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8 *Unsecured Creditors of Verity Health System of*
9 *California, Inc., et al.*

10 **UNITED STATES BANKRUPTCY COURT**
11 **CENTRAL DISTRICT OF CALIFORNIA – LOS ANGELES DIVISION**

12 In re:
13 VERITY HEALTH SYSTEM OF CALIFORNIA,
14 INC., *et al.*,
15 Debtors and Debtors In Possession.

Lead Case No. 18-20151
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-20181-ER

16 Affects:

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

Chapter 11 Cases

Hon. Ernest M. Robles

**OFFICIAL COMMITTEE OF
UNSECURED CREDITORS'
RESPONSE TO CASH MANAGEMENT
MOTION [DKT. 23]**

Debtors and Debtors In Possession.



1 The Official Committee of Unsecured Creditors of Verity Health System of
2 California, Inc., *et al.* (the “Committee”) appointed in connection with the chapter 11 cases of the
3 above-captioned debtors and debtors-in-possession (the “Debtors”), hereby submits this response
4 (the “Response”) to Debtors’ *Emergency Motion of Debtors for Authority to (1) Continue Using*
5 *Existing Cash Management System, Bank Accounts and Business forms; (2) Implement Changes to*
6 *the Cash Management System in the Ordinary Course of Business; (3) Continue Intercompany*
7 *Transactions; (4) Provide Administrative Expense Priority for Postpetition Intercompany Claims;*
8 *(5) Obtain Related Relief* [Dkt. 23] (the “Cash Management Motion”).

9 **I. INTRODUCTION**

10 1. The Committee was appointed by the United States Trustee on September 17,
11 2018. The Committee’s advisors have been getting up to speed and have been engaged in
12 discussions with the Debtors’ advisors over the past several days regarding the Cash Management
13 Motion. Although progress has been made, some issues remain.

14 **II. ARGUMENT**

15 **A. Tracking**

16 2. Paragraph 5 of the form of Cash Management Order proposed by the Debtors
17 seeks to address tracking, tracing, and accounting issues, by providing as follows:

18 5. The Debtors are authorized and empowered to continue
19 performing under and honoring intercompany transactions related to
20 the Cash Management System in the ordinary course of business, in
21 their business judgment and in their sole discretion subject to the terms
22 of the DIP Documents; provided that the Debtors shall not be
23 authorized to undertake any such intercompany transactions that are
24 (i) not on the same terms as, or materially consistent with, the Debtors’
25 operation of their business in the ordinary course during the prepetition
26 period, or (ii) prohibited or restricted by the terms of any DIP
27 Document; provided further that the Debtors shall (i) keep records of
28 any postpetition intercompany transactions that occur during the
chapter 11 cases and (ii) implement accounting procedures to identify
and distinguish between prepetition and postpetition intercompany
transactions;

(Cash Management Order ¶ 5.)

3. Overall, while the Debtors’ proposal approximates what is required, the
Committee would amplify this provision to state as follows:

1 Accounting/Recording: The Debtors shall maintain current
2 records with respect to all transfers of cash so that all
3 intercompany transactions may be readily ascertained, traced,
4 and distinguished between prepetition and postpetition
5 transactions and recorded properly on applicable intercompany
6 accounts. The Debtors shall provide reasonable access to such
7 records and procedures to the Committee's advisors.

8 4. In addition, the Committee has requested that the Cash Management Order
9 mandate that the Committee's advisors be provided with more frequent and fulsome reporting than
10 contemplated by the current form of Order, by amending the Order to provide as follows:

11 Information: The Debtors shall provide the Committee with:
12 (i) information regarding past intercompany activities among
13 Debtors and non-debtors; Intercompany balances at filing and
14 underlying transactions; (ii) intercompany balances at filing
15 and underlying transactions; and (iii) monthly summaries of all
16 intercompany transfers (cash and non-cash).

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18 **B. Intercompany Transactions**

19 5. Paragraph 6 of the form of Cash Management Order provides as follows:

20 6. In accordance with sections 364(b), 503(b)(1) and
21 507(a)(2) of the Bankruptcy Code, all intercompany claims arising
22 after the Petition Date based upon transfers made using the Cash
23 Management System shall be accorded administrative expense
24 priority.

25 (Cash Management Order ¶ 6.).

26 6. The Committee questions the need for any postpetition intercompany transfers
27 given that the DIP loan is the primary source of liquidity for the Debtors. A Debtor that has a
28 funding request should draw from the DIP loan. It seems unnecessary for one Debtor to be lending
29 funds to another.

