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Case No. 2:19−cv−10352−DSF[1]
UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

In re: VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*,[2] Debtors and Debtors in Possession.	On Appeal from the United States Bankruptcy Court for the Central District of California (Bankr. Lead Case No.: 2:18-bk-20151-ER) **APPELLANT'S OPENING BRIEF**

[1] This appeal (2:19-cv-10352-DSF) has been consolidated with the following related appeals: 2:19-cv-10354-DSF and 2:19-cv-10356-DSF.

[2] The other Debtors in the chapter 11 cases, being jointly administered under Lead Case No. 2:18-bk-20151-ER, are O'Connor Hospital 2:18-bk-20168-ER, Saint Louise Regional Hospital 2:18-bk-20162-ER, St. Francis Medical Center 2:18-cv-20165-ER, St. Vincent Medical Center 2:18-bk-20164-ER, Seton Medical Center 2:18-cv-20167-ER, O'Connor Hospital Foundation 2:18-bk-20179-ER, Saint Louise Regional Hospital Foundation 2:18-cv-20172-ER, St. Francis Medical Center of Lynwood Foundation 2:18-cv-20178-ER, St. Vincent Foundation 2:18-cv- 20180-ER, St. Vincent Dialysis Center, Inc. 2:18-cv-20171- ER Seton Medical Center Foundation 12:8-cv-20175-ER, Verity Business Services 2:18-cv-20173-ER, Verity Medical Foundation 2:18-cv-20169-ER, Verity Holdings, LLC 2:18-cv-20163-ER, DePaul Ventures, LLC 2:18-cv-20176-ER, and DePaul Ventures – San Jose Dialysis, LLC 2:18-cv-20181-ER.

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STRATEGIC GLOBAL MANAGEMENT, INC., Appellant, v. STATE OF CALIFORNIA; VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al*. Appellees.	Judge: Hon. Dale S. Fischer Place: Courtroom 7D, 350 W. First Street, Los Angeles, CA 90012

CORPORATION DISCLOSURE STATEMENT (FRAP 26.1)

Appellant Strategic Global Management, Inc. hereby discloses that it is a nongovernmental corporate party, and that no parent corporation or publicly held corporation owns 10% or more of its stock.

TABLE OF CONTENTS

Page

JURISDICTIONAL STATEMENT 1

INTRODUCTION 1

ISSUES ON APPEAL 2

STATEMENT OF FACTS & PROCEDURAL HISTORY 3

A. The Parties 3

B. The Asset Purchase Agreement 3

C. Dispute over Debtors' satisfaction of conditions precedent to closing 5

1. Section 8.7: Medi-Cal settlement requirement 5

a. The bankruptcy court's orders with respect to § 8.7 6

b. Debtors' failure to obtain a Medi-Cal settlement with the Department as of November 19, 2019. 7

2. Dispute over satisfaction of § 8.6: AG's conditions to sale 9

a. The requirements of § 8.6 9

b. The AG's decision 10

c. Settlement between the AG and Debtors 11

d. The bankruptcy court's November 18 order. 13

3. The November 26 status conference. 13

4. The bankruptcy court's *sua sponte* decision on the contract dispute 14

D. The Debtors' filings pending appeal 16

1. "Emergency" contempt filing in the bankruptcy court 16

2. "Emergency" motions to dismiss SGM's appeals. 17

3. Initiation of litigation in the bankruptcy court over the APA, its meaning, and SGM's alleged breach. 17

SUMMARY OF ARGUMENT 17

LEGAL DISCUSSION 19

STANDARDS OF REVIEW 19

I. The bankruptcy court's *sua sponte* orders of November 18 and 27 were rendered without due process and are thus void.....19

A. Due process requires meaningful notice and opportunity to be heard. 19

B. The bankruptcy court's November 27 and 18 orders violated due process and must be reversed or vacated.....20

1. The bankruptcy court did not afford SGM (or any party) notice or opportunity to be heard before issuing its November 27 order. 21

2. The November 18 "appeal waiver" order was rendered without due process.....24

II. SGM did not waive any rights to appeal. 25

III. This Court should rule that SGM was not "obligated" to close the sale on December 5, 2019 because Debtors had not satisfied all of their conditions precedent under the APA.....28

A. Debtors did not meet the requirements of § 8.7.....29

1. There was no § 8.7 settlement agreement in place on November 19, as represented by the Debtors, nor on December 5, the date Debtors demanded SGM close the sale. 29

2. Neither the Sale Order entered May 2, 2019, nor the October 11 order authorizing the transfer of the Medi-Cal provider agreement satisfied § 8.7.....30

a. The Medi-Cal Transfer Order did not satisfy § 8.7.....30

b. The Sale Order did not satisfy § 8.7.....31

B. Debtors did not satisfy the conditions of § 8.6. 33

1. Debtors settled with the AG over SGM's objection. 33

2. The bankruptcy court entered the proposed order without following the necessary procedure. 34

CONCLUSION 36

TABLE OF AUTHORITIES

Page(s)

Federal Cases

In re A & C Prop.
784 F.2d 1377 (9th Cir. 1986) . Bankruptcy 35, 36

Aerojet–General Corp. v. American Arbitration Association
478 F.2d 248 (9th Cir. 1973) 26

Bird v. Glacier Elec. Coop., Inc.
255 F.3d 1136 (9th Cir. 2001) 19

In re Birting Fisheries, Inc.
178 B.R. 849 (W.D.Wash., 1995).....25

In re Colortran, Inc.
218 B.R. 507 (B.A.P. 9th Cir. 1997) 18, 20, 24, 25

DeBilio v. Golden (In re DeBilio)
2014 WL 4476585 (B.A.P. 9th Cir. 2014) 35

In re Fagerdala USA—Lompoc, Inc.
891 F.3d 848 (9th Cir. 2018) 19

Fuentes v. Shevin
407 U.S. 67 (1972).....19

Garner v. Shier (*In re Garner*)
246 B.R. 617 (9th Cir. B.A.P. 2000) 19

In re Golden Plan of California, Inc.
829 F.2d 705 (9th Cir. 1986) .....*passim*

Hamer v. Neighborhood Hous. Servs. of Chicago
138 S. Ct. 13 (2017).....18, 25

In re Levoy
182 B.R. 827 (B.A.P. 9th Cir. 1995) 18, 20

In re Loloee
241 B.R. 655 (B.A.P. 9th Cir. 1999) .....*passim*

In re Manning
No. ADV 6:12-1149, 2013 WL 4428761 (B.A.P. 9th Cir. Aug. 19, 2013) 20, 24, 25

In re Mickey Thompson Entertainment Group, Inc.
292 B.R. 415 (9th Cir. B.A.P. 2003) 35

Miller v. American Exp. Co.
688 F.2d 1235 (9th Cir. 1982) 32

Operating Eng. Pension Trust v. Charles Minor Equip't Rental, Inc.
766 F.2d 1301 (9th Cir. 1985) 19

Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson
390 U.S. 414 (1968).....35

In re Sanders
No. 8:15-BK-14615-TA, 2016 WL 3971324 (B.A.P. 9th Cir. July 15, 2016) 1, 2, 20

United States v. Amwest Sur. Ins. Co.
54 F.3d 601 (9th Cir. 1995) 18, 25, 26

United States v. Depue
912 F.3d 1227 (9th Cir. 2019) (en banc) 25

Federal Statutes

11 U.S.C.
§ 363(f).....33
§ 365(b).....6, 7

28 U.S.C.
§ 158(a)(1) 1

California Statutes

California Corporations Code
§ 5926.....12, 34

Other Authorities

Federal Rules of Bankruptcy Procedure, Rule 8001, *et seq.* 1

Federal Rules of Bankruptcy Procedure, Rule 9019 .....35, 36

Federal Rules of Bankruptcy Procedure, Rule 9019(a) 35

Federal Rules of Civil Procedure, Rule 12(b)(6).....1, 16, 23

JURISDICTIONAL STATEMENT

Appellant Strategic Global Management, Inc. ("SGM") timely appealed from bankruptcy court orders entered November 14, November 18, and November 27, 2019. (Bank. Dkt. # 3726, 3727, 3746.) This Court has jurisdiction over these appeals, which were consolidated on January 20, 2020, under 28 U.S.C. § 158(a)(1) and the Federal Rules of Bankruptcy Procedure, Rule 8001, *et seq*. (the "Bankruptcy Rules").

INTRODUCTION

These consolidated appeals challenge three bankruptcy court orders involving an Asset Purchase Agreement ("APA") between SGM and Respondent Verity Health System of California, Inc. and its related entities (collectively, "Debtors"). Two of these orders were entered *sua sponte* and without due process:

(1) a November 27, 2019 order, issued *sua sponte*, purporting to adjudicate a dispute over the terms of the APA without providing the parties advance notice or opportunity to be heard, and without allowing the parties to present evidence, put on witnesses, or brief their arguments. The bankruptcy court even cut off SGM's future rights by stating that any adversary proceeding SGM might file regarding the dispute would be dismissed under Federal Rules of Civil Procedure, Rule 12(b)(6), and by ruling that SGM had no right to appeal the order.

