Docket #0044 Date Filed: 10/24/2019

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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

In re

VERITY HEALTH SYSTEM OF CALIFORNIA, INC.

Debtors and Debtors in Possession.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF VERITY HEALTH SYSTEM OF CALIFORNIA, INC., ET AL.,

Plaintiffs,

v.

UMB BANK, NATIONAL ASSOCIATION,

Defendant.

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

Adv. No.: 2:19-ap-01166-ER

REPLY OF DEFENDANT, UMB BANK, IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS THE AMENDED COMPLAINT

Hearing
Date: November 21, 2019
Time: 10:00 a.m.
Courtroom: 1568
Judge: Hon. Ernest M. Robles

Complaint Filed: June 13, 2019

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[1] In accordance with Local Rule 9013-2(c)(3)(D), copies of any unpublished decisions cited herein are attached hereto as Exhibit 1.

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Defendant files this reply brief in further support of its Motion to Dismiss the Amended Complaint (the "Motion to Dismiss"), and in response to the *Plaintiff's Opposition to Motion of Defendant UMB Bank, National Association to Dismiss First Amended Complaint for Determination of Validity, Priority, and Extent of Liens and Security Interests,* dated October 17, 2019 (the "Opposition"), and respectfully states as follows:[2]

PRELIMINARY STATEMENT

Although Plaintiff concedes a number of UMB's arguments made in the Motion to Dismiss, it attempts to substitute equally untenable arguments, presented for the first time in the Opposition, and continues to make claims that are hypothetical and premature.

In the Opposition, Plaintiff concedes that the correct, initial valuation methodology that should be applicable to UMB's Prepetition Collateral is going concern value. That concession should lay to rest any argument that UMB's collateral could be charged with a so-called "going concern premium." Plaintiff's "going concern premium" theory fails unless the initial collateral valuation is made on a liquidation/foreclosure basis. There can be no "going concern premium" if the initial collateral value is determined on a going concern basis.

Plaintiff, however, substitutes an argument that supposedly achieves the same result by asking this Court to rule that going concern value is, essentially, an independent asset class that must be separately listed and described in a valid collateral description. According to Plaintiff, the failure to include phrases such as "going concern value" or "enterprise value" in a collateral description renders it flawed as a matter of law, and prevents a secured creditor from obtaining the full proceeds of a going concern sale. In other words, Plaintiff demands that this Court, once again, strip out any going concern value from UMB's Prepetition Collateral, despite the fact that it admits that going concern value is the correct valuation methodology. This is simply calling Plaintiff's

[2] Capitalized terms used but not defined herein shall have the meanings ascribed to them in *Defendant's Memorandum of Points and Authorities in Support of Defendant's Motion to Dismiss the Amended Complaint,* dated October 1, 2019 [Adv. Pro. Doc.No. 40] (the "Supporting Memorandum").

discredited "going concern premium" argument by another name, and is a collateral attack on controlling precedent in this Circuit.

Plaintiff's new theory is also meritless. Going concern value, enterprise value and the like are just valuation methodologies. They are not separately identifiable classes of assets. They cannot be separated from the underlying assets which generate such value. Perfected security interests are granted by listing and describing assets or categories of assets, not by listing valuation methodologies that may, under certain circumstances, be applied to those assets. Nothing in any secured transactions law or any statute requires a secured creditor to list in its collateral description both the underlying asset as well as all of the possible valuation methodologies that may apply to that asset. Plaintiff is not only wrong on existing law, but it is asking this Court to create new law which would have profoundly significant ramifications.

Plaintiff's remaining Counts should also be dismissed. In its Motion to Dismiss, UMB demonstrated that this Court conclusively found and determined that UMB had an equity cushion in its Prepetition Collateral, and that UMB relied upon such finding in consenting to the priming lien of the DIP Lender. This Court's evidentiary findings as to value have been proven not only to be correct but, based upon the actual Sales Proceeds, a bit understated. The Opposition creates a strawman argument by asserting that Plaintiff should be allowed to continue to challenge any lien in the Debtors' bank accounts and post-petition QAF payments because UMB has made a claim that it currently has a Prepetition Replacement Lien (as defined in the Final DIP Order) on account of an actual diminution in the value of its equity cushion. This is false. UMB has <u>not</u> yet made claim that it has suffered a diminution in the value of its Prepetition Collateral or that it asserts a Prepetition Replacement Lien to protect its equity cushion. UMB expects the Sales Proceeds to repay its secured claim in full without the need to make a claim for diminution in value. Although UMB reserves the right to make such a claim if it is not ultimately paid in full, it has not made such a claim and may never make such a claim. Plaintiff has argued against a phantom claim that is not currently expected to arise, may never arise, is unknown today, and has

not been made by UMB. In short, Plaintiff's arguments in its Opposition are factually incorrect as well as hypothetical and premature.

For all of the reasons set forth in the Supporting Memorandum, as well as those included herein, this Court should dismiss each of the Amended Complaint's four Counts with prejudice.

ARGUMENT

I. There Is No Support for Plaintiff's Argument That Going Concern Value Is a Post-Petition Asset That May Be Carved Out from Proceeds of a Going Concern Sale.

