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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

In re VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*, Debtors and Debtors in Possession. _____	Case No.: _____ (Related to District Court Appeals: Case Nos.: 2:19-cv-10352-DSF; 2:19-cv-10354-DSF; and 2:19-cv-10356-DSF)_ Lead Chapter 11 Bankr. Case No.: 2:18-bk-20151-ER
☒ Affects All Debtors ☐ Affects Verity Health System of California, Inc. ☐ Affects O'Connor Hospital ☐ Affects Saint Louise Regional Hospital ☐ Affects St. Francis Medical Center ☐ Affects St. Vincent Medical Center ☐ Affects Seton Medical Center ☐ Affects O'Connor Hospital Foundation ☐ Affects Saint Louise Regional Hospital Foundation ☐ Affects St. Francis Medical Center of Lynwood Foundation ☐ Affects St. Vincent Foundation ☐ Affects St. Vincent Dialysis Center,	Jointly Administered With: CASE NO.: 2:18-bk-20162-ER CASE NO.: 2:18-bk-20163-ER CASE NO.: 2:18-bk-20164-ER CASE NO.: 2:18-bk-20165-ER CASE NO.: 2:18-bk-20167-ER CASE NO.: 2:18-bk-20168-ER CASE NO.: 2:18-bk-20169-ER CASE NO.: 2:18-bk-20171-ER CASE NO.: 2:18-bk-20172-ER CASE NO.: 2:18-bk-20173-ER CASE NO.: 2:18-bk-20175-ER CASE NO.: 2:18-bk-20176-ER CASE NO.: 2:18-bk-20178-ER CASE NO.: 2:18-bk-20179-ER CASE NO.: 2:18-bk-20180-ER CASE NO.: 2:18-bk-20181-ER

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Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures – San Jose ASC, LLC
Debtors and Debtors in Possession.

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a California nonprofit public benefit corporation, ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation, ST. VINCENT DIALYSIS CENTER, INC., a California nonprofit public benefit corporation, and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, SETON MEDICAL CENTER, a California nonprofit public benefit corporation, and VERITY HOLDINGS, LLC, a California limited liability company; and

Plaintiffs,

v.

KALI P. CHAUDHURI, M.D., an individual, STRATEGIC GLOBAL MANAGEMENT, INC., a California corporation, KPC HEALTHCARE HOLDINGS, INC. a California Corporation KPC HEALTH PLAN HOLDINGS, INC. a California Corporation, KPC HEALTHCARE, INC. a Nevada Corporation, KPC GLOBAL MANAGEMENT, LLC, a California Limited Liability Company, and DOES 1 through 500,

Defendants.

Adv. Case No.: 2:20-ap-01001-ER

NOTICE OF MOTION AND MOTION FOR WITHDRAWAL OF REFERENCE OF ADVERSARY PROCEEDING FROM THE BANKRUPTCY COURT

Date: [TBD]
Time: [TBD]
Judge: [TBD]
Place: [TBD]

[Declaration Of Gary E. Klausner Filed Concurrently Herewith]

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PLEASE TAKE NOTICE that Defendant Strategic Global Management, Inc. ("SGM") hereby submits the attached motion (the "Motion") for an order withdrawing the reference from the Bankruptcy Court of the above-referenced adversary proceeding (the "Adversary Proceeding") so that, among other reasons, the District Court can adjudicate the Adversary Proceeding after it resolves the three currently pending appeals (the "Appeals") of the Bankruptcy Court's orders in the associated Chapter 11 proceedings.

PLEASE TAKE FURTHER NOTICE that this Motion is made pursuant to 28 U.S.C. §§ 157; Rule 5011 of the Federal Rules of Bankruptcy Procedure; Rule 9 of Chapter IV, Local Rules of the United States District Court for the Central District of California ("L.R."); Rule 5011-1 of the Local Rules of the United States Bankruptcy Court for the Central District of California on the grounds that withdrawal of the references is both permissive and warranted because, among other things: (i) the Adversary Proceeding is a "non-core" matter under 28 U.S.C. § 157(b) and, with the exception of SGM, *none* of the defendants has consented to the jurisdiction of the Bankruptcy Court, such that it must be adjudicated by an Article III court; (ii) the Bankruptcy Court has been divested of jurisdiction to adjudicate the Adversary Proceeding by SGM's filing of three appeals from the Bankruptcy Court's orders regarding the same subject matter as the Adversary Proceeding (the "Appeals"); (iii) the Adversary Proceeding and Appeals concern disputes over the same contract, and, therefore, judicial efficiency and economy would be best served by having the Adversary Proceeding adjudicated in the Court that will hear the Appeals; and (iv) the Bankruptcy Court has already purported to adjudicate SGM's liability and breach, without notice or hearing before the Adversary Proceeding was filed and, therefore, it would be unfair and a denial of SGM's due process rights to permit the Adversary Proceeding, or any part of it, to be adjudicated by the Bankruptcy Court.