(2) a November 18, 2019 order, issued *sua sponte*, purporting to curtail SGM's rights under the APA and ruling that SGM had no right to appeal a November 14, 2019 order. The November 14 order, which is also on appeal, is based on a settlement between the California Attorney General (the "AG") and Debtors, and was entered over SGM's objection that the order failed to preserve the rights it bargained for under the APA.

It is elementary that due process requires notice and a meaningful opportunity to be heard. While bankruptcy proceedings are "flexible," that "does not allow a bankruptcy court to steamroll over a party's due process rights." *In re*

Sanders, No. 8:15-BK-14615-TA, 2016 WL 3971324, *2 (B.A.P. 9th Cir. July 15, 2016).

Responding to "emergencies" manufactured by Debtors, the bankruptcy court ignored SGM's due process rights by issuing the orders set forth above. Particularly egregious was the November 27 decision, which purports to adjudicate Debtors' satisfaction of conditions precedent to closing the sale and SGM's consequent "obligation" to close or be in breach. In so doing, the bankruptcy court necessarily interpreted the parties' agreement and applied its own interpretation to the facts presented by Debtors in an incomplete and one-sided record.

This Court should also rule on the merits that, because it is undisputed Debtors failed to meet all of the conditions precedent to SGM's obligation to close, SGM was not obliged to close by December 5, 2019, as the bankruptcy court ruled on November 27.

In sum, this Court should:

(1) reverse or vacate the two orders rendered without due process;

(2) rule that SGM did not waive its right to appeal any of the three orders; and

(3) rule that (a) SGM was not obligated to close by December 5 because Debtors had not met all of the contractual precedents to closing; and (b) the November 14 order was the product of a settlement that failed to preserve the rights for which SGM bargained under the APA.

ISSUES ON APPEAL

1. Did the bankruptcy court's November 18 and 27 orders violate SGM's due process rights because they were issued *sua sponte* and without notice or a meaningful opportunity to be heard?

2. Did the bankruptcy court err in determining in the foregoing orders that SGM had waived its rights to appeal?

3. Did the bankruptcy court err in determining, in its November 27

order, that SGM was "obligated" to close the sale because Debtors had met all of the conditions precedent to closing?

4. Did the bankruptcy court err in entering the November 14 order, based on a settlement between Debtors and the AG that violated SGM's contractual rights and the Debtors' failure to satisfy the standards for approving settlements?

STATEMENT OF FACTS & PROCEDURAL HISTORY

A. The Parties

Verity and its related entities owned and operated six non-profit hospitals in the State of California: St. Francis Medical Center Hospital in Lynwood, St. Vincent Medical Center in Los Angeles, Seton Hospital in Daly City, and Seton Medical Center Coastside in Moss Beach, O'Conner Hospital in Santa Clara County and St. Louis Hospital in Santa Clara County. (AA01467.)

On August 31, 2018, Verity filed voluntary petitions for relief under Chapter 11 of Title 11 of the U.S. Bankruptcy Code ("Bankruptcy Code") and commenced these Chapter 11 cases. During the course of its case, Debtors have been operating their business as debtors in possession. (AA084.)

All of Debtors' hospitals have sustained significant and unabated operating losses for decades. (Bankr. Dkt. # 3901, p. 12:12.) St. Vincent alone sustained losses of $65 million in 2019. (Bankr. Dkt. # 3906, p. 2:10-12.)

After Verity's Chapter 11 filing, Verity sold two of its hospitals (the O'Connor Hospital and the St. Louis Hospital) to the County of Santa Clara. (AA01467.)

B. The Asset Purchase Agreement

In January 2019, SGM and Debtors entered into an Asset Purchase Agreement ("APA") (Appellant's Appendix ("AA") 0110-738) providing the terms and conditions under which SGM agreed to purchase the four remaining hospitals for $610 million, subject to certain price adjustments. The bankruptcy court approved the sale to SGM in its Sale Order of May 2, 2019 (AA0739-65),

and SGM wired a $30 million deposit into Debtors' bank account.[3]

The APA did not have a specific closing date, *inter alia*, because Debtors needed to satisfy numerous contractual conditions and resolve certain regulatory issues before the sale would be in a position to close. (AA0117, § 1.3; AA145, § 8.4) (conditioning closing on Debtors' meeting the requirements of Sections 7 and 8).

The APA provided that any non-breaching party could terminate the agreement on December 31, 2019, if the sale had not closed by then; in that event both parties could walk away without liability and SGM would receive the return of its deposit. (AA0148, § 9.1(i).)

Three conditions to closing under the APA are of particular relevance to these appeals: § 8.7, which pertains to the transfer of Medi-Care and Medi-Cal provide agreements to SGM; § 8.6, which deals with conditions imposed by the California Attorney General ("AG"); and § 8.4, which required Debtors to meet certain additional obligations within 15 business days of receiving written notice, if "the respects in which such obligations, covenants, agreements and conditions that have not been performed have had or would have a Material Adverse Effect." (AA0145, § 8.4.)

Between January and early fall of 2019, SGM and Verity worked constructively towards a closing of the sale. (*See generally* Bankr. Dkt. # 2994, pp. 32-35.) SGM, for its part, had to negotiate with six labor unions and persuade them to modify their respective collective bargaining agreements. (*Id.*) SGM also analyzed hundreds of executory contracts, including contracts with health plans, medical practice groups, independent physician associations, vendors and suppliers, which were to be assumed and assigned to SGM upon closing. (*Id.*)

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[3] The bankruptcy court determined that SGM was a "Good Faith Purchaser" of the hospitals because "SGM has proceeded in good faith and without collusion in all respects in connection with the sale process[.]" (AA0744.)

SGM worked with the Debtors and state and federal regulators regarding the prospective assumption and assignment of Medicare and Medi-Cal provider agreements. (*Id.*) SGM drafted numerous management agreements that would need to be completed and put in place at the time of closing. All told, SGM expended enormous resources on consultants, attorneys, and other experts and in-house personnel to address all of these issues and more to be in a position to assume the ownership and management of the hospitals upon closing of the sale. (*Id.*) At no point could SGM be painted as reluctant or uncertain about the purchase and rehabilitation of the hospitals.

C. Dispute over Debtors' satisfaction of conditions precedent to closing

1. Section 8.7: Medi-Cal settlement requirement

Disputes materialized in mid-November 2019, mainly with respect to Debtors' performance of conditions precedent to closing.

In particular, § 8.7 of the APA required Debtors to transfer Verity's Medi-Cal provider agreements to SGM "pursuant to a settlement agreement" with the California Department of Health Care Services (the "Department"). (AA0147, § 8.7.) Without these provider agreements, SGM would not be entitled to receive reimbursements for services provided to the many patients who rely on Medi-Cal.

At the time the APA was being negotiated, the Department claimed that Debtors owed it substantial amounts, including approximately $30 million in quarterly fees that hospitals are required to pay pursuant to Welfare & Institutions Code § 14169.52(a) ("Quality Assurance Fees"), and approximately $25 million in fee-for-service overpayments Verity had received for medical services provided to Medi-Cal beneficiaries. (AA0782-84.) Medi-Cal eventually claimed Verity owed it approximately $80 million. (AA08.)

To satisfy the requirements of § 8.7, the settlement agreement with the Department had to resolve "all outstanding financial defaults under any of Sellers'

. . . Medi-Cal provider agreements," and provide "full satisfaction, discharge, and release of any claims under the . . . Medi-Cal provider agreements, whether known or unknown[.]" (AA0147, § 8.7.)

a. The bankruptcy court's orders with respect to § 8.7

Earlier in the year, in March 2019, the Department objected to the proposed sale to SGM, specifically to Debtors' assertion that the Medi-Cal provider agreements were not executory contracts, governed by Bankruptcy Code § 365, and thus could be transferred to SGM "free and clear" of claims, interests, and encumbrances (collectively, "claims"). (AA022-26.) According to the Department, the provider agreements were executory contracts, and thus could not be transferred "free and clear" until all unpaid obligations to the Department, including the unpaid Quality Assurance Fees and overpayments, were "cured" as required by 11 U.S.C.§ 365(b). (AA017-22.)

The bankruptcy court's May 2, 2019 Sale Order did not resolve the dispute between Debtors and the Department as to whether the provider agreements were executory contracts, leaving for later determination the issue of whether and under what conditions the provider agreements could be transferred "free and clear" of the Department's claims. (AA0739-65.) While the Sale Order authorized the sale of Debtors' assets to SGM "free and clear of claims, liens, and encumbrances," the order included the caveat that *"[n]othing in this Sale Order shall apply to Medical Provider Agreements until and unless there is a court order approving a settlement between the Debtors and the [Department] or a court order resolving the [Department's] objection.*" (AA0763) (emphasis added). The issue of whether the provider agreements could be sold free and clear of the Departments claims, liens, and encumbrances was left unresolved.