Plaintiff has abandoned the original basis for its argument that a so-called "going concern premium" must be carved out from UMB's Prepetition Collateral. Plaintiff originally argued that a premium must be deducted from the value of UMB's secured claim which is equal to the difference between the foreclosure/liquidation value of UMB's Prepetition Collateral and the going concern value of UMB's Prepetition Collateral.[3] Plaintiff now admits, as it must, that the Supreme Court's holding in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997), as well as controlling Ninth Circuit precedent such as *First Southern Nat'l Bank v. Sunnyslope Hous. L.P. (In re Sunnyslope Hous. L.P.*) 859 F.3d 637, 644 (9th Cir. 2017) (en banc) (citing *In re Taffi*, 96 F.3d 1190, 1192 (9th Cir. 1996) (en banc), *cert. denied*, 138 L. Ed. 2d 987, 117 S. Ct. 2478 (1997)), provide that "going concern value" is the only proper measure for valuing the Prepetition Collateral because the Debtors have always contemplated a going concern sale of their assets. *See* Opposition at 12. Therefore, Plaintiff has conceded that there is no carve-out for any "going concern premium" measured by the difference between the foreclosure or liquidation value of the

[3] Plaintiff asserted that the "bankruptcy process created significant value above what the Defendant ***would have realized upon foreclosure*** on its interest in the Collateral," and that this "going concern premium" is therefore "not the proceeds of the Collateral." *See* Am. Compl. at ¶ 24 (emphasis added). Plaintiff further defined "the going concern premium generated by these Chapter 11 Cases," as "the delta between (i) the prices that would have been paid for the Debtors' assets if the Secured Creditors ***had foreclosed and/or the Debtors ceased operations***, and (ii) the prices generated by the SCC Sale and SGM Sale (together, the "Sales") through these cases[.]" *See Official Committee of Unsecured Creditors' Objection to Motion of the Debtors for an Order Approving Proposed Disclosure Statement and Other Relief [Dkt. 2995]*, dated Sept. 18, 2019 [Docket No. 3092] (the "DS Objection") at 8 (emphasis added).

Prepetition Collateral as of the Petition Date and the going concern value of the Prepetition Collateral as of the date of the Sales.

Despite its concession, Plaintiff continues to assert arguments that directly contradict the rules of *Rash* and *Sunnyslope*. In fact, Plaintiff's new allegations are nothing more than back door attacks on *Rash* and *Sunnyslope*.

For example, Plaintiff has doubled down on its assertion that the Debtors' continuing post-petition operations have "increased" the net realizable value of UMB's collateral during the course of the Debtors' cases. *See* Opposition at 2; 8. Evidently, Plaintiff sees no inconsistency in recognizing that "under the current circumstances, 'going concern value' is the proper measure for ascertaining the value of the Debtor's assets that comprise the 'Prepetition Collateral,'" (Opposition at 12), and simultaneously arguing that there is some "increase" above the going concern value to which UMB is not entitled. The going concern value of the Debtors' assets at the time of the Sales necessarily and, by definition, included the value that was expected to be generated during the pendency of these cases through operating the Hospitals as a going concern. *See, e.g., Bond v. Kerns*, Case No. CV-12-00875-TUC-RCC, 2013 U.S. Dist. LEXIS 184286, *2 n. 1 (D. Ariz. Dec. 16, 2013) (citations and internal quotation marks omitted) ("Going-concern is defined as the value of the assets of an enterprise considered as an operating business and therefore based on its earning power and prospects rather than on the value of the same assets in the event of liquidation."). Plaintiff's continued reference to an "increase" assumes that the starting point for valuation is something lower than going concern value, such as the foreclosure or liquidation value asserted by Plaintiff in the Amended Complaint and in its DS Objection, which theory Plaintiff has been compelled to admit is not supported by applicable case law.

None of the cases cited by Plaintiff in its Opposition supports its argument that some sort of value attributable to the post-petition labor of the Debtors' employees, or the ongoing operation of the Debtors' business, constitutes a separate category of assets, the value of which can be carved out of a secured creditor's secured claim. The absence of such precedent is hardly surprising, since it is a fundamental axiom of valuation methodology that determining the going concern value of

any operating business assumes that it will continue to operate and that labor will continue to be provided by employees working at the business. Plaintiff only cites cases in which courts have reiterated the unremarkable holding that, under Section 552 of the Bankruptcy Code, a prepetition lender's security interest does not extend to new assets created after the petition date. Plaintiff's drastic overstatement of the holdings of inapposite cases is illustrative of the complete lack of support for its position.

Plaintiff's primary authority is a decision from the Bankruptcy Court for the Northern District of Illinois. *HBSC Bank USA v. UAL Corp. (In re UAL Corp.),* 351 B.R. 916 (Bankr. N.D.Ill. 2006). Plaintiff goes so far as to claim that *UAL* is "fatal" to the Motion to Dismiss. *See* Opposition at 13. To the contrary, *UAL Corp.* is completely inapposite. In *UAL Corp.*, the court simply ruled, pursuant to Section 552(b) of the Bankruptcy Code, that the debtor's post-petition negotiation of a 10-year option to extend a lease on real estate that was subject to a prepetition lien was not proceeds of the creditor's prepetition security interest. *Id.* at 924. The debtor's rights in the post-petition, extended lease option were an entirely new asset that did not exist at the time of the filing. Not surprisingly, the court ruled that the prepetition security interest could not extend to an asset which did not even exist as of the petition date. *Id.* at 923. UAL has nothing to do with "going concern value." *UAL* simply holds that, where the debtor obtains a new property right after filing, a prepetition lien does not encumber that new, post-petition asset. That concept has existed since the enactment of the Bankruptcy Code. The *UAL* court simply prohibited the secured creditor from claiming an increase to its collateral value as a result of the debtor's acquisition of post-petition property rights. In this case, UMB is not claiming any increase in the value of its prepetition lien after the Petition Date on account of the Debtors' acquisition of any new assets. As explained in detail in the Supporting Memorandum, this Court has already found that, as of the Petition Date, UMB is oversecured on a going concern basis. UMB does not seek to increase that valuation and, most likely, UMB's collateral has not, in fact, increased in value since the Petition Date, especially in light of the undisputed fact that the Debtors have been losing approximately $450,000 per day. *See* Supplemental Cash Collateral Motion at ¶ 15.