30 7. If, however, such a transfer is necessary, it should be accorded the proper
31 priority. In many cases, courts have afforded debtor-to-debtor intercompany transfers superpriority
32 claims status.¹ The Committee requests the following clarification, which grants such superpriority

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¹ *See, e.g., In re Alpha Natural Resources*, No. 1533896 (KRH) (Bankr. E.D. Va. Oct. 8, 2015) [Docket No. 624];
In re FirstEnergy Solutions Corp., No. 18-50757 (AMK) (Bankr. N.D. Ohio May 8, 2018) [Docket No. 488];
In re Lehman Brothers Holdings Inc., No. 08-13555 (JMP) (Bankr. S.D.N.Y. Nov. 6, 2008) [Docket No. 1416];
In re M & G USA Corporation, No. 17-12307 (BLS) (Bankr. D. Del. Jun. 22, 2018) [Docket No. 1609]; *In re*
Winn-Dixie Stores, Inc., No. 05-03817 (JAF) (Bankr. M.D. Fla. May 19, 2005) [Docket No. 1331].

1 claims status to claims arising out of such transfers, but provides that the status of such Debtor-to-
2 Debtor intercompany claims is *junior in priority* to liens and claims granted to DIP lenders yet
3 *senior* to liens and claims granted to the Debtors' prepetition secured lenders as adequate protection:

4 Debtor/Debtor Claims—Superpriority Claim: Claims held by a Debtor
5 against another Debtor arising from post-petition intercompany
6 transactions shall give rise to superpriority claims pursuant to sections
7 364, 503, and 507 of the Bankruptcy Code (each, an "Intercompany
8 Superpriority Claim") that are junior in priority to the liens and claims
9 granted to the DIP lenders but senior to the liens and claims granted to
10 the Debtors' prepetition secured lenders as adequate protection
11 pursuant to any order of this Court.

9 **C. Committee Consent for Transfers from Debtors to Non-Debtors**

10 8. Intercompany transfers to non-Debtors are of particular concern to the
11 Committee. The protections accorded such transfers between Debtors generally are not available.
12 Accordingly, the Committee proposes the following provision in the final form of Cash Management
13 Order:

14 Debtor/Non-Debtor Transfers—Notice and Consent: The Debtors will
15 seek a further order of this Court prior to engaging in any transfer
16 involving amounts in excess of \$250,000 in the aggregate from a
17 Debtor to any non-Debtor without three (3) business days' notice be
18 provided to the Committee and its prior consent having been obtained.

19 9. The Committee's objective is not to impede the ordinary course operation of
20 the Debtors' business. For this reason, the Committee is prepared to carve out from this prohibition
21 an agreed-upon list of non-objectionable non-Debtor intercompany transfers that occur on a regular
22 basis—but the baseline prohibition should remain in the Order to guard against non-ordinary course
23 transfers to non-Debtor affiliates, as well as insiders or former insiders.

23 **D. Amendments**

24 10. Finally, the proposed Cash Management Order raises an issue as to the
25 amendment of cash management arrangements and procedures. Paragraphs 2 and 15 of the Debtors'
26 form of Order provide:

27 2. The Debtors are authorized to implement changes to
28 their Cash Management System in the ordinary course of business,
including closing any existing bank accounts or opening any new bank
accounts (collectively, the "Bank Accounts")...

15. The Debtors and the Banks may, without further Order of this Court, agree to and implement changes to the Cash Management System and procedures in the ordinary course of business, including, without limitation, the opening and closing of bank accounts, subject to the terms of any DIP Document.

(Cash Management Order ¶¶ 2, 15.).

11. It is the Committee's position that the final form of Cash Management Order should be amended to require that:

Amendments: (i) notice is to be provided to the Committee (along with the U.S. Trustee) prior to the opening of any new Bank Accounts; and (ii) changes may be made without further Order of the Court, but only after the Committee and the U.S. Trustee have been provided three (3) business days' notice of, and the opportunity to object to, the proposed changes.

III. RESERVATION OF RIGHTS

12. The Committee's discussions with the Debtors regarding the Cash Management Motion are ongoing, and, in response (in part) to the Committee's comments, the Debtors are in the process of revising their proposed final form of Order on this motion. If there are any issues that remain unresolved in the proposed final form of Order, the Committee reserves the right to supplement this Response and address such issues at the October 3 hearing.

IV. CONCLUSION

13. Based on the foregoing, the Committee respectfully requests that (i) to the extent that the Debtors do not adequately address the issues raised herein by the Committee, the Court enter a form of Cash Management Order that reflects the Committee's proposed changes; and (ii) the Court grant such other and further relief as the Court deems just and proper.

1 DATED: September 27, 2018

MILBANK, TWEED, HADLEY & M^cCLOY

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/s/ Gregory A. Bray
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MARK SHINDERMAN
JAMES C. BEHRENS

Proposed Counsel for the Official Committee of
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PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is:

2029 Century Park E, 33rd Floor, Los Angeles, CA 90067.

A true and correct copy of the foregoing document entitled (*specify*): **OFFICIAL COMMITTEE OF UNSECURED CREDITORS' RESPONSE TO CASH MANAGEMENT MOTION [DKT. 23]**

_____ will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On (*date*) September 27, 2018, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:

On (*date*) September 27, 2018, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (*state method for each person or entity served*): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on (*date*) September 27, 2018, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

September 27, 2018 Ricky Windom
Date Printed Name

/s/ Ricky Windom
Signature

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