On September 11, 2019, the Department renewed its objection to treatment of its provider agreements as non-executory contracts by filing a supplemental brief objecting to the sale. (Motion to Augment the Record ("MA"), Ex. 3.) The

Debtors filed a reply, once again contending that the Medi-Cal provider agreements were not executory contracts. (MA, Ex. 4.) At the same time, Debtors acknowledged their contractual obligation under APA § 8.7 to transfer the provider agreements free and clear of any claims, liabilities or obligation that they owed the Department. (*Id*. at 7:16-22.)

On September 26, 2019, the bankruptcy court filed a memorandum of decision agreeing with the Debtors that the Medi-Cal provider agreements are not executory contracts, and, therefore, could be transferred free and clear of liens, claims, and interests, without the necessity of curing all defaults as would have been required by 11 U.S.C. § 365(b). (MA, Ex. 5.) However, the court added a caveat: it expressly declined to decide whether the Department could "recoup" from SGM the amounts Debtors owed the Department; *i.e*., whether the Department could recover its unpaid claims against Debtors by recouping payments that would otherwise be due to SGM. (*Id*. at p. 10, fn. 10.) If the Department could do that, SGM would be paying Verity's unpaid Medi-Cal obligations—totaling nearly $80 million—in contravention of the protection (a full release and discharge) that SGM had bargained for in § 8.7.

In a later order approving the transfer of provider agreements (the October 11 Transfer Order), the bankruptcy court was again careful to observe that "nothing in this paragraph shall be construed to limit whatever rights [the Department] may or may not have to withhold, under principles of equitable recoupment, payments owed by [the Department] to the Debtors and or the SGM Buyers[.]" (AA01464.) This left undecided how the Department would collect the $80 million owed by Verity, and from which party. The Department filed an appeal from this Transfer Order, which was assigned to District Judge James V. Selna.

b. Debtors' failure to obtain a Medi-Cal settlement with the Department as of November 19, 2019.

On November 20, 2019, Debtors' counsel wrote to SGM, representing that

"all conditions to closing" had been satisfied as of November 19, 2019, and demanding that SGM close the sale in ten business days, by December 5, 2019. (MA, Ex. 9.) SGM's counsel responded by letter dated November 22, 2019, advising Debtors that their demand was premature because Debtors had not yet satisfied all of their obligations under the APA, including, but not limited to, those under §§ 8.7 and 8.6. (*Id.*)

SGM's letter also listed numerous other sale- related problems regarding Debtors' failure to comply with representations, warranties, and conditions that were necessary for closing, some of which were identified by leading health care law firm Hooper, Lundy and Bookman, PC ("Hooper Lundy"), including: 1) substantial material deterioration of the hospitals' net patient revenue; 2) Debtors' failure to comply with legal requirements applicable to the conduct and operation of its hospitals; 3) Debtors' failure to obtain approval from the Office of Statewide Health Planning and Development for the operation of several hospital facilities; 4) Debtors' failure to respond to building and safety code violations; 5) Debtors' failure to comply with seismic requirements at St. Vincent and Seton hospitals; and 6) Debtors' failure to reserve funds for its accrued obligations. (*Id.*)

On November 25, 2019, SGM's counsel requested from Debtor's counsel "proof" that Debtors had satisfied § 8.7. (*Id.*) Debtors' counsel responded that § 8.7 was satisfied by the bankruptcy court's order authorizing "the transfer of the Medi-Cal Agreement free and clear of any interests asserted by [the Department]" in its October 11 Transfer Order (pending appeal by the Department). Debtors' counsel omitted the court's express caveat that its decision did not resolve the recoupment issue. *Id.* Debtors' counsel also asserted that the Sale Order of May 2019 had "terminated any creditor's recoupment rights [Docket No. 2306]." (*Id.*) Again, however, counsel ignored the court's caveat regarding the reservation of all issues regarding the transfer of the Medi-Cal provider agreements. According to Debtors' counsel, based on his selective reading of the orders, "[t]hose Orders afford equal

or greater protection to SGM than any settlement could have, thereby satisfying Section 8.7." (*Id.*) "In any event," counsel added, "a settlement with [the Department] was reached on November 22, so there is no reason to debate this point further." (*Id.*)

Counsel's reference to a November 22 settlement signaled that Debtors had not, in fact, met their § 8.7 settlement obligations when they sent the November 20, 2019 demand letter asserting that all conditions had been satisfied as of November 19. In any event, there was no November 22 settlement: on November 26, at a status conference, Debtors' counsel conceded they still had not obtained a settlement with the Department, but asserted they had reached an agreement "in principle [sic]." (AA01591.) As of December 5, the date Debtors set for closing, they had still had not entered into a settlement agreement with the Department. Debtors did not obtain a signed settlement agreement until December 9. (Appellant's Request for Judicial Notice "RJN", Ex. 4.)

In sum, the express requirements of § 8.7 had not been met on November 20, the date Debtors initially demanded that SGM close the deal, or on November 27, the date the bankruptcy court ruled that all of the conditions to closing had been met, or on December 5, the day the court decided SGM was "obligated" to close.

2. Dispute over satisfaction of § 8.6: AG's conditions to sale

a. The requirements of § 8.6

Debtors and SGM were both concerned that the AG, in evaluating the proposed sale, might attach conditions that would effectively "kill the deal" by imposing enormous costs on SGM. (AA0966-68.) Both SGM and Verity had encountered such obstacles in the past in transactions involving the sale of hospitals. (*Id.*)

To address these concerns, the parties negotiated § 8.6, which provided that if the AG were to impose "Additional Conditions" on the sale; i.e., conditions that did not already appear on the list of "Purchaser Approved Conditions" attached to

the APA, Debtors could move the bankruptcy court for entry of a "Supplemental Sale Order" that would allow the hospitals and their assets to be sold "free and clear" of the AG's Additional Conditions. (AA0145-47, § 8.6.)

If Debtors succeeded in obtaining a Supplemental Sale Order from the bankruptcy court, § 8.6 provides, SGM would have a 21-day "Evaluation Period" to determine, "in the exercise of [its] reasonable business judgment and in consultation with [its] financing sources," whether to go forward with the sale. (*Id.*)

This evaluation period was essential to SGM, because, at the time of drafting, no one knew whether the bankruptcy court would enter a Supplemental Sale Order or what that order might say. (AA01453-54.) Before investing hundreds of millions of dollars into the purchase and restoration of four failing hospitals, SGM and its lenders needed to be sure that the AG could not impose "Additional Conditions" under any circumstances.

If the Supplemental Sale Order were to become a "final, non-appealable order" before the end of the Evaluation Period, SGM would have to "consummate the Sale provided that all other conditions to closing ha[d] been satisfied[.]" (AA0145-47.) Section 8.6 defines "a final, non-appealable order" as including "a Supplemental Sale Order (i) which has been affirmed or the appeal of which has been dismissed by any appellate court and for which the relevant appeal period has expired (other than any right of appeal to the U.S. Supreme Court), or (ii) which has been withdrawn by the appellant." (*Id.*)

b. The AG's decision

On September 25, 2019, the AG rendered his decision regarding the proposed transfer of the hospitals to SGM. (AA01011-1050.) As anticipated, the AG's decision included onerous and costly conditions to which the parties had not agreed, *e.g.*, Additional Conditions as defined in § 8.6.

A few days later, Debtors, with SGM's support, filed the enforcement

motion contemplated by § 8.6, seeking an order from the bankruptcy court stating that the sale could go forward free and clear of the Additional Conditions. (AA1452-54; AA01011-1050.)

In opposing the motion, the AG aggressively challenged the bankruptcy court's power to question his authority under state law to approve, disapprove or approve with conditions, an application to transfer the assets of a non-profit hospital to a for-profit entity. (AA01176-1459.)

The bankruptcy court issued a lengthy memorandum of decision granting the motion, and stating, *inter alia*, that the AG had abused his discretion in imposing the Additional Conditions, and making clear that these conditions would have no effect on the transfer of the hospitals and their assets to SGM. (AA01466-89.) The court certified its decision for direct appeal to the Ninth Circuit Court of Appeals. (*Id.*)

c. Settlement between the AG and Debtors

Alarmed at the prospect of such a precedent, the AG proposed a settlement with Debtors: he would waive his right to appeal the decision (which would have delayed the proceedings substantially) if Debtors would agree to vacatur of the bankruptcy court's memorandum of decision, and entry of a "simple" order granting the motion. (AA1498-1504.)

Debtors were amenable, and the parties, including SGM, participated in negotiating the terms of the order with the AG. When the AG refused to accept SGM's modifications to its proposed order, Debtors unilaterally agreed to the terms of a stipulation and proposed order, and submitted the AG's proposed order to the court with a request for immediate entry. (AA01490-93; AA01506-08.)

