meet certain requirements set forth by local, state, and federal law. See, e.g.,
28

1 22 Cal. Code Regs §§ 70001, et seq.; Cal. Health & Safety Code §§ 1250 et seq. Furthermore, the
2 Critical Vendors in this case have little incentive to continue services with the Debtors should the
3 Court fail to grant the Debtors’ Motion, and indeed, many have indicated as much. And, the
4 automatic stay of § 362(a) is inadequate to address the issue. In support of the Motion, however,
5 is the fact that even the most disfavored creditors will be as well off, if not better well off, if the
6 Court grants the Debtors’ Motion.

7 As noted above, the Debtors intend to market and sell their Hospitals and other assets as a
8 going concern. Therefore, it is critical that, while the Debtors proceed with an expedited
9 marketing and sale process for their Hospitals and other assets, the Debtors maintain their medical
10 and business operations and preserve the value of their assets. The Debtors can only do so by
11 continuing to retain their employees or contractors, operate their medical facilities, or meet their
12 Patients’ daily medical services needs and statutory compliance requirements in the ordinary
13 course of business, which the Debtors simply cannot do without the services and goods provided
14 by the Critical Vendors.

15 **iii. Section 503(b)(9) Allows for Prepetition Payment on Goods Received**
16 **within Twenty (20) Days Prior to Petition Date**

17 Alternatively, § 503(b)(9) provides administrative priority for the “value of any goods
18 received by the debtor within twenty (20) days before the date of commencement of a case under
19 this title in which goods have been sold to the debtor in the ordinary course of such debtor’s
20 business.” *See also In re Brown & Cole Stores, LLC*, 375 B.R. 873, 878 (B.A.P. 9th Cir. 2007)
21 (recognizing that § 503(b)(9) applies to critical vendors supplying goods). These claims must be
22 paid in full for the Debtors to confirm a chapter 11 plan. *See* 11 U.S.C. § 1129(a)(9)(A).

23 In fact, the Bankruptcy Code does not prohibit a debtor from paying such claims prior to
24 confirmation. As administrative claims incurred in the ordinary course of business, the Debtors
25 submit that they may pay such claims in accordance with their business judgment pursuant to
26 § 363(c)(1). Courts have regularly authorized the payment of claims arising under § 503(b)(9) in
27 the ordinary course of business. *See, e.g.,* Order Pursuant to 11 U.S.C. §§ 503(b)(9) and 105(a) (i)
28 Approving Procedures for the Assertion, Resolution, and Satisfaction of Claims Asserted

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 Pursuant to 11 U.S.C. § 503(b)(9) and (ii) Prohibiting Vendors from Pursuing Such Claims
2 Outside the Procedures at 4, *In re Chassix Holdings, Inc.*, No. 15-10578 (Bankr. S.D.N.Y. Apr.
3 14, 2015) (No. 275) (authorizing debtors to pay vendors’ claims entitled to priority under §
4 503(b)(9) “in the ordinary course if the Debtors determine it is in the estates’ best interests to do
5 so”); Interim Order Authorizing Debtors to Pay Certain Prepetition Claims of Critical Vendors
6 and Section 503(b)(9) Claims, Approving Related Procedures, and Granting Related Relief, *In re*
7 *The Great Atlantic & Pacific Tea Co., et al.*, No. 10-24549 (Bankr. S.D.N.Y. Dec. 14, 2010) (No.
8 55) (interim and final orders authorizing payment of claims entitled to administrative priority
9 pursuant to § 503(b)(9) up to \$5 Million); Final Order Authorizing Debtors to Pay Certain
10 Prepetition Claims of Critical Vendors and Section 503(b)(9) Claims, Approving Related
11 Procedures, and Granting Related Relief, *In re The Great Atlantic & Pacific Tea Co., et al.*,
12 (Bankr. S.D.N.Y. Jan. 13, 2011) (No. 504) (interim and final orders authorizing payment of
13 claims entitled to administrative priority pursuant to § 503(b)(9) up to \$5 Million); Interim Order
14 Authorizing, But Not Directing, Payments Of Pre-Petition Claims Of Certain Critical Vendors
15 And Administrative Claim Holders And Granting Related Relief; *In re Lear Corp.*, No. 09-14326
16 (Bankr. S.D.N.Y. July 8, 2009) (No. 68) (interim and final orders authorizing payment of claims
17 entitled to administrative priority pursuant to § 503(b)(9) up to \$23.15 Million and \$46.3 Million,
18 respectively); Final Order Authorizing, But Not Directing, Payments of Prepetition Claims of
19 Certain Critical Vendors and Administrative Claimholders and Granting Related Relief, *In re*
20 *Lear Corp.*, (Bankr. S.D.N.Y. July 31, 2009) (No. 245) (interim and final orders authorizing
21 payment of claims entitled to administrative priority pursuant to § 503(b)(9) up to \$23.15 Million
22 and \$46.3 Million, respectively); Final Order Authorizing the Debtors to Pay the Prepetition
23 Claims of Certain Essential Suppliers and Administrative Claimholders, Continuing the Debtors’
24 Troubled Supplier Program and Granting Certain Related Relief at 6, *In re Chrysler LLC*, No. 09-
25 50002 (Bankr. S.D.N.Y. May 20, 2009) (No. 1318) (authorizing debtors to pay uncapped “claims
26 of any creditors or claimants entitled to administrative priority pursuant to section 503(b)(9) . . .
27
28

1 in the ordinary course of the Debtors’ businesses and on such terms and conditions as the Debtors
2 deem appropriate,” subject to the terms of debtors’ DIP facility).