The balance of the cases cited by Plaintiff similarly fail to support Plaintiff's position, as none of them establish an independent category of collateral that may be separated and carved out from proceeds of a going concern sale. At best, they simply acknowledge that, under Section 552, post-petition assets are not subject to prepetition liens. None of the cases even intimate that "going concern value" constitutes a separate category of assets that may be stripped from the underlying asset. For example, Plaintiff's reliance on *In re Cafeteria Operators, L.P.*, 299 B.R. 400 (Bankr. N.D. Tex. 2003) as "equally fatal" to UMB's position is unavailing. *Cafeteria Operators* simply ruled that, when proceeds arise from a sale of assets that include both collateral and unencumbered property, the portion of the proceeds derived from the sale of the unencumbered assets do not constitute lien proceeds. *Id.* at 410. The court authorized the debtors to utilize the lender's cash collateral over its objection, and granted the lender a replacement lien on all of the debtor's assets. *Id. Cafeteria Operators* contains no discussion of a "going concern value" at all, let alone does it identify such value as a separate category of assets that may be stripped from the underlying assets. Likewise, in *Far East Nat'l Bank v. United States Tr. (In re Premier Golf Props., LP),* 477 B.R. 767 (B.A.P. 9th Cir. 2012), the court determined that greens fees and driving range fees are not the rents, proceeds or profits of the lender's prepetition security interest. There is no discussion of carving out going concern value from the collateral. Moreover, there are no such assets involved in the Debtors' bankruptcy proceedings. The Committee also relies on *Arkison v. Frontier Asset Mgmt., LLC (In re Skagit Pac. Corp.),* (B.A.P. 9th Cir. 2004), in which the court determined that an account receivable generated post-petition is not proceeds of the lender's prepetition security interest in receivables. Once again, this has nothing to do with stripping off going concern value from the underlying asset. In fact, *Skagit* undercuts Plaintiff's argument because the court did note that its analysis would change if "the court grants a replacement lien in any new post-petition accounts receivable[.]" *Id.* at 337. UMB has, in fact, been granted a replacement lien by virtue of the Final DIP Order in this case.

Plaintiff's characterization of *In re Ebbler Furniture & Appliances, Inc.*, 804 F.2d 87 (7th Cir. 1986) is misleading and inaccurate. The *Ebbler* Court was asked to define the word "value"

as used in Section 547(c)(5) of the Bankruptcy Code, which section prevents a secured creditor from improving its position at the expense of an unsecured creditor during the 90 days prior to filing the bankruptcy petition. *Id.* at 89. Noting that other definitions of "value" provided by the Bankruptcy Code would not be useful for Section 547(c)(5) purposes, the Seventh Circuit found that the bankruptcy court appropriately utilized "cost basis" as the method for valuing the collateral. *Id.* at 90. Thus, the holding of *Ebbler* has absolutely nothing to do with the issues in this case. In its Opposition, Plaintiff merely cites to Judge Easterbrook's concurring opinion. Not only is a Seventh Circuit decision from 1986 not controlling on this Court, but Judge Easterbrook's concurring remarks are nothing more than *dicta*, even in the Seventh Circuit.

Plaintiff also cites *Ardmor Vending Co. v. Kim (In re Kim)*, 130 F.3d 863 (9th Cir. 1997) as though it somehow supports its argument. It does not. In *Kim,* the debtor intended to continue to operate its dry cleaning business using the secured creditors' collateral. The Ninth Circuit reversed the holdings of the B.A.P. and the bankruptcy court because they improperly valued the prepetition secured creditors' collateral (a lease and certain equipment) based on a liquidation value rather than as a turn-key operation. Because the debtor proposed to continue to use the property, a valuation on a going concern basis indicated that the secured creditors were fully secured in the entire enterprise value of the business. *Id.* at 866. Far from supporting Plaintiff's argument, *Kim* supports UMB's position that the value of the Prepetition Collateral must be determined by its going concern value. Plaintiff likewise misstates *In re 26 Trumbull Street*, 77 B.R. 374 (Bankr. D. Conn. 1987). Contrary to the Committee's misleading parenthetical in its Opposition (Opposition at 16), nowhere in this two page decision does the court opine on, let alone allocate, anything described as "going concern value." Rather, the court agreed with the secured creditor's valuation methodology of the collateral, and allocated the sales proceeds among the assets, based upon which assets were subject to the secured creditor's lien and which were not. *Id.* at 375.

It is notable that Plaintiff is unable to identify any precedent, in this circuit or others, that would support its theory. Instead, Plaintiff can only cite academic articles, despite its assertion

that its argument is not purely academic. *See* Opposition at 15 n. 9.

II. Plaintiff's "Going Concern Premium" Argument Conflates Valuation Methodologies with Asset Categories, and Asks This Court to Create New Law Holding that "Going Concern Value" Constitutes a Separately Identifiable Category of Assets That Must Be Included in a Collateral Description in Order to Establish a Perfected Lien

In its Opposition, Plaintiff conflates two distinct concepts: valuation methodology and asset categorization. "Going concern value" is a valuation methodology, not a category of assets. Assets include items such as real property, accounts, machinery and equipment, contract or license rights, etc. Valuation methodologies describe how such assets may be assigned a value. There is no requirement in any real estate law or in the Uniform Commercial Code (the "UCC") to include in the collateral description all conceivable valuation methodologies that may subsequently be applied to value that collateral. The only requirement for attachment and perfection of a lien is to list or describe the assets themselves either by asset, or by category of asset. In fact, the UCC does not mention valuation methodology when it specifies the requirements for a proper collateral description. *See* UCC Section 9-109(a) ("[Article 9 of the UCC] apples to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;"); UCC Section 9-108(a) ("a description of personal or real property is sufficient whether or not it is specific, if it reasonably identifies what is described").

As explained by the Supreme Court in *Rash*, an asset may have a number of different valuations, depending on the debtors' use or disposition of the asset. *See Rash,* 520 U.S. at 962-63. One of those valuations is going concern value. But, it is the same asset that generates those different valuations, not a separate and distinct category of asset called "going concern value." Simply put, a valuation methodology is not an asset that can be subject to a separate lien; it is simply the value of an asset, and it is the asset, not the valuation methodology, which is the collateral subject to the rules and requirements of perfection. As noted in UMB's Motion to Dismiss, and as conceded in the Opposition, Plaintiff has not challenged the fact that UMB has satisfied the requirement for perfection (other than with respect to certain bank accounts and post-petition QAF payments).