The stipulation includes a peculiar paragraph in which the AG acknowledges but disagrees with the bankruptcy court's conclusion:

> The [AG] does not agree or concede that the Additional Conditions (as defined in the Order) are an "interest in property" for purposes of 11 U.S.C. § 363(f), but

> acknowledges that the Court so held in the Memorandum Decision (which is to be vacated and withdrawn pursuant to the Order) and that, solely and exclusively for the purposes of the APA (as defined in the Order) and the Motion, the Order so states. (AA01492-93.)

The proposed order states, in relevant part:

> Solely and exclusively for purposes of the APA . . . the Additional Conditions . . . are an "interest in property" for purposes of 11 U.S.C. § 363(f) and the assets (as defined in the APA) can be sold free and clear of the Additional Conditions[.] (AA01532, ¶3.)

Further, the order states that, "[n]otwithstanding" the bankruptcy court's exclusive jurisdiction (acknowledged in an earlier provision), "nothing contained in this Order shall prohibit or limit the authority of the [AG] to enforce, *in the state courts* and pursuant to section 5926 of the California Corporations Code, the Purchaser Approved Conditions sent for the Schedule 8.6 to the SGM APA." (AA01532, ¶4) (emphasis added).

SGM objected, observing that the proposed order was at best ambiguous and failed to provide SGM with adequate protection from the AG's potential enforcement of the Additional Conditions. (AA01509-1515.) SGM proposed the following language that would have clarified the Supplemental Sale Order:

> The Debtors' transfer to SGM of the Debtors' assets (the "SGM Sale") pursuant to [the APA] is free and clear of, and shall not be subject to or conditioned upon SGM's performance of, compliance with, or adherence to, and and all of the Additional Conditions (as defined in the [APA])[.] (AA01512.)

The AG's counsel refused to adopt this language, although he could not explain how it would prejudice the AG. (AA01505-08.)

Over SGM's objection, the bankruptcy court approved the order proposed by the AG and entered a Supplemental Sale Order on November 14, 2019. (AA01509-15; AA01531-33.)

/ / /

d. The bankruptcy court's November 18 order.

Although entry of the Supplemental Sale Order triggered SGM's 21-business day Evaluation Period under § 8.6, the bankruptcy court effectively nullified that by issuing a *sua sponte* order on November 18 declaring that the November 14 order was final and nonappealable, thereby terminating SGM's Evaluation Period under § 8.6. (AA01543-47; AA1548-49.)

3. The November 26 status conference.

On November 15, Debtors moved the bankruptcy court to postpone the hearing on their chapter 11 disclosure statement, a proceeding related to Debtors' plan of reorganization, in which SGM was not participating. (AA01534-42.) The court granted the motion and converted the hearing to a status conference, which it set for November 26.

On November 24, Debtors filed a status conference report advising the bankruptcy court that they intended to ask for an expedited procedure to determine whether their failure to meet the conditions noted by Hooper Lundy rose to the level of Material Adverse Effects under § 8.4. (AA01557-61.) SGM responded by filing a Reservation of Rights, stating that, if Debtors were to request such an expedited process, SGM would oppose it, and that SGM was reserving its rights to a full and fair opportunity to litigate its rights under the APA. (AA01562-71.)

On the morning of November 26, just hours before the 10 a.m. status conference was set to begin, Debtors submitted, without SGM's consent and over its filed objection, sealed copies of the November 20, November 22, and November 25 correspondence between counsel, along with a sealed document that contained Debtors' discussion of an alternative disposition process for the hospitals if the sale to SGM did not close ("Plan B"). (AA01579-80; MA Ex 9.) SGM has never seen Plan B, which presumably recites a parade of horrors that would

transpire if the sale did not close.[4]

4. The bankruptcy court's *sua sponte* decision on the contract dispute

Debtors' last-minute, "ex parte" filing of Plan B, along with the sealed correspondence (submitted over SGM's objection), had the desired effect. At the start of the November 26 status conference, the bankruptcy court announced it had already decided the parties' contractual dispute—which was not before it—based on the documents submitted by Debtors earlier that morning.

Instead of following even the abbreviated procedure Debtors had said they would request, or giving any party notice or an opportunity to file briefs or put on evidence or call witnesses, the bankruptcy court announced it had decided that Debtors had satisfied all conditions precedent to closing as *of November 19, 2019*, and that SGM was thus "obligated" to close the sale on December 5, 2019: "As far as the court is concerned, the purchaser is the proud owner" of four hospitals. "Have fun." (AA1593-94) [dismissing as "picayune" SGM and Hooper Lundy's concerns about the failure of Debtors and the hospitals to meet their obligations].

SGM's counsel advised the court that SGM had not refused to close, and objected that SGM's rights would be curtailed by a decision reached without due process:

> There's been no complaint. There's been no response. There's been no motion for summary judgment. There's been no presentation of evidence. This Court has simply concluded based upon an exchange of letters, some of which contain some hyperbole, that our client will be in breach if we don't close. I think that's unfortunate. (AA01597.)

The bankruptcy court was unmoved. The next day it issued a written decision confirming its conclusions, and rejecting SGM's argument that it was

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[4] SGM assumes this based on the bankruptcy court's subsequent statements concerning the prospect of sick people being out on the street if the closing did not occur immediately. (AA01595.)

entitled to an adversary proceeding or any proceeding of any kind. (AA01603-10; AA1611-12.) The court ruled that Debtors' request for an expedited procedure to determine whether their institutional failures rose to the level of "Material Adverse Events" (the only thing that Debtors had asked it to decide) did not require an adversary proceeding. (AA01605.) The court did not explain why its decision, interpreting the contract and making findings of fact, did not require an adversary proceeding, or any other proceeding.

As to briefing, the bankruptcy court stated the dispute had already been "briefed" through counsel's letters, which were filed by Debtors the morning of the hearing, over SGM's objection, along with the mysterious "Plan B" document to which the court obliquely referred. (AA01606; AA01608-09) (referring to the "significant harm that closure of the Hospitals would impose upon patients . . . . suffering from severe illnesses," a prospect that was not discussed in any filed pleadings or supported by any evidence).

The bankruptcy court did not address Debtors' failure to meet the conditions set forth in § 8.6 of the APA, which was not subject to the "Material Adverse Event" provision. (AA01603-10.) Regarding § 8.7, which was also not subject to the "Material Adverse Event" provision, the court dropped a footnote stating that § 8.7 was satisfied, not by a settlement agreement as required by § 8.7, but by the court's entry of its October 11 Transfer Order. (AA01609, fn. 7.)

The bankruptcy court did not explain how it was able to review, let alone assess, the gravity of the problems that were subject to § 8.4. The court had nothing to go on but the Hooper Lundy letter, submitted on the morning of the hearing, which enumerated a long list of serious Health and Safety Code violations and advised SGM that it could be found in violation of state law if it were to take over Verity's facilities in their present condition. Instead of scheduling a hearing so that it could hear from experts, the court defined the term Material Adverse Event (which is not defined in the APA) to mean only something as extreme as a

hospital's loss of licensure. (AA01608.)

Finally, the bankruptcy court decided that, because SGM had agreed that the bankruptcy court would "exclusively settle[]" disputes in connection with the termination of the agreement for Material Adverse Effects (AA01606), SGM had effectively waived its right to appeal the bankruptcy court's November 27, 2019 order. (*Id.*) (the court: "This provision means that only the Bankruptcy Court and no other court (*including any appellate court*) is entitled to determine Material Adverse Effect issues") (emphasis added).

Even if SGM had filed an adversary complaint (or were to do so), the bankruptcy court noted, it "would dismiss such a complaint under Civil Rule 12(b)(6) for failure to state a claim[.]" (AA01608, fn.4.)

On November 29 and December 3, 2019, SGM timely noticed appeals from the bankruptcy court's orders of November 14, 18, and 27. (Bank. Dkt. # 3726, 3727, 3746.)

D. The Debtors' filings pending appeal[5]

1. "Emergency" contempt filing in the bankruptcy court

At the close of business on Friday, December 6, 2019, after SGM had filed appeals from each of the court's November orders, Debtors filed an "emergency" motion asking the bankruptcy court to order SGM officers and attorneys to appear and show cause, *inter alia*, why SGM did not close the sale on December 5. (RJN, Ex. 1.) Debtors also asked the court to make findings regarding SGM's breach, liability, and the forfeiture of its $30 million deposit. (*Id.*) In essence, Debtors attempted to enforce a breach of contract claim via a contempt proceeding.

The bankruptcy court denied the motion on December 9, but included in its order a statement that Debtors could proceed to dispose of the hospitals and their assets under an alternative plan without breaching the APA. (RJN, Ex. 2-3.)

[5] The following section is supported by court filings supplied in SGM's concurrently filed Request for Judicial Notice ("RJN").

