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

In re

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*,

Debtors and Debtors In Possession.

☒ Affects All Debtors

☐ Affects Verity Health System of California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☐ Affects St. Francis Medical Center
☐ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital Foundation
☐ Affects St. Francis Medical Center of Lynwood Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center, Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose Dialysis, LLC

Debtors and Debtors In Possession.

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

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

Hon. Judge Ernest M. Robles

DEBTORS' (I) REQUEST TO STRIKE OR, IN THE ALTERNATIVE, OVERRULE STRATEGIC GLOBAL MANAGEMENT, INC.'S UNAUTHORIZED "SURREPLY" IN SUPPORT OF SGM'S CONFIRMATION OBJECTION AND (II) RESPONSE TO TOYON ASSOCIATES, INC.'S EVIDENTIARY OBJECTIONS TO THE DECLARATION OF PETER C. CHADWICK IN SUPPORT OF THE CONFIRMATION BRIEF

[RELATED TO DOCKET NOS. 4993, 5385, 5407, 5448]

Hearing:
Date: August 12, 2020
Time: 10:00 am
Location: Courtroom 1568
255 E. Temple St., Los Angeles, California

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Verity Health System of California, Inc. ("VHS") and the affiliated debtors, the debtors and debtors in possession (collectively, the "Debtors") in the above-captioned chapter 11 bankruptcy cases (the "Cases"), hereby file this (i) request to strike *Strategic Global Management, Inc.'s Response to "Memorandum of Law in Support of Confirmation of the Second Amended Joint Chapter 11 Plan[.]* [Docket No. 5448] (the "Surreply") filed by Strategic Global Management, Inc. ("SGM"), to the *Memorandum of Law in Support of Confirmation of Second Amended Joint Chapter 11 Plan (Dated July 2, 2020) of the Debtors, the Committee, and the Prepetition Secured Creditors* [Docket No. 5385] (the "Confirmation Brief"),[1] and (ii) response to *Toyon Associates, Inc.'s Objection to Debtors' Evidence in Support of Confirmation of Second Amended Joint Chapter 11 Plan (Dated July 2, 2020) of the Debtors, the Committee, and Prepetition Secured Creditors* [Docket No. 5407] (the "Toyon Evidentiary Objections") filed by Toyon Associates, Inc. ("Toyon"). In support hereof, the Debtors respectfully state as follows:

I.

REQUEST TO STRIKE THE SURREPLY

The Surreply should be stricken because it violates the Local Bankruptcy Rules and this Court's order [Docket No. 4997] (the "Disclosure Statement Order") setting the briefing schedule on confirmation of the joint plan of liquidation [Docket No. 4993] (the "Plan"). The Surreply was filed less than 48 hours prior to the confirmation hearing in these Cases, and does little more than rehash the same unpersuasive arguments already raised by SGM or raise arguments that SGM *could have*, but did not, raise in its confirmation objection. To the extent the Court is not inclined to strike the Surreply, the Debtors submit that it should be overruled for the same reasons set forth in the Confirmation Brief and as set forth below.

A. The Surreply Should Be Stricken Because It Violates the Disclosure Statement Order, the Bankruptcy Rules, and the Local Rules.

On July 30, 2020, SGM filed the *Objection of Strategic Global Management, Inc. to Confirmation of Second Amended Joint Chapter 11 Plan of Liquidation (Dated July 2, 2020) of*

[1] Unless otherwise defined herein, all capitalized terms have the definitions set forth in the Confirmation Brief.

the Debtors, the Prepetition Secured Creditors, and the Committee [Docket No. 5288] (the "SGM Objection"). On August 5, 2020, the Debtors filed the Confirmation Brief, which included an omnibus reply to the SGM Objection and other confirmation objections filed by the July 30, 2020 objection deadline. On August 10, 2020, SGM filed the Surreply. *See* Surreply at 1.

The Court's confirmation briefing order does not authorize parties to file surreplies and specifically provides that objections to confirmation filed inconsistent with the Court's briefing order will not be considered and will be overruled. *See* Disclosure Stmt. Order ¶ 28 at 14-15, *Id.* ¶ 30 at 15. The Disclosure Statement Order provided that objections must comply with the Bankruptcy Rules and Local Bankruptcy Rules and had to be filed and served by July 30, 2020. *See id.* The Disclosure Statement Order also set August 5, 2020, as the deadline to file a memorandum of law in support of confirmation. *See id.* ¶ 31 at 15-16. The Disclosure Statement Order did not authorize parties to file a supplemental reply, *i.e.*, a surreply, and specifically provided that: "*Confirmation Objections that are not timely filed and served in the manner set forth above shall not be considered by the Court and shall be overruled*." *Id.* ¶ 30 at 15 (emphasis added). Based on the Disclosure Statement Order, alone, the Surreply should be stricken and overruled as violating the Court's briefing schedule.