Plaintiff has not cited – and cannot cite - one case that stands for the proposition that "going concern value" is a distinct type or category of asset that must be separately described in a collateral description in order to perfect a lien. That proposition also makes no logical sense. If "going concern" or "enterprise" value were a separate category of collateral under the UCC, it could theoretically be sold separately and apart from the underlying asset. Further, if this Court were to adopt Plaintiff's argument, it would be tantamount to establishing new law applicable to all secured transactions: in order to be entitled to the full sale proceeds arising from the sale of a debtor's collateral that is being sold on a going concern basis, the secured lender would need to include words such as "going concern" or "enterprise value" as a distinct category of assets in the collateral description in its mortgage or UCC-1 financing statement.

Plaintiff is simply wrong on the law. But, solely for the sake of argument, even if there does exist a separate category of assets and collateral known as "going concern value," UMB would have a perfected lien. Plaintiff's mythical asset class could only be encompassed by the UCC collateral category denoted as "intangibles." Plaintiff could not possibly argue that "going concern value" is a tangible asset. *See* UCC Section 9-102(42) (definition of "General Intangibles"). Since UMB's collateral description does include "intangibles," UMB would have a perfected lien in "going concern value," even assuming Plaintiff's theory has any merit whatsoever. *See* Supporting Memorandum at 5-6 (describing UMB's security interest as including intangibles).

Last, Plaintiff appears to acknowledge the invalidity of its own argument. In footnote 6 on page 13 of the Opposition, Plaintiff states that it

> has not objected, and would not object, to the Debtors, and the Court, adopting a 'going concern value' metric for all relevant purposes, including 'valuation' of the Prepetition Liens and Prepetition Obligation, so long as any amounts attributable to Debtors' assets as to which the UMB Secured Creditors have not been able to establish valid, perfected, and enforceable liens is deducted from the value of Prepetition Liens and Prepetition Obligation for distribution purposes.

Plaintiff's offer to limit this litigation and to value all collateral based only a going concern basis is a constructive step in the right direction. UMB interprets such an offer to mean that Plaintiff's lien challenge will no longer include any attempts to carve out any going concern value on any basis whatsoever from UMB's secured claim, including any substitute basis argued in the Opposition, and that Plaintiff's claims are now limited, as presented in the Initial Complaint, to a challenge with respect to the perfection of UMB's liens on (i) the Debtors' prepetition bank accounts, and (ii) the Debtors' rights in payments arising from post-petition QAF cycles (*viz.*, QAF cycles 6 – 10).

III. Contrary to Plaintiff's Representations, UMB is Not Currently Asserting A Prepetition Replacement Lien; Therefore, Counts II and III Are Premature and Fail to Present a Case or Controversy.

In its Motion to Dismiss, UMB argues that Plaintiff's lien challenge with respect to UMB's security interest in the Debtors' Deposit Accounts[4] is moot because all of the funds in those accounts have long since been used and expended by the Debtors to fund their significant cash flow operating losses. Plaintiff admits that all such funds are now gone. *See* Opposition at 17. This should render Plaintiff's lien challenge with respect to the Deposit Accounts moot. Plaintiff argues, however, that its challenge to UMB's security interest in the Deposit Accounts continues to be relevant because UMB presently contends that it will have a diminution claim, and the extent of UMB's prepetition liens in the Deposit Accounts will need to be determined in order to calculate the amount of such diminution. *Id.* Plaintiff factually misstates UMB's position. While UMB would be entitled to a Prepetition Replacement Lien pursuant to the express terms of the Final DIP Order that would encumber **all** of the Debtors' assets to the extent of any diminution in the value of its Prepetition Collateral, UMB is not currently asserting that there is any diminution in value. UMB reserves the right to make such a claim in the future if it is not paid in full but, at present, UMB expects to be fully paid if the remaining Hospital sale closes on a timely basis and on its

[4] As defined in the Amended Complaint.

current terms. In fact, UMB has consistently maintained that it is oversecured, based both on this Court's findings in connection with the Final DIP Order and as confirmed by the fact that the actual Sales Proceeds are expected to exceed UMB's secured claim by an even greater margin. *See* Supporting Memorandum at 9; 19-21. The Sales may also result in excess Sales Proceeds that would inure to the benefit of the unsecured creditors. Therefore, Plaintiff's argument that Count II of the Amended Complaint should survive because UMB is currently claiming a Prepetition Replacement Lien due to a diminution in value is simply wrong as matter of fact and is, at best, hypothetical and premature. Count II should be dismissed because it presents no current case or controversy.

In Count III of the Amended Complaint, Plaintiff seeks to invalidate any lien on post-petition QAF (*viz*., QAF Payments received on account of QAF Cycles 6 – 10). Once again, solely for purposes of the Motion to Dismiss and reserving all rights, UMB is not currently asserting a Prepetition Replacement Lien on post-petition QAF Payments, because UMB expects to be paid in full from the Sales Proceeds. Thus, UMB may never need to assert any diminution claim resulting in a Prepetition Replacement Lien. Accordingly, like the relief sought in Count II, the relief sought in Count III is hypothetical, premature and fails to present a case or controversy.

Finally, it should also be noted that Plaintiff's assertion that the funds held in the Deposit Accounts "have been consumed in running the Hospitals, thus benefiting the UMB Secured Creditors, when those funds could instead have been made available to unsecured creditors" (Opposition at 17) attempts to turn reality on its head. If Plaintiff genuinely believed that it was in its constituency's best interest for the Debtors to immediately liquidate so that it could have had access to the Deposit Accounts, it had every opportunity to seek appropriate relief in this Court. Plaintiff voluntarily chose not to do so. Instead, Plaintiff allowed these cases to be fully funded and paid for by the Prepetition Secured Creditors in the hopes that the continued operation of the Hospitals, including the use of the cash in the Deposit Accounts, would afford the unsecured creditors the possibility for a greater recovery than if the Hospitals were shuttered and the cash

were distributed. Plaintiff took the risk. It should not now be entitled to charge UMB with the downside cost of its own gamble.