PLEASE TAKE FURTHER NOTICE that the Motion is based on this

Notice of Motion and Motion, the concurrently filed Declaration of Gary E. Klausner in support of the Motion (the "Klausner Declaration"), the arguments of counsel at any hearing on the Motion, and any other admissible evidence brought before the Court.

PLEASE TAKE FURTHER NOTICE that SGM will serve this Notice of Motion and Motion, and the Klausner Declaration on the parties set forth in the Proof of Service attached hereto. A response to the Motion must be filed in accordance with L.R. 7-9.

PLEASE TAKE FURTHER NOTICE that, in the event that the Court sets a hearing on the Motion, SGM shall provide notice of entry of the order setting the hearing as directed by the Court.

Dated: January 21, 2020

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

By: */s/ Gary E. Klausner*
Gary E. Klausner
Counsel for Strategic Global Management

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Three appeals from the Bankruptcy Court's orders of November 14, 2019, November 18, 2019 and November 27, 2019 (the "Appeals"), are currently pending in the U.S. District Court for the Central District of California (the "District Court"). All three appeals concern the respective obligations of Plaintiffs Verity Health Systems of California, Inc. and the other Chapter 11 Debtors in above-captioned bankruptcy cases ("Plaintiffs" or "Verity") and Strategic Global Management, Inc. ("SGM") under their Asset Purchase Agreement ("APA"). The Appeals divested the Bankruptcy Court of jurisdiction to make further rulings relating to the APA while the appeals are pending. *See e.g.*, *Griggs v. Provident Consumer Discount Co*., 459 U.S. 56, 58 (1982) ("The filing of a notice of appeal is an event of jurisdictional significance-it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal."); *Matter of Combined Metals Reduction Co*., 557 F.2d 179, 200 (9th Cir. 1977) (holding that rule applies in bankruptcy context).

Although Plaintiffs are surely aware of this black letter law, they recently filed an adversary Complaint in the Bankruptcy Court against SGM alleging breach of the APA, based largely on the Bankruptcy Court's prior erroneous rulings, which are the subject of the Appeals. Plaintiffs did not stop there. Although SGM deposited $30 million upon the execution of the APA and devoted thousands of hours trying to close the complicated sale of four hospitals, Plaintiffs also "tortified" the contract dispute by adding claims against SGM for promissory fraud and a cause of action curiously titled "Tortious Breach of Contract (Breach of Implied Covenant of Good Faith and Fair Dealing)." *See* (Complaint, Doc. No. 3901).

In addition to the claims against SGM, Plaintiffs also assert claims against SGM's principal Kali P. Chaudhuri, M.D. and any other entity they could find with

his initials in the corporate name, including KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., and KPC Global Management, LLC (collectively, the "Non-SGM Defendants").[1] None of these Non-SGM Defendants are parties to the contract at issue; none consented to the jurisdiction of the Bankruptcy Court; none waived their respective rights to a jury trial, or participated in the bankruptcy proceedings in any manner. Accordingly, none is properly before the Bankruptcy Court.

The interests of justice, due process, and judicial economy compel the withdrawal of the reference to allow this substantial dispute to be heard before an Article III Court.

By this Motion, SGM asks this Court to exercise its discretion under 28 U.S.C. § 157(d) to withdraw the reference of the Adversary Proceeding to the Bankruptcy Court so that this Court can adjudicate the matter after it has resolved the three currently pending appeals of the Bankruptcy Court's orders in the associated Chapter 11 proceedings.[2]

Reference should be withdrawn for the following reasons.

First, the Complaint is a "non-core" matter under 28 U.S.C § 157(b), and as noted above, with the exception of SGM, *none* of the Defendants has consented to the jurisdiction of the Bankruptcy Court. As set forth more fully below, due process mandates that the rights of the Non-SGM Defendants be adjudicated by an Article III court – including all motions and other matters preceding trial.

Second, the Bankruptcy Court has already been divested of jurisdiction to

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[1] The Non-SGM Defendants have not yet appeared in this action.

[2] The District Court's granting of this Motion will result in the District Court's presiding over both the Appeals and the Adversary Proceeding. However, the District Court's role in connection with the Appeals is as an appellate court, and any proceedings with respect to the Adversary Proceedings will be deferred pending final adjudication of the Appeals. *See* Part III A.1 below.

adjudicate the Adversary Proceeding by SGM's filing of three appeals from the Bankruptcy Court's November orders. All three Appeals have been consolidated pursuant to this District Court's order entered on January 17, 2020, and all three Appeals concern the rights, claims, obligations and liabilities of the Plaintiffs and SGM under the APA. The pendency of these Appeals divests the Bankruptcy Court of jurisdiction to adjudicate the Adversary Proceeding, or to make any rulings relating to the Adversary Proceeding, which likewise concerns the rights of Plaintiffs and SGM under the APA. Accordingly, until the Appeals have been finally adjudicated, the Bankruptcy Court lacks jurisdiction over the matters at issue, and the Adversary Proceeding cannot go forward.