Additionally, the Surreply is impermissible under the Bankruptcy Rules and Local Bankruptcy Rules. *See* FED. R. BANKR. P. 3020(b)(1) (only authorizing the filing of objections to confirmation and providing that confirmation objections are governed by Rule 9014); *see also* LBR 9013-1(g); *In re Whitaker*, Case No. 09-9000, 2011 WL 4790755, at *2 (Bankr. N.D. Ga. Sept. 30, 2011) ("Neither the Bankruptcy Rules nor the local rules provide for a surreply. Plaintiff did not seek or obtain permission from the court to file her surreply."). The Bankrutpcy Rules do not so provide because "[c]ourts generally view motions for leave to file a sur-reply with disfavor," *Hill v. England*, Case No. CVF05869RECTAG, 2005 WL 3031136, at * 1 (E.D. Cal. Nov. 8, 2005), because "they usually are a strategic effort by the nonmovant to have the last word on a matter" after briefing has closed. *Avery v. Barsky*, 2013 WL 1663612, at *2 (D. Nev. Apr. 17, 2013) (citing *Lacher v. W.*, 147 F.Supp.2d 538, 539 (N.D. Tex. 2001)). The Surreply is doubtless an impermissible, strategic effort to have the last word, particularly given that it was

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filed less than 48 hours prior to the confirmation hearing. SGM's noncompliance with the Bankruptcy Rules and Local Bankruptcy Rules is further compounded by its disregard for the briefing schedule set by the Court. *See In re Mark Twain Marine Indus., Inc.*, 115 B.R. 948, 954-55 (Bankr. N.D. Ill. 1990) (striking surreply filed without leave after briefing deadline established in court order). For the foregoing reasons, the Court should strike the Surreply in its entirety or, in the alternative, overrule it and give it no weight.

B. <u>The Surreply Should Be Overruled on the Merits if Considered by the Court</u>.

Assuming, *arguendo*, that the Court is inclined to consider the Surreply, the Surreply should be overruled as a matter of fact and law. As an initial matter, the Surreply merely restates arguments raised in the SGM Objection and raises arguments that SGM could have raised in the SGM Objection. *See In re Klein*, Case No. 2:13–AP–01777-RN, 2013 WL 6253819, at *9 (Bankr. C.D. Cal. Dec. 4, 2013) (Raising a new issue "in the Reply when the information seems readily available at the time the Motion was filed cannot be considered at this stage of the briefing. . . . Because such arguments will not be considered, the Trustee's surreply is not considered as well."). Moreover, the Surreply is unpersuasive and should be overruled on the merits for the reasons set forth in the Confirmation Brief as well as for the following three reasons summarily set forth below.[2]

First, SGM continues to attack the Plan as if it holds an "allowed" administrative claim. SGM, however, is a defendant in ongoing litigation commenced by the Debtors, and the Debtors sufficiently reserved for SGM in the unlikely event that it obtains a favorable judgment. *See* Surreply, at 2 ("The Plan may not be confirmed consistent with Section 1129(a)(9)(A) unless there is a funding source for payment of SGM's allowed administrative claim."). SGM's plan is transparent: by creating a presumption of an allowed claim, no matter how far removed in likelihood or timing, it will be able to enter the ambit of § 1129(a)(9). *See id.* ("[I]f SGM obtains an affirmative judgment on its counter-claims, that judgment will have administrative priority, and will have to be paid in full[.]"). But, this hope is insufficient to defeat the plain meaning of §

[2] The Debtors reserve the right to make additional responsive arguments in the event the Court considers the Surreply.

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1129(a)(9), or the Plan's clear satisfaction thereof. Furthermore, SGM cites no legal authority for its propositions—for consideration of its asserted administrative claim in the context of § 1129(a)(9), or in support of a reserve. SGM cites only two cases, both of which both explicitly and implicitly address § 1129(a)(11)—not (a)(9). *See In re Pizza of Hawaii, Inc*., 761 F.2d 1374 (9th Cir.1985); *In re Dennis Ponte, Inc*., 61 B.R. 296 (B.A.P. 9th Cir. 1986). *See* Surreply at 2. And, SGM's defensiveness over providing greater evidence in support of its claims provides further support for the "unrealistic and premature" nature of its asserted administrative claim. Accordingly, the Debtors stand on their Confirmation Brief and repeat their request that the SGM Objection be overruled.