IV. Plaintiff Is Not Entitled to Attack Any and All Aspects of UMB's Secured Claim Well After the Expiration of the Challenge Deadline Based on the Word "Including" in Count I of the Amended Complaint

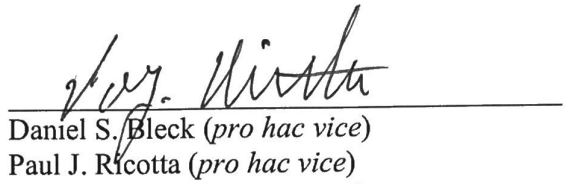
Plaintiff makes the untenable argument that, despite the expiration of the Challenge Deadline, by qualifying Count I with the word "including," it is entitled to challenge additional categories of UMB's collateral that are not specifically enumerated in the Amended Complaint. *See* Opposition at 5; 21. Plaintiff's argument would create a secret Lien Challenge and eviscerate federal pleading standards which require that defendants be "provided fair notice of the claim being asserted and the grounds upon which it rests." *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570 (2007). The case cited by Plaintiff in support of its position does not hold differently. In *In re Kline,* the court allowed plaintiff to amend its complaint to include a specific bank account as an "additional example" of an asset that was allegedly fraudulently transferred, the existence of which debtor hid from plaintiff. No. 8:13-bk-11334-TA, 2014 WL 12665719, at *2 (Bankr. C.D. Cal. Mar. 11, 2014). Neither *Kline,* nor any other case cited by Plaintiff, can support the outlandish position that by simply using the word "including" in a complaint, a plaintiff is free to continue to add additional facts and causes of action well past the Challenge Deadline. If Plaintiff is allowed to maintain that Count I of the Amended Complaint merely contains a "non-exhaustive list of assets in which the UMB Secured Creditors do *not* have a lien," (Opposition at 3), when is Plaintiff ever required to provide an exhaustive list? By filing a lien challenge by the deadline, Plaintiff should not be given *carte blanche* subsequently to prosecute any lien challenge.

CONCLUSION

For the reasons stated above, as well as those set forth in the Supporting Memorandum, each of the Counts of the Amended Complaint should be dismissed, with prejudice.

DATED: October 24, 2019

MINTZ LEVIN COHN FERRIS GLOVSKY AND POPEO, P.C.



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Attorneys for UMB Bank, N.A. as master indenture trustee

EXHIBIT 1

Neutral
As of: September 19, 2019 2:16 PM Z

Bond v. Kerns

United States District Court for the District of Arizona

December 13, 2013, Decided; December 16, 2013, Filed

No. CV-12-00875-TUC-RCC

Reporter
2013 U.S. Dist. LEXIS 184286 *; 2013 WL 7046375

Mark Bond and Ashlea Bond, Appellants, v. Dianne C. Kerns, et al., Appellees.

Prior History: *In re Bond, 2012 Bankr. LEXIS 4107 (Bankr. D. Ariz., Sept. 5, 2012)*

Core Terms

valuation, liquidation value, cases, bankruptcy court, calculate

Counsel: **[*1]** For Mark Bond, Debtors, Ashlea Bond, Debtors, Appellants: H Lee Horner, Jr., LEAD ATTORNEY, Goldstein Horner & Horner Attorneys, Cortaro, AZ.

Dianne C Kerns, Chapter 13, Trustee, Appellee, Pro se, Tucson, AZ.

For Prince Road Associated LLC, Appellee: Karl E MacOmber, LEAD ATTORNEY, Monroe & McDonough PC, Tucson, AZ.

Judges: Raner C. Collins, Chief United States District Judge.

Opinion by: Raner C. Collins

Opinion

ORDER

Pending before the Court is Appellants' appeal from the Bankruptcy Court's dismissal of their Chapter 13 case. This matter has been fully briefed, and the Court heard oral arguments on December 12, 2013. For the following reasons, the Court will dismiss the appeal.

I. Background

The Bonds have a 70% interest in AMG Enterprizes, LLC, which is doing business as Old Chicago Deli, a restaurant in Green Valley.

Prince Road is an unsecured creditor of the Bonds and is a landlord for a commercial property that the Bonds leased via a different LLC (ITP Enterprizes, LLC) for their Green Valley Furnishings business.

The Bonds filed their petition for relief under Chapter 13 of the United States Bankruptcy Code on December 13, 2011. In their proposed Chapter 13 plan, the Bonds gave Old Chicago a value of $5,000.00: **[*2]** the liquidation value of the used restaurant equipment. Mr. Bond consulted a restaurant equipment vendor for an informal appraisal but did not consult a business broker.

Prince Road filed an objection to the confirmation of the Bonds' Chapter 13 plan, arguing that the Bonds had undervalued their LLCs and that the plan did not treat Prince Road in a fair or reasonable manner because it would pay Prince Road nothing. The Bonds conceded that they planned to continue operation of Old Chicago, but maintained a liquidation value was the proper valuation of their interest in Old Chicago.

After holding an evidentiary hearing on Prince Road's objection to the plan confirmation, Judge Hollowell ordered the Bonds to apply a "going concern"[1] methodology to calculate their 70% interest in Old Chicago, and to amend their plan accordingly. Judge Hollowell explained that she would not confirm the Bonds' original plan because it was inappropriate to apply a liquidation valuation to Old Chicago, and that it

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[1] "Going-concern" is defined as "the value of the assets of an enterprise considered as an operating business and therefore based on its earning power and prospects rather than on the value of the same assets in the event of liquidation." Merriam-Webster Dictionary, *http://www.merriam-webster.com/dictionary/going-concern%20value*

needed to be treated as an ongoing business. She further stated the Bonds must "calculate a value which reflects what creditors may receive from Debtors' continued possession and operation." (Doc. **[*3]** 17, Ex. L at 8). Judge Hollowell also stated that "the business itself is generating something and it's more than the liquidation value," and that the creditors were "entitled to get as much money as [the Bonds] can get back to them." (Doc. 17, Ex. T at 38).