On December 17, 2019, Debtors filed a notice that the APA was terminated because SGM failed to close on December 5. (RJN, Ex. 6.)

2. "Emergency" motions to dismiss SGM's appeals.

On December 17 and 19, 2019, Debtors filed "emergency" motions in the District Court asking it to dismiss the appeals SGM had filed weeks earlier. (Distr. Ct. CV-10354 Dkt. # 13; Distr. Ct. CV-10356 Dkt. # 11.) This Court denied all three of Verity's motions on December 20, expressly rejecting Debtors' argument that SGM had waived its right to appeal the November 14 order by supporting Debtors' motion to enforce the sale free and clear of the AG's Additional Conditions. (Distr. Ct. CV-10356 Dkt. # 14.)

3. Initiation of litigation in the bankruptcy court over the APA, its meaning, and SGM's alleged breach.

On January 3, 2020, while the appeals were pending, Debtors filed an adversary complaint in the bankruptcy court against SGM and several non-signatories to the APA, relying heavily on the orders at issue in this appeal, to allege, *inter alia*, that Debtors had satisfied all of their obligations under the APA, that all conditions to closing had been satisfied and that SGM had breached the agreement by failing to close the sale on December 5, 2019. (Distr. Ct. CV-00613 Dkt. # 2, Ex. 6, ¶¶ 83, 90.)

On January 21, SGM filed a motion in the District Court to withdraw the reference from the bankruptcy court. (Distr. Ct. CV-00613 Dkt. # 1.) That motion is currently scheduled for hearing on February 24, 2020.

SUMMARY OF ARGUMENT

First, the bankruptcy court's November 18 and 27 *sua sponte* orders violated SGM's due process rights because they were issued without notice or a meaningful opportunity to be heard. "It is fundamental that due process of law requires 'notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their

objections.'" *In re Levoy*, 182 B.R. 827, 833 (B.A.P. 9th Cir. 1995) (*quoting Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 314 (1950)). If notice and opportunity are lacking, the order is void. *In re Loloee*, 241 B.R. 655, 661 (B.A.P. 9th Cir. 1999); *In re Golden Plan of California, Inc.*, 829 F.2d 705, 712 (9th Cir. 1986); *In re Colortran, Inc.*, 218 B.R. 507, 511 (B.A.P. 9th Cir. 1997).

Second, as an independent matter, the bankruptcy court erred in ruling that SGM waived its rights to appeal any of the challenged orders. "[W]aiver is the intentional relinquishment or abandonment of a known right." *Hamer v. Neighborhood Hous. Servs. of Chicago*, 138 S. Ct. 13, 17 n.1 (2017) (alterations, quotation marks, and citations omitted). Even an implied waiver of rights will be found only "where there is 'clear, decisive and unequivocal' conduct which indicates a purpose to waive the legal rights involved." *United States v. Amwest Sur. Ins. Co.*, 54 F.3d 601, 602–03 (9th Cir. 1995) (internal citations and quotations omitted). There is no basis for concluding that SGM expressly or impliedly waived its appeal rights with respect to any of the challenged orders.

Third, the bankruptcy court erred in determining, in its November 27 order, that Debtors had met all of the conditions precedent to closing. The record unequivocally demonstrates that Debtors, notwithstanding representations in their letters to SGM's counsel, had not met all of the conditions they were required to meet under the APA by that date or by December 5, the date the court determined SGM was "obligated" to close the sale. As a result, SGM cannot, as a matter of law, have been "obligated" to close the sale by December 5.

Fourth, the bankruptcy court erred in entering the November 14 order, based on a settlement between Debtors and the AG that violated SGM's contractual rights.

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LEGAL DISCUSSION

STANDARDS OF REVIEW

Claims regarding due process violations are reviewed de novo. *Bird v. Glacier Elec. Coop., Inc.*, 255 F.3d 1136, 1140 (9th Cir. 2001) (citing *Hilao v. Estate of Marcos*, 103 F.3d 767, 780 (9th Cir. 1996); *see also Garner v. Shier* (*In re Garner*), 246 B.R. 617, 619 (9th Cir. B.A.P. 2000) (whether a proceeding comports with the basic requirements of due process is a question of law reviewed de novo).Questions of law, including the principles of contract interpretation, are reviewed de novo; factual findings are reviewed under the clearly erroneous standard. *Operating Eng. Pension Trust v. Charles Minor Equip't Rental, Inc.*, 766 F.2d 1301, 1303 (9th Cir. 1985). "'[A]n appellate court must correct any legal error infecting a bankruptcy court's decision. So if the bankruptcy court somehow misunderstood the nature of the [legal question]—or if it devised some novel multi-factor test for addressing that issue—an appellate court should apply de novo review." *In re Fagerdala USA—Lompoc, Inc.*, 891 F.3d 848, 854 (9th Cir. 2018) (quoting *U.S. Bank Nat'l Ass'n v. Vill. at Lakeridge, LLC*, 138 S.Ct. 960, 968 n.7 (2018)) (alterations in original). Legal error constitutes clear error in the ultimate determination. *Id.*

I. The bankruptcy court's *sua sponte* orders of November 18 and 27 were rendered without due process and are thus void.

A. Due process requires meaningful notice and opportunity to be heard.

"For more than a century the central meaning of procedural due process has been clear: 'Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified.'" *Fuentes v. Shevin*, 407 U.S. 67, 80 (1972) (*quoting Baldwin v. Hale*, 68 U.S. 223, 233 (1863)). "It is equally fundamental that the right to notice and an opportunity to be heard 'must be granted at a meaningful time and in a meaningful manner.'" *Id.* (quoting

Armstrong v. Manzo, 380 U.S. 545, 552 (1965)).

This right applies with full force in bankruptcy court. "It is fundamental that due process of law requires 'notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.'" *In re Levoy*, 182 B.R. 827, 833 (B.A.P. 9th Cir. 1995) (*quoting Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 314 (1950)). Nothing permits a bankruptcy court to "steamroll over a party's due process rights." *In re Sanders*, 2016 WL 3971324, at *2.

If notice and opportunity are lacking, the order is void. *In re Loloee*, 241 B.R. at 661 ("If the notice is inadequate, then the order is void."); *In re Golden Plan of California, Inc.*, 829 F.2d 705, 712 (9th Cir. 1986) (reversing the district court's *sua sponte* consideration of a fraudulent conveyance issue because investors were denied adequate notice); *In re Colortran, Inc.*, 218 B.R. 507, 511 (B.A.P. 9th Cir. 1997) (concluding that bankruptcy court's *sua sponte* order invalidating creditor's lien without procedural safeguards was void because creditors were not given the opportunity to present a complete argument); *In re Manning*, No. ADV 6:12-1149, 2013 WL 4428761, at *7 (B.A.P. 9th Cir. Aug. 19, 2013) (vacating bankruptcy court order where it violated third party's procedural due process rights by setting aside a default without giving him adequate notice or a meaningful opportunity to be heard).

B. The bankruptcy court's November 27 and 18 orders violated due process and must be reversed or vacated.

The bankruptcy court's November 27 and 18 and orders, both of which issued *sua sponte*, violated SGM's right to procedural due process because SGM received no advance notice that the court intended to adjudicate the issues it did and SGM had no meaningful opportunity to be heard before the entry of the orders. *In re Golden Plan of California, Inc.*, 829 F.2d at 712; *In re Colortran*, 218 B.R. at 511; *In re Manning*, 2013 WL 4428761, at *7.

1. The bankruptcy court did not afford SGM (or any party) notice or opportunity to be heard before issuing its November 27 order.

As set forth in the Statement of Facts, *supra*, the bankruptcy court abruptly and unexpectedly decided, in the course of presiding over a status conference, that Debtors had met all of the conditions precedent to closing, and that SGM was obligated to close the sale by December 5, as Debtors demanded. The court reached this conclusion based on what could only have been a cursory review of documents assembled by Debtors and submitted under seal hours before the morning conference. These documents consisted of letters between counsel, with exhibits, and a secret document—Plan B—that Debtors refused to let SGM see. The entire package consisted of some seventy-seven pages, and included detailed findings by Hooper Lundy regarding the condition of the hospitals and their regulatory delinquencies.

The letters between the parties' counsel were not pleadings, briefs, or evidence or intended as their substitute. SGM did not consent to the submission of its own letter of November 22, and it objected to Debtors' ex parte motion to submit the letters under seal.

SGM's counsel arrived in court expecting to participate in a status conference, and to dispute the Debtors' request, if such a request were to be made (which it was not) that the Hooper Lundy list of regulatory and licensing deficiencies be adjudicated on an expedited basis. SGM had received no notice that the bankruptcy court was going to rule on anything, and was thus taken aback when the court announced it had reached a decision that no one had yet asked it to reach: namely, that Debtors had met all of the conditions precedent to closing and that SGM was "obligated" to close the sale in a matter of days or be in breach. The failure of notice alone violates SGM's due process rights and mandates vacatur. *In re Golden Plan of California, In.*, 829 F.2d at 712; *In re Loloee*, 241 B.R. at 661

("If the notice is inadequate, then the order is void.").