3 Thus, payment of the Medical Supplies and Equipment Providers’ claims for supplies
4 received by the Debtors within 20 days prior to the Petition Date must be allowed as
5 administrative expenses, and this Court should allow the Debtors to pay these claims in
6 accordance with the relief requested in this Motion.

7 **iv. Section 549 Provides the Court Authority to Approve Postpetition**
8 **Transfers of Property Such as Payment to Critical Vendors**

9 Finally, § 549(a)(2)(B), which governs postpetition transfers, provides in part that “the
10 trustee may avoid a transfer of property of the estate made after the commencement of the case;
11 and [] that is not authorized [] by the court.” 11 U.S.C. § 549(a)(2)(B). Therefore, it logically
12 follows that the Court may authorize certain postpetition payments to satisfy prepetition debts. In
13 fact, as one district court noted: “[i]t would appear that proposed transfers [to pay prepetition
14 claims] could be presented in advance to a bankruptcy court for its approval and would thereafter
15 be insulated from attack[.]” *In re Isis Foods, Inc.*, 37 B.R. 334, 336 n.3 (W.D. Mo.), *appeal*
16 *dismissed*, 738 F.2d 445 (8th Cir. 1984).

17 In this case, honoring the prepetition claims of the Debtors’ Critical Vendors will have no
18 negative impact on the payment of other creditors’ claims. In fact, honoring the prepetition claims
19 of the Critical Vendors will only maintain the quality of Patient care, improve the Debtors’
20 chances of successfully reorganizing or selling assets, and repaying their other creditors. Any
21 benefit to the Estates that could be gained by not paying the Critical Vendors’ claims would be
22 more than outweighed by the detriment to the Estates caused by the loss of the Debtors’
23 relationships with such Critical Vendors. As noted above, if the Critical Vendors refuse to
24 provide any further services or goods, the Debtors will not be able to retain their employees,
25 operate their business, or—most importantly—fulfill their Patients’ daily medical services needs.
26 Indeed, the Debtors will not be able to generate sufficient revenue to maintain the quality of
27 patient care and otherwise continue their business operations. This, in turn, will put Patients at
28 risk, cripple the Debtors’ business operations, and potentially squash any chance of

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 consummating a sale of the Debtors’ business as a going concern for maximum value and any
2 chance for the Debtors to successfully reorganize in this case.

3 **v. Policy Considerations for Granting this Motion**

4 In cases of similar magnitude filed in the Southern District of New York, Delaware, and
5 Texas bankruptcy courts routinely grant debtors’ motions to pay and/or honor the prepetition
6 claims of the critical vendors in the debtors’ discretion and in the ordinary course of the debtors’
7 business pursuant to similar protocols as the Protocol proposed herein. *See, e.g.*, Transcript at 35,
8 *In re The Reader’s Digest Ass’n, Inc.*, No. 09-23529 (Bankr. S.D.N.Y. Aug. 25, 2009) (No. 34);
9 *see also* Transcript at 56, *In re The Great Atlantic & Pacific Tea Co., et al.*, No. 15-23007 (Bankr.
10 S.D.N.Y. July 20, 2015) (No. 667) (approving interim critical vendor relief where the process was
11 supervised by “senior people who understand the tension involved in paying prepetition debt as
12 against the net benefit to the debtor of having critical supplies in essence for their stores”).