Second, in the Confirmation Brief, the Debtors pointed out that SGM had no cognizable setoff rights arising from its pending counter-claims in the pending adversary proceeding because, under California state law, contingent claims cannot be used to support a right of setoff. In response, SGM does not dispute that they have no cognizable right of setoff. Instead SGM argues that it might have setoff rights some day at some point in the future, if it prevails in the adversary proceeding, and those contingent hypothetical rights cannot be cut off by the Plan now. *See* Surreply, at 6, lns. 13-19. But, SGM ignores that the context in which it is making the argument is confirmation of a plan of liquidation, and that its objection to the discussion of setoff rights must be based on some prohibition in the Bankruptcy Code. The only provision upon which it could rely is § 1129(a)(1). Unfortunately, for SGM, § 1129(a)(1) only prohibits plan provisions contrary to the provisions of the Bankruptcy Code. Thus, SGM must point to some Bankruptcy Code provision supporting the right they claim protected by § 1129(a)(1); here it cites none. In fact, they concede that § 553(a) does not apply, both because they have no present right of setoff under state law to be preserved by § 553(a) and because § 553(a) only preserves setoff rights related to prepetition claims against prepetition debts, and they do not hold a prepetition claim. Even SGM concedes as much. *See* Surreply at 6, lns. 8-9 ("whether Section 553 literally applies is not controlling").

Similarly with regard to the right of recoupment, SGM asserts—again without support for the assertion—that recoupment rights are "not subject to elimination under the Bankruptcy

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Code." But there is no prohibition in the Bankruptcy Code in general or in § 1129 specifically prohibiting a plan of liquidation from cutting off recoupment rights. Congress wrote many specific prohibitions into § 1129, but did not include a prohibition against provisions in a plan that eliminate recoupment rights (or setoff rights that are not preserved by § 553(a) for that matter). The inclusion of many specific criteria for confirmation in § 1129, but absence of any mention of recoupment or setoff rights otherwise not protected by § 553(a) means that Congress did not intend to prohibit plan proponents from dealing with a creditor's rights of setoff or recoupment. *See Lamie v. United States Trustee*, 540 U.S. 526, 537 (2004) (courts should not add an "absent word" to a statute; "there is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted"); *Iselin v. United States*, 270 U.S. 245, 250 (1926) ("What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the Court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function.").

Third, SGM has substantially narrowed its arguments to the Plan's release, injunction, and exculpation provisions related to third parties, but its remaining arguments, restated in the Surreply, fail to address the impacts of recent Ninth Circuit precedent. By way of example, SGM abandons its broad attack on the Settlement Releases and suggests that the Settlement Releases *could* be permissible if only they were similar to the "opt-in" releases approved in *PG & E Corp*. *See* Surreply at 9 (citing *In re PG & E Corp*., – B.R. –, 2020 WL 3273475 (Bankr. N.D. Cal. June 17, 2020) ("Consensual third-party releases do not run afoul of section 524(e) or governing Ninth Circuit law such as *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995)) However, the *PG & E* court did not, as SGM claims, hold that nonconsensual releases are prohibited because such a ruling would be dictum—the court only addressed consensual releases. *See PG & E Corp*., 2020 WL 3273475t *11 ("The court concludes that *Lowenschuss* does not bar the voluntary opt-in releases contained in the Plan and therefore OVERRULES objections to these provisions."). Further, *Lowenschuss* did not make a distinction between consensual and nonconsensual releases because, as discussed in the Confirmation Brief,

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the Ninth Circuit held broadly that "without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors." 67 F.3d at 1401. As the Debtors noted, the Ninth Circuit clarified the limited scope of the "without exception" language in *Blixseth v. Credit Suisse*, 961 F.3d 1074 (9th Cir. 2020).

Moreover, SGM buries a new argument in a footnote that it clearly overlooked in the SGM Opposition. SGM claims that the Settlement Releases "do not involve a release of claims held by the Debtors against the Settlement Released Parties that may be approved as part of a settlement if found to be 'fair and reasonable under Rule 9019.'" Surreply at 9 n.9 (citing *In re PG & E Corp*., 2020 WL 3273475, at *10 n.5). SGM is plainly incorrect. As the Debtors discussed at length in the Confirmation Brief, the Plan provides:

> The entry of the Confirmation Order shall constitute the Bankruptcy Court's finding that (i) entering into the Plan Settlement is in the best interests of the Debtors, their Estates, and their creditors, (ii) the Plan Settlement is fair, equitable and reasonable, and (iii) the Plan Settlement meets all the standards set forth in Bankruptcy Rule 9019 and § 1123(b)(3)(A).

