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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.

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

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-20171-ER

Chapter 11 Cases

Hon. Ernest M. Robles

**DEBTORS' REPLY TO COMMITTEE'S
OPPOSITION TO ENTRY OF FIRST AMENDED
SUPPLEMENTAL CASH COLLATERAL
ORDER AND STIPULATION TO (A) AMEND
CASH COLLATERAL AGREEMENT AND
SUPPLEMENTAL CASH COLLATERAL
ORDER, (B) AUTHORIZE CONTINUED USE OF
CASH COLLATERAL, (C) GRANT ADEQUATE
PROTECTION, (D) MODIFY AUTOMATIC
STAY, AND (E) GRANT RELATED RELIEF
[RELATES TO DOCKET NOS. 3871 & 3880]**



1 **REPLY TO COMMITTEE’S OBJECTION**

2 Verity Health System of California, Inc., O’Connor Hospital, Saint Louise Regional
3 Hospital, St. Francis Medical Center, St. Vincent Medical Center, Seton Medical Center, Verity
4 Holdings, LLC, Verity Medical Foundation, O’Connor Hospital Foundation, Saint Louise
5 Regional Hospital Foundation, St. Francis Medical Center of Lynwood Medical Foundation, St.
6 Vincent Foundation, St. Vincent Dialysis Center, Inc., Seton Medical Center Foundation, Verity
7 Business Services, DePaul Ventures, LLC, and DePaul Ventures-San Jose Dialysis, LLC
8 (collectively, the “Debtors”), as debtors and debtors in possession in the above captioned chapter
9 11 cases (collectively, the “Chapter 11 Cases”), hereby file this reply to the opposition [Docket
10 No. 3880] (the “Opposition”) of the Official Committee of Unsecured Creditors (the “Committee”)
11 to (i) approval of the *Stipulation to (A) Amend Cash Collateral Agreement and Supplemental Cash*
12 *Collateral Order, (b) Authorize Continued Use of Cash Collateral, (C) Grant Adequate Protection,*
13 *(D) Modify Automatic Stay, and (E) Grant Related Relief* [Docket No. 3871] (the “Stipulation”),
14 and (ii) the entry of the First Amended Supplemental Cash Collateral Order in the form annexed
15 to the Stipulation as Exhibit “A” (the “First Amended Supplemental Cash Collateral Order”).

16 **I.**

17 **DEBTORS’ REPLY TO COMMITTEE’S OBJECTION**

18 The Committee inappropriately uses the Opposition as a platform to litigate its lien
19 challenges against the Prepetition Secured Creditors¹ and its appeal of this Court’s Final DIP
20 Order. The Court should not prejudice the merit of the Committee’s litigation or re-visit the Final
21 DIP Order. While the Committee is focused on advancing its own litigation without any evidence
22 in support thereof, the Debtors are focused on utilizing cash collateral to implement Plan B and
23 stabilize operations in light of the fact that the sale to Strategic Global Management, Inc. did not
24 close, as ordered by the Court.

25
26 _____
27 ¹ Unless defined herein, all defined terms shall have the meaning ascribed to them in the First
28 Amended Supplemental Cash Collateral Order.

1 In effect, the Stipulation is a 31-day extension of the *Final Order (A) Authorizing*
2 *Continued Use of Cash Collateral, (B) Granting Adequate Protection, (C) Modifying the*
3 *Automatic Stay, and (D) Granting Related Relief* [Docket No. 3022] (the “Supplemental Cash
4 Collateral Order”), which the Committee did not appeal. The Stipulation constitutes the negotiated
5 consent by the Prepetition Secured Creditors to authorize the Debtors to withdraw and use
6 pursuant to an agreed budget an additional \$40 million of the proceeds of the Santa Clara sale (the
7 “SCC Sale”). Those proceeds reside in special sale proceeds accounts (the “Escrow Deposit
8 Accounts”) established under the Final DIP Order² to protect the Prepetition Secured Creditors.
9 The proceeds of the SCC Sale is the collateral of the Prepetition Secured Creditors and does not
10 include any of the bank accounts or post-petition QAF being challenged by the Committee in the
11 Adversary Proceedings (defined below). See Final DIP Order at ¶ F. Given that the Debtors
12 require cash beyond what the Debtors will generate from the collection of accounts receivable, an
13 agreement from the Prepetition Secured Creditors to utilize proceeds from the SCC Sale is critical
14 to the Debtors’ operations.