Judge Hollowell gave the Bonds thirty days to amend their plan. They ultimately chose not to, maintaining their position that the liquidation value was the proper valuation to be used. Judge Hollowell dismissed the case on November 19, 2012.

On November 24, 2012 the Bonds timely filed a notice of appeal to the District Court. They also filed an application to stay dismissal with the bankruptcy court, which was denied. The Bonds then filed a motion for stay with the District Court, which was also denied.

II. Standard of Review

Dismissal orders are reviewed for an abuse of discretion, which includes a de novo review **[*4]** of the law and a review of the factual findings for clear error. *See* *In re JTS Corp., 617 F.3d 1102, 1109 (9th Cir. 2010)*; *In re Guastella, 341 B.R. 908, 915 (9th Cir. BAP 2006)*; *In re Stephen, BAP EC-10-1511-DMKPA, 2012 Bankr. LEXIS 1413, 2012 WL 1080455 (B.A.P. 9th Cir. Apr. 2, 2012)*.

III. Proper Valuation

The principal issue on appeal is whether the Bonds properly assessed the value of their 70% interest in Old Chicago based on the liquidation value of the restaurant equipment, or whether they were required to apply a going-concern valuation, as ordered by the bankruptcy court.

a. Law

In *In re Taffi, 96 F.3d 1190 (9th Cir. 1996)*, the IRS sought to enforce a tax lien on a home that the debtors were going to retain through their plan of reorganization. The Ninth Circuit found that when a Chapter 13 debtor "intends to retain property subject to a lien" and "the proposed use of the property is continued retention by the debtor, the purpose of the valuation is to determine how much the creditor will receive for the debtor's continued possession." *Id. at 1192*.

The Ninth Circuit expanded on *Taffi* in *In re Kim, 130 F.3d 863 (9th Cir. 1997)*. In *Kim*, the debtors filed a Chapter 13 bankruptcy plan treating one claimant **[*5]** as partially secured and the other as wholly secured. The claimants argued the debtors had undervalued the collateral securing their claims. The Ninth Circuit instructed that, "In light of *Taffi*," where the debtors "continue to operate the business ... valuation should be based on the use or disposition to be made of the interest, which in this case means the continued operation of the business in the same location." *Id. at 865*. Thus, the court rejected the debtors' attempt to use the liquidation value of their business equipment because the equipment was not going to be sold, but instead used to sustain an ongoing business. *Id*.

A number of other cases, both from this circuit and others, come to essentially the same conclusion: when a debtor plans to continue operation of a business, the business should be valued as a going concern. *See e.g.* *In re DAK Indus., Inc., 170 F.3d 1197, 1199-1200 (9th Cir. 1999)* (bankruptcy court properly concluded business was a going concern when it continued to operate during the preference period); *In re Tennessee Chemical Co., 143 B.R. 468, 474 (Bankr. E.D. Tenn. 1992)* (court applied going concern value even though business had not made a profit in three **[*6]** years, noting "[g]oing concern value means that value is added to the property because it can be operated as a business."); *In re Thomas, 246 B.R. 500, 505 (E.D.Pa. 2000)* ("liquidation value is not a proper measure of a company ... when the business will continue its operations"); *Matter of Prince, 85 F.3d 314, 319 (C.A.7 (Ill.) 1996)* ("[W]here a business is expected to continue as a going concern, the company's expected future earnings from operations often far exceed the liquidation value of the company's physical assets. Thus, when valuing a business that is continuing to operate as a going concern, liquidation value is generally an inaccurate approximation of what shares are worth to shareholders."); *In re McLaughlin, 217 B.R. 772, 781 (Bankr. W.D.Tex. 1998)*; *Williams v. Swimlear, 2008 WL 1805824 (E.D. N.Y.)*

b. Parties' Arguments

The Bonds correctly note that most Chapter 13 cases that consider going concern value focus on "how to

calculate the value of collateral securing a claim proposed to be stripped down" such as in *Kim* and *Taffi*. (Doc. 18 at 11). Thus, the Bonds conclude it is inappropriate to apply a going concern value in their case, because strip down of a secured claim **[*7]** is not at issue. The Bonds further argue that in a hypothetical forced-sale Chapter 7 case, Old Chicago would be worth no more than its used equipment because the Bonds would refuse to sign a non-compete agreement, would refuse to keep running the business, and that Old Chicago is worth nothing without their daily presence.

Prince Road argues that although the Bonds claim they are the only ones capable of successfully operating Old Chicago, and they imply the business isn't worth anything beyond the value of used equipment and therefore no one would buy it, the fact that the Bonds previously sold Old Chicago "proves the business has sale value beyond its liquidation value." (Doc. 22 at 5). Prince Road therefore argues the court's reasoning in cases such as *Thomas* and *Kim* applies here, and that the proper valuation for a business that will continue to operate is the going concern value.

Judge Hollowell acknowledged that most Chapter 13 cases addressing going-concern value focus on calculating the value of collateral securing a claim; however, she also stated the reasoning in those cases extends to the issues at hand here. Judge Hollowell found that although this case concerns an unsecured **[*8]** claim, the proposed liquidation value "ignores that the business is a going concern and that Debtors will operate it." *In re Bond, 2012 Bankr. LEXIS 4107, 2012 WL 3867427 at 4*. Judge Hollowell further stated that "[a]s *Taffi* and *Kim* concluded, this sort of circumstance requires that Debtors calculate a value which reflects what creditors may receive from Debtor's continued possession and operation. That valuation should be calculated on a going-concern basis." *Id*.

c. Analysis

It is uncontested that the Bonds plan to continue operation of Old Chicago. The record before the bankruptcy court, as well as the case law reviewed by this Court, supports Judge Hollowell's finding that the Bonds should apply a going concern valuation to Old Chicago. Although there are no cases directly on point to the situation presented here, a number of analogous cases all come to the same conclusion: when a debtor plans to continue operation of a business, the business should be valued as a going concern.