Debtors had not met all of the conditions precedent to closing. It is beyond dispute that Debtors had yet to reach a settlement agreement with the Department regarding the tens of millions of dollars in claims the Department wanted "cured" before Debtors could transfer Verity's provider agreements to SGM free and clear of its claims and right to recoupment.

Debtors conceded at the November 26 status conference that they had not obtained a settlement agreement, though they claimed to have reached one "in principle [sic]." (AA01591.) Even if an agreement had been reached in principal (and no evidence was ever presented of any terms or conditions of any prospective agreement) that settlement agreement was not committed to paper until December 9, when the Debtors filed a stipulation dated December 9, 2019 with the Bankruptcy Court—four days after SGM was supposedly obligated to close. (RJN, Ex. 4.)

SGM was not given the opportunity to file a brief or present evidence to dispute the assertions made by Debtors in their letters or in "Plan B." Instead, at the start of the November 26 status conference, the court excoriated counsel based on its perception—planted by Debtors—that SGM no longer wished to buy the hospitals, or was setting the stage to re-negotiate the terms of sale:

> What we have here, in my view, is just buyer's remorse and I don't share in the boo-hoo of that. I had an opportunity to read some of the correspondence going back and forth. The picayune, the smallness of those alleged transactions do not, in my view, reach the level of material adverse effect. Sorry. (AA01594.)

SGM's counsel tried to set the record straight, but the court's mind was made up. The next day, on November 27, 2019, again, with no advance notice that it intended to do so, the court issued a written Memorandum of Decision and an order stating that the issues had been "briefed" in counsel's letters, and that SGM was not entitled to an adversary proceeding, which is the usual way for bankruptcy

courts to adjudicate contract disputes. (AA01603-10; AA01611-12.) The court denied that it had issued any sort of declaratory relief when it told the parties the sale conditions were met and the sale must go forward under the APA.

Nor did the bankruptcy court explain how it had assessed the gravity of the problems that were subject to the "Material Adverse Effect" provision. The court had nothing to go on but the Hooper Lundy letter, which was meant for counsel's eyes only, and not intended to serve as an expert report. SGM had no opportunity to put on evidence, including expert evidence, to explain the serious Health and Safety Code violations and other delinquencies enumerated in the Hooper Lundy letter. Instead, the court denigrated these concerns as "picayune," (AA01594), and came up with its own definition of Material Adverse Event (there is none in the APA), which it used to rule that nothing less than a hospital's loss of licensure would fit the bill. (AA01608.)

Finally, the court did not explain how it had reached the conclusion that the Debtors had satisfied "all" conditions to closing as of November 19, 2019, since there was no way for the court to determine if conditions to closing that had not been discussed in counsel's exchange of letters (which SGM had expressly reserved in its letter of November 22) had been satisfied.

To make matters worse, the bankruptcy court ruled that SGM had waived its right to appeal the November 27 order because it had agreed in the APA that the bankruptcy court would "exclusively settle[]" disputes concerning Material Adverse Effects (AA0145, § 8.4; AA01606.) According to the court, "This provision means that only the Bankruptcy Court and no other court (*including any appellate court*) is entitled to determine Material Adverse Effect issues." (AA01606) (emphasis added).

On top of everything else, the court sealed SGM's fate by stating that any complaint SGM might file claiming that Debtors breached the APA would be dismissed "under Civil Rule 12(b)(6) for failure to state a claim[.]" (AA01608, fn.

4.)

The court's failure to provide SGM with notice or meaningful opportunity to brief its arguments, submit evidence, or put on witnesses was a patent violation of due process. *In re Loloee*, 241 B.R. at 661; *In re Golden Plan*, 829 F.2d at 712; *In re Colortran*, 218 B.R. at 511; *In re Manning*, 2013 WL 4428761, at *7.

In sum, this Court should vacate the November 27 order because the bankruptcy court abrogated SGM's due process rights in rendering it. Specifically, the bankruptcy court denied due process by: (1) depriving SGM of any notice of its intent to consider and rule on issues relating to (a) Debtors' satisfaction of the conditions to closing, (b) SGM's obligation to close the sale on December 5, 2019, (c) SGM's breach if it failed to close, and (d) SGM's right to appeal the court's rulings; and (2) depriving SGM of any opportunity to be heard, or even to appeal a ruling issued in the absence of due process.

2. The November 18 "appeal waiver" order was rendered without due process.

The November 18 order declaring that SGM could not appeal the AG order of November 14 was likewise issued without notice or any meaningful opportunity to be heard. The order was issued in response to the Debtors' request for a continuance of the hearing on its disclosure statement (a proceeding in which SGM was not involved and in which it had not participated). In requesting that the disclosure statement hearing be continued, Debtors had not asked the court to decide the question of whether SGM had waived its right to appeal the court's November 14 Order approving the settlement between the Debtors and the AG.

As set forth above, on November 14, 2019, the bankruptcy court entered an order drafted by the AG and Debtors, over SGM's objection. Entry of that order triggered SGM's 21-business day Evaluation Period under § 8.6. Four days into that Period, on November 18, with no party request before it, the bankruptcy court issued a *sua sponte* order declaring that the November 14 order was final and

nonappealable. (AA01549.) That ruling terminated SGM's Evaluation Period under § 8.6, and purported to cut off SGM's right to appeal the November 14 order. (*Id.*)

Because the ruling was issued without notice or a meaningful opportunity to be heard, this Court should hold it was void. *See In re Loloee*, 241 B.R. at 661; *In re Golden Plan*, 829 F.2d at 712; *In re Colortran*, 218 B.R. at 511; *In re Manning*, 2013 WL 4428761, at *7.

II. SGM did not waive any rights to appeal.

The bankruptcy court's rulings that its November 27 and November 14 orders were not appealable, fail along with everything else in the November 27 and November 18 orders because they were rendered without due process.

Furthermore, the court's "waiver" of appellate rights decisions are clearly erroneous. "[W]aiver is the intentional relinquishment or abandonment of a known right." *Hamer*, 138 S. Ct. at 17 n.1 (2017) (alterations, quotation marks, and citations omitted); *see also United States v. Depue*, 912 F.3d 1227, 1232 (9th Cir. 2019) (en banc) (same).

Even an *implied* waiver of rights will be found only "where there is 'clear, decisive and unequivocal' conduct which indicates a purpose to waive the legal rights involved." *United States v. Amwest Sur. Ins. Co.*, 54 F.3d 601, 602–03 (9th Cir. 1995) (internal citations and quotations omitted). *See also In re Birting Fisheries, Inc.*, 178 B.R. 849, 850 (W.D.Wash., 1995) ("To constitute implied waiver, there must exist unequivocal acts or conduct evidencing an intent to waive; waiver will not be inferred from doubtful or ambiguous factors.") (citation and internal quotations omitted).

Regarding the November 27 order, the court ruled that, because SGM had agreed in § 8.4 that the bankruptcy court would "exclusively settle[]" disputes in connection with termination of the agreement for failure to cure Material Adverse Effects (AA0145, § 8.4; AA01606), SGM had effectively waived its right to appeal

the bankruptcy court's November 27, 2019 order. (AA01606) (the court: "This provision means that only the Bankruptcy Court and no other court (*including any appellate court*) is entitled to determine Material Adverse Effect issues") (emphasis added).

In this context, the language in § 8.4 indicates nothing more than the parties' intent to have the bankruptcy court adjudicate such disputes rather than a California state court. The section does not address appellate rights and certainly contains no express waiver of appeal rights. Nor is there anything in the APA that "clearly and unequivocally" demonstrates an intent by either party to waive their appeal rights. *Amwest*, 54 F.3d at 602–03; ("[implied] waiver will not be inferred from doubtful or ambiguous factors.") (citation and internal quotations omitted); *see also Aerojet–General Corp. v. American Arbitration Association*, 478 F.2d 248, 251 (9th Cir. 1973) ("[w]hile it has been held that parties to an arbitration can agree to eliminate all court review of the proceedings, the intention to do so must clearly appear.")

The bankruptcy court thus erred as a matter of law in inferring a waiver of appellate rights from APA § 8.4.

Regarding the November 18 order, the bankruptcy court concluded that SGM had no right to appeal based on its declaration that the November 14 Supplemental Sale Order was a "final nonappealable order." (AA01543-47; AA01548-49.) The court ostensibly reached this conclusion based on its reading of § 8.6, which defines "a final, non-appealable order" as including "a Supplemental Sale Order (i) which has been affirmed or the appeal of which has been dismissed by any appellate court and for which the relevant appeal period has expired (other than any right of appeal to the U.S. Supreme Court), or (ii) which has been withdrawn by the appellant." (AA01545-46.)