15 In light of the foregoing, the Debtors’ exercise of their business judgment in entering into
16 the Stipulation is presumptively reasonable, and the Court is entitled to utilize its broad discretion
17 to determine whether or not an adequate protection package is within the bounds of reasonableness.
18 Here, the terms of the adequate protection package in the First Amended Supplemental Cash
19 Collateral Order are essentially the same as the adequate protection package provided to the
20 Prepetition Secured Creditors in the Supplemental Cash Collateral Order. It is not unreasonable
21 for the Prepetition Secured Creditors to condition their consent to the use of additional cash
22 collateral upon receipt of the full scope of the adequate protection package offered by the First
23 Amended Supplemental Cash Collateral Order, including preservation of the waivers under the
24

25 ² The “Final DIP Order” refers to the *Final Order (I) Authorizing Postpetition Financing, (II)*
26 *Authorizing Use of Cash Collateral, (III) Granting Liens and Providing Superpriority*
27 *Administrative Expense Status, (IV) Granting Adequate Protection, (V) Modifying Automatic Stay,*
28 *and (VI) Granting Related Relief*, dated October 4, 2018 [Docket No. 409].

1 Final DIP Order and the Supplemental Cash Collateral Order.³ The Prepetition Secured Creditors
2 will not consent if they are subject to 506(c) or 552(b) litigation in the future, especially since they
3 are effectively putting their existing cash proceeds at risk. Based on the foregoing, the Court
4 should overrule the Opposition, as further set forth below:

- 5 • **Committee’s Lack of Evidence.** The Committee provides no evidentiary support
6 for any of its arguments in the Opposition, including its assertion that the
7 Committee’s lien challenge [Adversary Proceeding Nos. 2:19-ap-01165-ER &
8 2:19-ap-01166-ER (collectively, the “Adversary Proceedings”)] will result in net
9 value for unsecured creditors.
- 10 • **The Committee’s Arguments Ignore the Prepetition Secured Creditors’**
11 **Replacement Liens Approved by the Final DIP Order.** The Committee argues
12 that (i) it “undisputed” that the Prepetition Secured Creditors did not have a
13 perfected security interest in certain deposit accounts, (ii) the Prepetition Secured
14 Creditors’ liens do not attach to QAF payments, and (iii) that a portion of the “going
15 concern premium” generated by the sale of assets as a going concern must be
16 allocated to unsecured creditors. These novel arguments are the subject of the
17 Committee’s Adversary Proceedings and should not be used as a basis to destroy
18 the Stipulation carefully negotiated by the Debtors and their Prepetition Secured
19 Creditors. Further, the unchallenged liens on the Debtors’ prepetition assets that
20 relate to hospital real property and hospital account receivables have been used by
21 the Debtors’ estates for over 16 months. The Committee has not demonstrated that
22 the value of those assets has not declined. Under the Final DIP Order, any
23 diminution of value of the Debtors’ assets subject to liens is protected by
24 replacement liens. *See* Final DIP Order at ¶5(a). Replacement liens cover any
25 otherwise unencumbered assets, encumbered assets that have value in excess of
26 prepetition lien balances, and all other collateral available to repay creditors
27 (excluding avoidance actions), including administrative claimants. *Id.* Since the
28 assets subject to replacement liens are co-extensive with the DIP liens, all assets of
the estates are encumbered for the benefit of Prepetition Secured Creditors.

The Prepetition Secured Creditors agreed to subordinate their liens to the \$185 million DIP Loan premised, *inter alia*, upon a finding that they were oversecured. *See* Tentative Ruling dated October 3, 2018, at p.8 [Docket 392]. In addition, the Debtors used \$86 million of the SCC sale proceeds to repay the DIP loan. For at least the next month, the Prepetition Secured Creditors are willing to allow further use of their sale proceeds to allow this case to stabilize even though the SGM sale is not going forward as planned and it is unknown if the Prepetition Secured Creditors’ Santa Clara sale proceeds will ever be fully replaced.