The Court finds Judge Hollowell did not abuse her discretion when she dismissed the Bonds' case after they failed to obey her order instructing them to amend their Chapter 13 plan. "An abuse of discretion may be based on an incorrect **[*9]** legal standard, or a clearly erroneous view of the facts, or a ruling that leaves the reviewing court with a definite and firm conviction that there has been a clear error of judgment." *In re Knedlik, BAP.WW-08-1011-KUKJU, 2008 Bankr. LEXIS 4670, 2008 WL 8444815 (B.A.P. 9th Cir. June 30, 2008)*. None of these situations apply here.

Second, in light of the facts of this case, it was not clearly erroneous for the bankruptcy court to find that the Bonds would continue to conduct business and Old Chicago was, therefore, a going concern. *See In re Greene, 583 F.3d 614, 618 (9th Cir.2009)* (The Court must accept the bankruptcy court's findings of fact unless the Court "is left with the definite and firm conviction that a mistake has been committed.").

Finally, the Court has considered de novo whether the bankruptcy court applied the correct legal standard in ordering the Bonds to apply a going concern valuation, and the Court finds no error here. The cases discussing going concern valuation do not turn on whether the claim is secured or unsecured, as the Bonds argue, but on whether the business will continue or cease operation. The fact that the Bonds plan to continue operating requires a valuation of the business **[*10]** that reflects what Prince Road may receive from the Bonds' continued possession and operation of Old Chicago. The appropriate valuation is, therefore, a going concern valuation.

IV. Conclusion

The Bonds' failure to timely file an amended Chapter 13 plan, after a clear order from the bankruptcy court, justified the dismissal of this case. Judge Hollowell was correct when she found Old Chicago to be a going concern, and ordered the Bonds to value it as such. Old Chicago is still a going concern, and it must be treated as one.

Accordingly,

IT IS HEREBY ORDERED affirming the Bankruptcy Court's dismissal order. The Clerk shall close its file on this matter.

Dated this 13th day of December, 2013.

/s/ Raner C. Collins

Raner C. Collins

Chief United States District Judge

End of Document

2014 WL 12665719
Only the Westlaw citation is currently available.
United States Bankruptcy Court, C.D. California, Santa Ana Division.

IN RE: Dennis P. KLINE, Debtor.
Pride Mobility Products Corporation, Plaintiff,
v.
Dennis P. Kline, Defendant.

Case No.: 8:13–bk–11334–TA
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Adv. No. 8:13–ap–01250–TA
|
Signed March 11, 2014
|
Date: February 6, 2014, Time: 11:00 a.m., Location: Courtroom 5B

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ORDER DENYING DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S FIRST AMENDED COMPLAINT

Theodor C. Albert, United States Bankruptcy Judge

***1** Defendant Dennis P. Kline's *Motion to Dismiss the First Amended Complaint* having been considered, for reasons set forth in the tentative ruling, and good cause appearing,

IT IS ORDERED as follows:

This is the defendant's motion to dismiss the First Amended Complaint under Rule 12(b)(6). The complaint is one objecting to discharge under 11 U.S.C. §§ 727(a) (2)(3)(4a)(A) and (5). Thethrust of the motion is that: (1) although the original complaint was timely, the amended complaint raises new facts and issues which are not sufficiently related to the original complaint so as to "relate back," and since the original complaint was filed on the last possible day, the new portions of the complaint must be dismissed with prejudice on limitations grounds; and (2) even if the new material did relate back, it still is not stated with sufficient detail to pass muster under Rule 9. Most of the new material relates to an alleged account at Citibank which debtor reportedly failed to list on his schedules, failed to reveal at the § 341a meeting, failed to reveal despite repeated discovery requests and which was material considering it contained many thousands both before and after the petition date.

First, the court must dispose of the plaintiff's arguments based on equitable tolling, equitable estoppel or exercise of some similar, vague powers under § 105. Because these principles have to be exercised only to the extent not inconsistent with plain language of specific rules, and the purposes served by those rules, they are largely unavailing in discharge and dischargeability matters. *Schunk v. Santos (In re Santos)*, 112 B.R. 1001, 1006–08 (9th Cir. BAP 1990). This is because FRBP 4004(a) and (b), 4007(c) and 9006(b)(3) carefully specify that the limitations can only be extended by court order within the original time period. The limitations are strictly construed in the Ninth Circuit and are not susceptible to expansion for equitable reasons or under § 105. *Id.*; see also *Kamjoo v. Wright (In re Wright)*, 2010 WL 6259968 (9th Cir BAP 2010).

But a closer question is whether there is any need for resort to equitable remedies. Plaintiff contends the amendments relate back to the original, timely-filed complaint. Plaintiff argues that the purpose of Rule 15 [governing amendments] is to facilitate decisions on the merits rather than pleadings or technicalities, and is applied more leniently when amendments are only against a single defendant and not adding additional parties. *United States ex rel. Cericola v. FNMA*, 529 F.Supp.2d 1139, 1148 (C.D. Cal. 2007), citing *Martell v. Trilogy, Ltd.*, 872 F.2d 322, 324 (9th Cir. 1989). The "relation back" standard of Rule 15 (c) is articulated in defendant's cited case *Gelling v. Dean (In re Dean)*, 11 B.R. 542, 545 (9th Cir. BAP 1981), *aff'd* 687 F.2d 307 (9th Cir. 1982): "In determining whether an amended cause of action is to relate back, the emphasis is not on the legal theory of the action, but whether the specified conduct of the defendant, upon which the plaintiff is relying to enforce his amended claim, is identifiable with the original claim. (*Citing* 3 Moore's Federal Practice ¶ 15.15(3) pp. 15–196–205 (2d ed. 1980)). The basic test is whether the evidence with respect to the second set of allegations could have been introduced under the original complaint liberally construed;

or as a corollary, that in terms of notice, one may fairly perceive some identification or relationship between what was pleaded in the original and amended complaints." citing *Rural Fire Protection Co. v. Hepp*, 366 F.2d 355 (9th Cir. 1966).