There is no way to construe this language to mean that only the AG's appeal was contemplated at the time of drafting, or that the Supplemental Sale Order

could be rendered "nonappealable" by judicial fiat. The time to take an appeal had not run, and there was no ruling by a court of appeal affirming or dismissing an appeal from the November 14 order when the bankruptcy court declared that order "nonappealable." Certainly, SGM cannot be said to have intentionally and knowingly abandoned its right to an Evaluation Period, or to an appeal based on § 8.6 of the APA.

Although the AG had decided not to move forward with an appeal himself, there is nothing in § 8.6 from which to infer that SGM could not appeal the November 14 Supplemental Sale Order.

Finally, the court determined that SGM was "judicially estopped" from claiming that it had the right to appeal from the November 14 Supplemental Sale Order, based on SGM's counsel's remarks at a February 6 hearing addressing, the parties' revisions to § 8.6. During that hearing, SGM's counsel stated: "If the Debtor can get us a final, non-appealable order, meaning that if there's an appeal, it gets resolved in the Debtor's favor, or maybe it gets dismissed, at that point [SGM] will be obligated to close the transaction, so long as all other conditions are satisfied." (AA01546.) In its November 18 memorandum decision, the bankruptcy court interpreted this to mean that the only party that could appeal was the AG.

There are at least two reasons why the court's reasoning must be rejected. First, the court's conclusion as to applying judicial estoppel was made without any notice that the court intended to consider that issue, or, for that matter, any notice that the court intended to make any ruling at all on November 18; its memorandum of decision and order were issued *sua sponte*. Thus, SGM was not given any opportunity to be heard on the subject of judicial estoppel.

Second, it is clear from the context of counsel's comments that he was referring to an appeal by the AG, and the effect of that appeal being resolved favorably. He was not addressing the possibility of SGM's having to appeal from a Supplemental Sale Order that was unacceptable to SGM. Accordingly, the court

erred in finding that SGM was judicially estopped from appealing the court's November 14 Order, to which SGM had timely objected.

This Court has already rejected Debtors' argument that SGM waived its right to appeal the November 14 order based on SGM's joinder in Debtors' original motion for a Superseding Sale Order.[6]

In light of the foregoing, this Court should rule that SGM did not waive its right to appeal any of the challenged orders.

III. This Court should rule that SGM was not "obligated" to close the sale on December 5, 2019 because Debtors had not satisfied all of their conditions precedent under the APA.

The bankruptcy court's November 27 order purports to determine that Debtors had satisfied all conditions precedent to closing by November 19, as Debtors claimed to have done in their demand letter of November 20 to SGM. (AA01603-10; AA01611-12.) Accordingly, the court found, SGM was "obligated" to close by December 5, 2019, as Debtors demanded. (AA01611-12.)

But it is undisputed that one or more of Debtor's closing conditions was *not* satisfied as of November 19, 2019, the date the Court referred to in its order, or even by December 5, so SGM cannot have been "obligated" to close the sale by December 5.

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[6] *See* this Court's December 20, 2019 order denying Debtors' motion to dismiss appeal of the November 14 order ("There is no question that Appellants vigorously opposed the entry of the [November 14] order and claimed that it did not provide them with the protection sought in the motion and to which they are entitled. While Appellants' arguments may ultimately turn out to be meritless, they did not waive the right to appeal an order that allegedly does not provide the result they had joined in seeking.").

A. Debtors did not meet the requirements of § 8.7.

1. There was no § 8.7 settlement agreement in place on November 19, as represented by the Debtors, nor on December 5, the date Debtors demanded SGM close the sale.

Section 8.7 provides, in pertinent part, that:

> Sellers shall transfer their . . . Medi-Cal provider agreement[] pursuant to a settlement agreement with the California Department of Health Care Services ("[the Department]"), which such settlement agreement[] shall result in: (i) resolution of all outstanding financial defaults under any of Sellers' . . . Medi-Cal provider agreements and (ii) full satisfaction, discharge and release of any claims under the . . . Medi-Cal provider agreements, whether known or unknown, that . . . [the Department], as applicable, has against the Seller or Purchaser for monetary liability arising under the . . . Medi-Cal; provider agreement[] before the Effective Time[.] (AA0147, § 8.7.)

There is no dispute that, as of November 19, 2019, Debtors had yet to reach a settlement agreement with the Department regarding the transfer of Verity's Medi-Cal provider agreement consistent with the requirements of APA § 8.7. Debtors stated in their demand letter of November 20 that they had reached a settlement agreement with the CMS regarding the Medicare provider agreement, but did not mention any agreement with the Department. (MA Ex. 9.)

As Debtors' counsel acknowledged at the November 26 status conference (seven days after his letter to SGM representing that Debtors had satisfied all conditions to closing), Debtors still had not entered into a settlement agreement with the Department. (AA01591.)

While Debtors' counsel asserted at the status conference that Debtors had reached an agreement "in principle [sic]" with the Department, (*id.*), Debtors never produced an agreement or evidence that an agreement had been reached and provided nothing from which the court could determine whether the requirements

of § 8.7 had been satisfied. Indeed, even if a non-binding oral agreement in principal existed, that would not have satisfied the requirements of § 8.7, which requires a settlement agreement resulting in "(i) resolution of all outstanding financial defaults under any of Sellers' Medicare and Medi-Cal provider agreements and (ii) full satisfaction, discharge and release of any claims[.]" (AA0147, § 8.7.) Thus, as of the Court's November 27 order, there was no evidence from which the court could have determined that § 8.7 had been satisfied.

Because Debtors failed, as of November 19, or even as of the date and time they set for closing, to satisfy the conditions set forth in § 8.7, this Court should rule that SGM was not obligated to close by December 5, 2019, and did not breach the APA by failing to do so.

2. Neither the Sale Order entered May 2, 2019, nor the October 11 order authorizing the transfer of the Medi-Cal provider agreement satisfied § 8.7.

a. The Medi-Cal Transfer Order did not satisfy § 8.7.

In the bankruptcy court's November 27 decision, the court dropped a footnote stating that § 8.7 was satisfied, not by a settlement agreement as required by that provision, but by the bankruptcy court's October 11 order authorizing the transfer of the Medi-Cal provider agreement to SGM. (AA01609, fn. 7.) But while the October 11 Transfer Order authorized Debtors to transfer the Medi-Cal provider agreements to SGM, the court reserved the issue of Department's right to recoup from SGM:

> [N]othing in this paragraph shall be construed to limit whatever rights [the Department] may or may not have to withhold, under principles of equitable recoupment, payments owed by [the Department] to the Debtors and or the SGM Buyers, for the purpose of recovering alleged Pre-Transfer Effective Date Liabilities under or related to the Medi-Cal Program and/or []Program. (AA01464.)

As a result, if SGM *had* closed the sale on December 5, it would have been

subject to the Department's recoupment rights, in direct contradiction of § 8.7.

Further, because the Department had appealed the October 11 order, and the appeal was still pending in the District Court, the order was not final. For this reason, too, the Transfer Order cannot be said to have satisfied § 8.7.

In sum, the Transfer Order would have left SGM subject to (1) a potential recoupment claim of up to $80 Million and (2) an appellate decision (on the Department's appeal) that could have vacated or reversed the order. Thus, even if the conditions of § 8.7 could have been satisfied by a court order, as opposed to a "settlement agreement" (and they could not), Debtors neither sought nor obtained an order from the court resolving the recoupment issue.[7]

b. The Sale Order did not satisfy § 8.7.

Debtors have contended that the Sale Order satisfied the requirements of § 8.7 because it generally provided for the Debtors' assets to be transferred "free and clear" of claims, including recoupment claims. But that assertion is contradicted by the order itself, which provides for the Department to *reserve all of its rights* pertaining to the assumption and assignment of the Medi-Cal provider agreements:

> Nothing in this Sale Order shall apply to Medical Provider Agreements until and unless there is a court order approving a settlement between the Debtors and the [the Department] or a court order resolving the [the Department's] objection. (AA0763, ¶32.)

The foregoing language does not exclude the Department's recoupment rights. Furthermore, the bankruptcy court's September 26, 2019 memorandum decision approving the transfer of the Medi-Cal provider agreements to SGM expressly refers to § 8.7 and Debtors' as yet unsatisfied obligation to resolve the issue prior to closing:

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[7] Whatever the Transfer Order might have achieved, it was vacated in December pursuant to a stipulation dated December 9, 2019 between the Debtors and the Department providing for transfer of the provider agreements to SGM. (AA01613-14.)

> The [APA,] which governs the sale of the Hospitals to SGM, provides that the sale cannot close unless issues regarding alleged financial defaults existing under each Provider Agreement have been resolved. (MA, Ex. 5 at p. 3.)