Plan § 7.1 at 43. The Plan clearly contemplates—and SGM did not challenge—separate approval of the Plan Settlement and the PBGC Settlement under Bankruptcy Rule 9019. Indeed, the Bankruptcy Court approved the releases provided in the PBGC Settlement pursuant to Bankruptcy Rule 9019. *See* Docket No. 5329. Further, SGM does not address the fact that each Class overwhelmingly voted to accept the Plan, which was solicited with clear notice of the release, injunction, and exculpation provisions contemplated under the Plan Settlement. *See Pac. Gas & Elec. Co.*, 304 B.R. 395, 416 (Bankr. N.D. Cal. 2004) ("Given that section 1123(b)(3)(A) permits a plan of reorganization to include settlements, and given the overwhelming votes in favor of the Plan, such review might be unnecessary.").

SGM's remaining arguments offer mere restatements of the SGM Objection. As set forth in the Confirmation Brief, the exculpation mirrors the scope of those approved in *Blixseth* and *PG & E*. Further, the injunctions are no broader than those that are regularly approved by courts in this District—a fact SGM choses to ignore. *See* Confirmation Br. at 87 (citing *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, No. 2:16-bk-17463-ER, Docket No. 1372 at 15 (Bankr. C.D. Cal.

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Sept. 18, 2018); *In re T Asset Acquisition Co., LLC*, No. 2:09-bk-31853-ER, Docket No. 741, at 4-5 (Bankr. C.D. Cal. June 6, 2011); *In re SCI Real Estate Invs., LLC*, Case No. 2:11-bk-15975-PC, Docket No. 186, at 18 (Bankr. C.D. Cal. June 15, 2012); *In re Danville Land Invs., LLC*, Case No. 2:11-bk-62685-DS, Docket No. 150, at 8 (Bankr. C.D. Cal. May 23, 2013)). Nor does SGM ever contend that the releases, exculpations, or injunctions relate to claims that SGM may have against co-liable parties. Accordingly, the releases, injunctions, and exculpations are permissible.

II.

RESPONSE TO THE TOYON EVIDENTIARY OBJECTIONS

The Toyon Evidentiary Objections to the *Declaration of Peter C. Chadwick* (the "Chadwick Declaration") in support of the Confirmation Brief should be overruled for the following reasons:

- Toyon objects to Mr. Chadwicks testimony that Toyon "did not provide a benefit to the Debtors' estates . . . accordingly Toyon would not be entitled to distributions from the Administrative Claims Reserve." *See* Toyon Evid. Obj. at 1 (citing Chadwick Decl. ¶ 34). Toyon claims that, under Federal Rule of Evidence ("FRE") 704(a), "[t]his testimony is not admissible to the extent that it offers an opinion on an ultimate issue of law." *See* Toyon Evid. Obj. at 1. However, FRE 704(a) actually states that "[a]n opinion is ***not*** objectionable just because it embraces an ultimate issue." *See* FRE 704(a) (emphasis added). In any event, Mr. Chadwick does not offer an opinion on an ultimate issue of law. He is the Debtors' Chief Financial Officer explaining the debtors' exercise of business judgment. *See* Toyon Evid. Obj. at 1 (asserting that, under FRE 701(a), "the testimony is not rationally based on the witness's perception and offers an improper legal conclusion"). He plainly has a basis for the statements in his declaration, and they are helpful to the issues before the court.

- Toyon claims that Mr. Chadwick's testimony that Toyon "did not provide a benefit to the Debtors' estates, . . . accordingly Toyon would not be entitled to distributions from the Administrative Claims Reserve" is further objectionable under FRE 602. *See* Toyon Evid. Obj. at 1 (citing Chadwick Decl. ¶ 34). As the debtors' Chief Financial Officer, Mr. Chadwick has personal knowledge of the issues in his declaration, so his declaration satisfies FRE 602.

- Toyon also asserts that Mr. Chadwick's testimony that "[t]he Debtors in the exercise of their sound business judgment concluded that Toyon's pursuit of appeals which did not result in recoveries to the Debtors did not provide a benefit to the Debtors' estates," must be hearsay because it "appears to be based upon statements made by unidentified and undisclosed witnesses." *See* Toyon Evid.

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> Obj. at 2 (citing Chadwick Decl. ¶ 34). The Chadwick Declaration does not contain hearsay. It provides an explanation of the Debtors' business judgment by their Chief Financial Officer, who was directly involved in exercising that business judgment.

Accordingly, for the reasons set forth above, the Toyon Evidentiary Objections should be overruled in their entirety.

III.

CONCLUSION

WHEREFORE, the Debtors respectfully request that the Court (i) strike or otherwise overrule the Surreply, (ii) overrule the Toyon Evidentiary Objections, (iii) confirm the Plan, and (iv) grant such other and further relief as is just and proper under the circumstances.

Dated: August 10, 2020

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