13 Furthermore, allowing the Debtors to pay the Critical Vendor Claims, pursuant to all or
14 some of the above-referenced provisions, is especially appropriate where, as here, doing so is
15 consistent with the “two recognized policies” of chapter 11 of the Bankruptcy Code—preserving
16 going concern value and maximizing the value of property available to satisfy creditors. *See Bank*
17 *of Am. Nat’l Trust & Savs. Ass’n v. 203 N. LaSalle St. P’Ship*, 526 U.S. 434, 453 (1999). Indeed,
18 reflecting the recognition that payment of prepetition claims of certain essential suppliers and
19 vendors is, in fact, both critical to a debtor’s ability to preserve going-concerns and maximize
20 creditor recovery—thereby increasing prospects for a successful reorganization and/or sale—
21 courts have regularly granted relief consistent with that which the Debtors are seeking in this
22 Motion. Final Order (I) Authorizing, But Not Directing, Debtors to Pay Pre-Petition Claims of
23 Critical Vendors and (II) Authorizing and Directing Financial Institutions to Honor and Process
24 Related Checks and Transfers, *In re Geokinetics Inc.*, No. 18-33410 (Bankr. S.D. Tex. July 16,
25 2018) (No. 196); Final Order (I) Authorizing Debtors To Pay Certain Prepetition Claims of
26 Critical Vendors and (II) Granting Related Relief, *In re GST AutoLeather, Inc.*, No. 17-12100
27 (Bankr. D. Del. Nov. 13, 2017) (No. 254); Order (FINAL) Authorizing the Debtors to Pay
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 Prepetition Claims of Certain Critical Vendor, *In re M&G USA Corporation*, No. 17-12307
2 (Bankr. D. Del. Nov. 30, 2017) (No. 292); Order (Final) Authorizing the Debtors to Pay or Honor
3 Prepetition Obligations to Certain Critical Vendors, *In re Appvion, Inc.*, No. 17-12082 (Bankr. D.
4 Del. Oct. 30, 2017) (No. 210); Order [FINAL] (A) Authorizing Debtors to Pay Certain
5 Prepetition Claims of Critical Vendors and (B) Granting Related Relief, *In re True Religion*
6 *Apparel, Inc.*, No. 17-11460 (Bankr. D. Del. July 31, 2017) (No. 233); Order Granting Motion for
7 Payment of Critical Vendors, *In re Emas Chiyoda Subsea Ltd.*, No. 17-31146 (Bankr. S.D. Tex.
8 Mar. 28, 2017) (No. 173); Order Granting Motion For Authority To Pay Or Honor Pre-Petition
9 Obligations To Certain Critical Vendors, *In re Goodrich Petroleum Corp.*, No. 16-31975 (Bankr.
10 S.D. Tex. May 12, 2016) (No. 165).

11 Moreover, as noted above, the amounts proposed to be paid to the Debtors' most critical
12 vendors, up to the Critical Vendor Cap—as mentioned in the Declaration of Richard Adcock in
13 Support of the Emergency Motions filed concurrently herewith—in the Debtors' discretion and in
14 the ordinary course of the Debtors' business, and pursuant to the Protocol, have already been
15 included in the Budget that has been approved by the Debtors' senior secured lender, as set forth
16 in the Chou Declaration. Accordingly, the Debtors have the financial ability to make the
17 payments proposed to be made to the Debtors' most critical vendors, and such payments will not
18 render the Debtors' Estates administratively insolvent.

19 For the reasons noted above, the Debtors' ability to pay and/or honor the prepetition
20 claims (up to the Critical Vendor Cap) of the Critical Vendors is instrumental to the Debtors'
21 maintenance of the quality of patient care and reorganization efforts and is in the best interests of
22 the Estates and their creditors. Any disruption in the Debtors' ability to pay and/or honor such
23 claims (up to the Critical Vendor Cap) would undoubtedly cause immediate and irreparable harm
24 to the value of the Debtors' business and assets, and potentially eradicate any chance for the
25 Debtors to consummate a sale of their business and assets. To avoid this result, the Debtors
26 should be permitted to pay and/or honor the prepetition claims of the Critical Vendors, as listed in
27
28

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1 the exhibits to the Chou Declaration, in the Debtors' discretion and in the ordinary course of the
2 Debtors' business, and in accordance with the Protocol, terms, and conditions set forth herein.

3 **VI. CONCLUSION**

4 **WHEREFORE**, the Debtors respectfully request that this Court hold an emergency
5 hearing on the Motion and issue an Interim Order:

- 6 (1) affirming the adequacy of the notice given;
7 (2) granting the Motion in the interim;
8 (3) authorizing, but not directing, the Debtors to continue to pay and/or honor the
9 prepetition claims (up to \$5 Million) of the Critical Vendors, in the ordinary course of the
10 Debtors' business, in the Debtors' discretion, and in accordance with the Protocol and the Budget;

11 and

- 12 (4) granting such other and further relief as the Court deems just and proper under the
13 circumstances.

14 **WHEREFORE**, the Debtors also respectfully request that this Court hold a final hearing
15 on the Motion and issue a Final Order:

- 16 (1) affirming the adequacy of the notice given;
17 (2) granting the Motion in its entirety;
18 (3) authorizing, but not directing, the Debtors to continue to pay and/or honor the
19 prepetition claims (up to a total of \$20 Million) of the Critical Vendors, in the ordinary course of
20 the Debtors' business, in the Debtors' discretion, and in accordance with the Protocol and the

21 Budget; and

- 22 (4) granting such other and further relief as the Court deems just and proper under the
23 circumstances.

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Dated: August 31, 2018

DENTONS US LLP
SAMUEL R. MAIZEL
JOHN A. MOE, II
TANIA M. MOYRON

By /s/ Tania M. Moyron
Tania M. Moyron

Proposed Attorneys for the Chapter 11
Debtors and Debtors In Possession

DENTONS US LLP
601 SOUTH FIGUEROA STREET, SUITE 2500
LOS ANGELES, CALIFORNIA 90017-5704
(213) 623-9300