- **The Court Should Reject the Committee’s 506, 552, and Marshaling Arguments.** In connection with the Court entering the Final DIP Order, the Court rejected the Committee’s arguments with respect to 506(c), 552 and marshaling. The Committee has offered no reason why the Court should re-visit its prior ruling, particularly when the issues are on appeal at the Ninth Circuit Court of Appeals. As significant, the Final DIP Order continues to apply irrespective of the entry or

³ See Supplemental Cash Collateral Order, ¶ 22.

1 non-entry of the First Amended Supplemental Cash Collateral Order. *See* Final
2 DIP Order, § 29 (“Survival of Final Order and Other Matters. The provisions of
3 this Final Order and any actions taken pursuant hereto shall survive entry of any
4 order which may be entered (i) confirming any Plan in the Chapter 11 Cases, (ii)
5 converting any of the Chapter 11 Cases to a case under chapter 7 of the Bankruptcy
6 Code or any Successor Cases, (iii) to the extent authorized by applicable law,
7 dismissing any of the Chapter 11 Cases, (iv) withdrawing of the reference of any
8 of the Chapter 11 Cases from this Court, or (v) providing for abstention from
9 handling or retaining of jurisdiction of any of the Chapter 11 Cases in this Court.”).

6 Additionally, the Committee admits that the purpose of adequate protection is to
7 preserve the status quo. Subjecting the Prepetition Secured Creditors to 506(c) and
8 552(b) suits, especially upon the grounds cited by the Committee, does not preserve
9 the status quo for the Prepetition Secured Creditors. Indeed, as the Court is aware,
10 the Debtors are losing \$450,000 per day, and do not generate sufficient cash from
11 receivables to indefinitely continue in business. Therefore, the use of the Santa
12 Clara sale proceeds is a material risk proposition for the Prepetition Secured
13 Creditors and, absent future sales that are currently not in prospect, the status quo
14 may not be preserved for the Prepetition Secured Creditors. The continuation of
15 adequate protection package approved under the Final DIP Order and the
16 Supplemental Cash Collateral Order is at least reasonable attempt by the Debtors
17 to lessen the risk being undertaken by the Prepetition Secured Creditors.

12 Further, it is not the law that the unsecured creditors are automatically entitled to
13 monetary relief under 506(c) or 552(b) whenever unencumbered assets are
14 consumed during a case in which other encumbered property is sold. *See, e.g., In*
15 *re Cascade Hydraulics & Utility Service, Inc.*, 815 F.2d 546, 548 (9th Cir. 1987);
16 see also 4 Collier on Bankruptcy ¶ 506.05 (16th ed. 2019). In fact, the only factor
17 cited by the Committee for the proposition that it should be entitled to pursue 506(c)
18 and 552(b) claims is that the Debtors’ general labor has assisted in the sale of
19 encumbered assets. That factor is present in virtually every case, and the
20 Committee cites no case in the 9th Circuit where that mere fact is sufficient under
21 506(c) or 552(b), assuming *arguendo* that the Final DIP Order did not control the
22 result.

18 **The Committee’s Additional Arguments Should Be Rejected.** The Committee
19 argues that that any payments should be applied to reduce the principal balance of
20 the Prepetition Secured Creditors claim if they are undersecured. The Final DIP
21 Order, however, already addresses the foregoing issue. The Final DIP Order
22 provides that any postpetition adequate protection payments should be re-
23 characterized as principal payments in the event that the Prepetition Secured
24 Creditors are undersecured notwithstanding their replacement liens. *See* Final DIP
25 Order 5(b), lines 22-28.

23 The Committee argues that the Stipulation cannot be approved without the payment
24 of postpetition obligations in full. The Prepetition Secured Creditors are not the
25 guarantors of administrative expenses. This issue also ignores the Budget and is a
26 plan confirmation issue.

1 **II.**

2 **CONCLUSION**

3 For the foregoing reasons, the Debtors respectfully request that this Court (i) enter the First
4 Amended Supplemental Cash Collateral Order, (ii) overrule the Opposition, and (iii) grant the
5 Debtors such other and further relief as is just an proper.

6 Dated: December 30, 2019

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10 By /s/ Tania M. Moyron
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