Moreover, as demonstrated above, the court's October 11 Transfer Order expressly reserved the recoupment issue for later determination, which never occurred. So, any argument that the sale order, alone or in combination with the Transfer Order must fail. In sum, none of the bankruptcy court orders in place on November 19, 2019 provided protection remotely equivalent to the settlement agreement required by § 8.7.

SGM did not bargain for a theory to assert when the Department attempted to recover the Debtors obligations against SGM; it bargained for an agreement, signed by the Department discharging and releasing SGM from any liability or recourse relating to claims against the Debtors. It is thus beyond dispute that Debtors had not satisfied their obligations under § 8.7 as of November 19, or November 27, or December 5, for that matter.

In sum, this Court can and should find that Debtors had not satisfied their obligations under § 8.7 as of November 19, 2019, as of November 27, or as of December 5, the date the bankruptcy court found SGM was required to close. *See Miller v. American Exp. Co.*, 688 F.2d 1235, 1240 (9th Cir. 1982) (instructing the trial court to enter partial summary judgment for appellant based on application of undisputed facts to law).[8]

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[8] SGM's letters also identify Verity's failure to comply with its obligations regarding the operation of the hospitals and compliance with health and safety laws and regulations, but this Court need not reach the merits of those disputes to reverse the November 27 order. It is sufficient that the Court determine that the bankruptcy court's summary rejection of SGM's contentions regarding those issues was improper.

B. Debtors did not satisfy the conditions of § 8.6.

1. Debtors settled with the AG over SGM's objection.

As set forth above, the parties negotiated § 8.6 to prevent the AG from dealing a death blow to the APA by requiring conditions that were not on the parties' list of agreed conditions. As it happened, the AG's decision did include onerous and costly conditions to which the parties had not agreed, e.g., Additional Conditions as defined in § 8.6. (AA01010-50.)

A few days later, Debtors, with SGM's support, filed the enforcement motion contemplated by § 8.6, seeking an order from the bankruptcy court stating that the sale could go forward free and clear of the Additional Conditions. (AA0890-01175; AA1453-54.)

The bankruptcy court issued a lengthy memorandum of decision granting the motion, and stating, *inter alia*, that the AG had abused his discretion in imposing the Additional Conditions, which could have no effect on Debtors' transfer of the hospitals and their assets to SGM. (AA01488-89.)

Alarmed at the prospect of such a precedent, the AG offered to give up its right to appeal if Debtors would agree to vacatur of the bankruptcy court's memorandum of decision, and entry of a "simple" order granting the motion. (AA01499-1500.) The parties, including SGM, participated in negotiating the terms of the order with the AG, but AG would not agree to SGM's modifications to its proposed order.

Instead, the AG drafted a stipulation stating that he did not agree or concede that the hospitals could be sold free and clear of its Additional Conditions, although he acknowledged that the court had decided they could be sold free and clear "solely and exclusively for the purposes of the APA." The proposed order mirrored this language, stating that "[s]olely and exclusively for purposes of the APA . . . the Additional Conditions . . . are an "interest in property" for purposes of 11 U.S.C. § 363(f)" and that "the assets (as defined in the APA) are being sold free

and clear of the Additional Conditions[.]" (AA01532.)

SGM objected to this language as ambiguous and inadequate to provide it with adequate protection from the AG's potential enforcement of the Additional Conditions, as § 8.6 requires. (AA01509-15.) What, for instance, does "solely and exclusively for purposes of the APA" mean? Would it mean that a subsequent buyer from SGM would have to abide by the Additional Conditions? SGM also objected to the AG's reservation of its authority "to enforce, *in the state courts* and pursuant to section 5926 of the California Corporations Code," the conditions on which the parties had agreed," notwithstanding its acknowledgement that the bankruptcy court had exclusive jurisdiction over such disputes. (*Id.*) (emphasis added).

SGM proposed alternative language that would have clarified these issues:

> The Debtors' transfer to SGM of the Debtors' assets (the "SGM Sale") pursuant to [the APA] is free and clear of, and shall not be subject to or conditioned upon SGM's performance of, compliance with, or adherence to, and and all of the Additional Conditions (as defined in the [APA])[.] (AA01512.)

The AG refused to consider this language, without explaining how it might prejudice him or Debtors.

In a rush to get the order done, Debtors agreed to the AG's terms and submitted to the bankruptcy court the stipulation and proposed order drafted by the AG. (AA1491-93; AA1506-08.) The bankruptcy court conducted a hearing on November 13 and rejected SGM's arguments that the order proposed by the Debtors and AG was insufficient to protect it from the Additional Conditions. On November 14, the Court entered the proposed order in the form as requested by Debtors and the AG, with one edit offered by the AG.

2. The bankruptcy court entered the proposed order without following the necessary procedure.

Debtors sought and obtained bankruptcy court approval of their settlement

and compromise with the AG without following the procedures or satisfying the standards governing compromises and settlements—namely, Bankruptcy Rule 9019 and *In re A & C Prop*., 784 F.2d 1377, 1381 (9th Cir. 1986) ("*A&C*"). Bankruptcy Rule 9019(a) authorizes a bankruptcy court to approve a compromise or settlement "on motion" and "after notice and a hearing." Fed. R. Bankr. P. Rule 9019(a); *see also id*. ("Notice shall be given to creditors, the United States trustee . . . and to any other entity as the court may direct."). Here, Debtors bypassed the motion practice entirely by failing to schedule a hearing before filing their stipulation with the AG and the proposed order. The bankruptcy court scheduled a hearing only because SGM objected to the proposed order.

In *A&C*, the Ninth Circuit established a four-part test which the moving party must satisfy to obtain court approval for a settlements or compromises: "(a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises." *A & C*, 784 F.2d at 1381. Courts are instructed to apprise themselves of "all facts necessary for an intelligent and objective opinion," and make sufficient findings before approving a settlement. *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25 (1968) ("There can be no informed and independent judgment . . . until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion[.]"); *DeBilio v. Golden (In re DeBilio)*, 2014 WL 4476585, *6 (B.A.P. 9th Cir. 2014) (bankruptcy court "erred by failing to make findings evidencing consideration of the A & C factors," which "underscore[s] the need for findings as required by [that case]."). In addition, the settlement proponent must persuade the court that the settlement is in the best interests of the estate. *In re Mickey Thompson Entertainment Group, Inc.*, 292 B.R. 415, 420–21 (9th Cir.

B.A.P. 2003).

The stipulation between Debtors and the AG was unquestionably a compromise and settlement; the AG agreed to waive its right to appeal from an adverse ruling, and Debtors agreed to forego the benefits (which were important to *SGM*) of the court's lengthy and comprehensive memorandum decision regarding the unenforceability of the Additional Conditions. Debtors failed to present any evidence to the court on any of the four factors required by A&C.

Instead of applying Bankruptcy Rule 9019 and the *A&C* factors, the bankruptcy court approved the stipulation between Debtors and the AG and entered the order as drafted by the AG just five days after the submission of the stipulation, which, as demonstrated above, failed to satisfy the conditions set forth in APA § 8.6. (AA01490-1497; AA01498-1504; AA01529-30; AA001531-33.) This Court should rule that this was reversible error.

CONCLUSION

For the foregoing reasons, this Court should:

(1) reverse or vacate the bankruptcy court's rulings of November 18 and November 27, 2019, because they were issued without due process;

(2) reverse the bankruptcy court's determination, in the foregoing orders, that SGM waived its appellate rights with respect to the November 14 and November 27 orders;

(3) determine that, because Debtors failed to meet all of their obligations under the APA, SGM was not obligated to close the sale by December 5; and

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(4) reverse the November 14, 2019 order approving the settlement between Debtors and the AG and entering the AG's proposed order.

Respectfully submitted,

Dated: February 14, 2020

LEVENE, NEALE, BENDER, YOO & BRILL L.L.P.

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CERTIFICATE OF COMPLIANCE

1. Pursuant to Fed. R. Bankr. P. 8015(h), this brief complies with the type-volume limitations of Fed. R. Bankr. P. 8015(a)(7) because, excluding the parts of the brief excepted by Fed. R. Bankr. P. 8015(g), this brief contains 11,455 words.

2. This brief complies with the typeface requirements of Fed. R. Bankr. P. 8015(a)(5) and the type-style requirements of Fed R. Bankr. P. 8015(a)(6) because the document was prepared in the proportionally spaced 14-point Times New Roman font.

Dated: February 14, 2020

/s/ Gary E. Klausner
GARY E. KLAUSNER

CERTIFICATE OF SERVICE

1. I hereby certify that on February 14, 2020, I electronically filed the foregoing document with the Clerk of the Court for the United States District Court for the Central District of California using the CM/ECF system.

2. I further certify that parties of record to this appeal who either are registered CM/ECF users, or who have registered for electronic notice, or who have consented in writing to electronic service, will be served through the CM/ECF system.

3. I further certify that some of the parties of record to this appeal may not have not consented to electronic service. I have served the foregoing documents by the means set forth below:

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