2** The original complaint contains allegations regarding ownership of RSL, accounts in the Cook Islands, sales of watches and reference is made to a safety deposit at Chase Bank, and a wine collection only disclosed post-petition. ¶¶ 81–103. The plaintiff in the original complaint observes a marked discrepancy between a prepetition financial statement and the amounts listed on the schedules, suggesting missing assets. ¶ 84–85 and 88–89, 91. Similarly, the plaintiff in the complaint notes that the loss of Source One's (debtor's corporation) assets is unexplained. ¶¶ 104–111. No specific reference is made to an account at Citibank. However, the stated facts are all by reference run through the more expansive charging allegation of the First Claim for Relief found at ¶ 113: "The debtor has, with intent to hinder, delay, or defraud his creditors, transferred, removed or concealed property within one year prior to filing the Bankruptcy Petition, ***including by selling his shares in RSL and using the Cook Islands Trust to conceal assets." (emphasis added) So the alleged specific instances of transfers and concealments, though not including reference to Citibank, are specifically not made exclusive, but only exemplary. A similar analysis could be done for the Second Claim for Relief and use of the word "including" at ¶ 116 as well as the incorporation of all preceding paragraphs in ¶ 115. So, adopting the *Dean* standard, the court has little doubt that evidence of a hidden and omitted bank account at Citibank would be admissible concerning the First and the Second Claims for Relief "liberally construed."

Moreover, the court views the teaching of *Cericola* as instructive here. The relator plaintiff in *Cericola* outlined in her original timely complaint a scheme to defraud the government by FNMA's procurement of insurance on loans not qualified for HUD insurance. The original complaint was woefully short of details on the specific loans in question, but nevertheless the court viewed the original complaint sufficient for relation back purposes (and thus avoiding a limitations issue) because it put the defendant on notice as to the general outlines of the scheme. 529 F.Supp.2d at 1149. Similarly, in the case at bar, no doubt the plaintiff would have originally mentioned Citibank had it known of same. But that does not mean that there is not sufficient notice of the more general failure to account for assets and attempts to hinder, delay and defraud creditors and conceal from the trustee and creditors the defendant's assets.

Defendant's authorities are largely distinguishable. *In re Magno,* 216 B.R. 34 (9th Cir. BAP 1997) involved the question of whether a § 523 theory of relief was a "lesser included" offense within a timely-filed § 727 complaint. The BAP correctly determined there was little connection between the elements of an individual fraud theory and the more general intent to hinder, delay or defraud and/or a false oath in the case. *Id.* at 42. Somewhat closer, but still not persuasive, is *Stodd v. Mufti (In re Mufti)*, 61 B.R. 514 (Bankr. C.D.Cal. 1986). In *Mufti,* the facts alleged in the original timely complaint concerned a fraudulent pre-petition transfer of real estate, but this did not sufficiently relate to amended (and untimely) allegations concerning fraudulent concealment of same. This is logical: the original complaint dealt with a prepetition *transfer* that was fraudulent as to creditors; the second theory necessarily related to a post-petition failure to *testify* truthfully regarding same, an entirely different theory. But here, the undisclosed Citibank account is only *an additional example* of what has already been alleged regarding prepetition attempts to conceal or transfer assets out of the reach of creditors and failures post-petition to account in testimony or in schedules when the duty arose. The court finds these sufficiently connected to allow relation back (and thus timely) assertion of the theories set forth in the amended complaint. Surely the law cannot be that a plaintiff is kept from introducing more recently-discovered further examples of the same sort of offense as described in the original complaint.

Even less persuasive is the defendant's second basis for the motion. Here, defendant, citing the *Twombly* and *Iqbal* cases and Rule 9, argues that the amended complaint still does not contain sufficient detail allowing reasonable formation of an answer. Actually, the amended complaint contains a considerable (and more than sufficient) quantity of factual detail. First, *Twombly* and *Iqbal,* properly understood, merely hold for the proposition that a complaint must contain sufficient allegations of fact so as to create a plausible basis for relief. That standard is easily surpassed here. Second, although Rule 9 requires a greater allegation of factual detail to support fraud, this does not mean that a complaint must contain every conceivable fact supporting the claim. For example, the court doubts that the plaintiff has to allege exactly what debtor received in exchange for his Maserati or what the alleged value of RSL was. This sort of detail will come out in discovery. Nor is it necessary that Mr. Maahs and

Ms. Vallefuco fit within the statutory definition of "insiders" found at § 101(31). "Insiders" can be as expressed in common parlance in this context. The purpose in the federal pleading system is to give adequate notice of what must be defended, with sufficient detail to raise theories of liability beyond a speculative level. The rest is properly dealt with during the course of the litigation.

***3** The Defendant's motion to dismiss is DENIED.

The Defendant shall file an answer to Plaintiff's first amended complaint within thirty (30) days of entry of this order.

All Citations

Not Reported in B.R. Rptr., 2014 WL 12665719

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A true and correct copy of the foregoing document entitled (*specify*): **REPLY OF DEFENDANT, UMB BANK, IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS THE AMENDED COMPLAINT** 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*) October 24, 2019, 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:

- Alexandra Achamallah aachamallah@milbank.com, rliubicic@milbank.com
- Nicholas A Koffroth nick.koffroth@dentons.com, chris.omeara@dentons.com
- Samuel R Maizel samuel.maizel@dentons.com, alicia.aguilar@dentons.com;docket.general.lit.LOS@dentons.com;tania.moyron@dentons.com;kathryn.howard@dentons.com;joan.mack@dentons.com;derry.kalve@dentons.com
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- Mark Shinderman mshinderman@milbank.com, dmuhrez@milbank.com;dlbatie@milbank.com
- United States Trustee (LA) ustpregion16.la.ecf@usdoj.gov

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2. SERVED BY UNITED STATES MAIL:
On (*date*) _____, 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*) October 24, 2019, 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.

VIA FEDERAL EXPRESS
Honorable Ernest Robles
U.S. Bankruptcy Court
Roybal Federal Building
255 E. Temple Street, Suite 1560
Los Angeles, CA 90012

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

10/24/19	Diane Hashimoto		/s/ Diane Hashimoto
Date	*Printed Name*		*Signature*