Third, because the Adversary Proceeding and the Appeals concern disputes over the same contract, judicial efficiency and economy would be best served by having the Adversary Proceeding adjudicated in the Court that will hear the Appeals.

Fourth, as set forth in SGM's briefs to this Court filed in opposition to Plaintiffs' unsuccessful emergency motion to dismiss the Appeals, the Bankruptcy Court has already purported to adjudicate SGM's liability and breach—without notice or hearing—before the Adversary Proceeding was filed. By bringing an Adversary Proceeding in the Bankruptcy Court, Plaintiffs transparently seek to exploit the Bankruptcy Court's unripe and procedurally improper rulings.

In sum, this Court should exercise its discretion to withdraw the reference of the Adversary Proceedings to protect Defendants' constitutional rights and to ensure the expedient and efficient resolution of this dispute.

II. STATEMENT OF FACTS

A. Background

1. Plaintiffs are Debtors in Chapter 11 cases currently pending in the Bankruptcy Court, which were commenced on or about August 31, 2018 (the "Petition Date").

2. On or about January 8, 2019, SGM and Verity entered into an "*Asset*

Purchase Agreement" (the "APA"), pursuant to which SGM agreed, subject to certain terms and conditions, to purchase four of Plaintiffs' hospitals: St. Vincent Medical Center, St. Vincent Dialysis Center, St. Francis Medical Center, Seton Medical Center and Seton Medical Center Coast Side (collectively the "Hospitals"). A copy of the APA (excluding exhibits) is attached as **Exhibit "1"** to the Declaration of Gary E. Klausner filed concurrently herewith ("Klausner Declaration").

3. None of the Non-SGM Defendants executed the APA, guaranteed any of SGM's obligations in connection with the APA, or otherwise assumed or accepted any liability for any of SGM's obligations in connection with the APA.

4. The Bankruptcy Court approved the APA by its order of May 2, 2019 [Doc. No. 2306] (the "Sale Order"). While authorizing the Debtors to sell the Hospitals to SGM, the Sale Order does not include, or make any reference to, any of the Non-SGM Defendants. Neither SGM nor any of the Non-SGM Defendants has filed a proof of claim in the Chapter 11 cases. None of the Non-SGM Defendants has appeared in the Chapter 11 cases.

5. The APA does not contain a specific closing date. Rather, § 1.3 of the APA provides that the Sale will close only after Plaintiffs have satisfied all enumerated conditions to performance. The APA further provides that in the event that the sale has not closed as of December 31, 2019, the APA could be terminated, without liability, by either party.

6. SGM's closing obligation was subject to numerous terms and conditions, representations, and warranties, including those set forth in Section 8 of the APA. Included in Section 8 are: (1) § 8.6 ("Section 8.6") which establishes the conditions that Plaintiffs needed to satisfy regarding approval of the Sale by the California Attorney General ("AG") (whose approval was required by California state law for the transfer of the Plaintiffs' assets to SGM); and (2) § 8.7 ("Section 8.7") pertaining to the transfer of Plaintiffs' "provider agreements" with Medicare and Medi-Cal to SGM.

7. Until the beginning of Fall 2019, the parties worked cooperatively, devoting substantial time and resources to the enormously complex process of transferring the assets of four operating Hospitals, and satisfying all of the various conditions to closing, including those set forth in Section 8 of the APA. These tasks included evaluating and addressing "cures" of hundreds of executory contracts; negotiating modifications to collective bargaining agreements with six separate unions; and analyzing relationships with medical practice groups, health plans, suppliers and purveyors of medical supplies and equipment; Health and Safety Code issues, seismic compliance, and licensing matters.

B. Disputes between the Parties

8. On November 20, 2019, Plaintiffs suddenly demanded that SGM close the sale on December 5, 2019 (the "Closing Demand"). In the Closing Demand, Plaintiffs represented that as of November 19, 2019, they had satisfied all conditions to require SGM to close the Sale. SGM disputed Plaintiffs' contention, and on November 22, 2019, SGM delivered to Plaintiffs a letter describing Plaintiffs' failure to satisfy these and other conditions of the APA. Plaintiffs responded by letter dated November 25, 2019. (These three letters are referred to herein as the "Breach Letters").

9. The Bankruptcy Court entered three orders regarding Plaintiffs' purported satisfaction of its conditions to closing: the November 14, 2019 Order (approving a settlement between Plaintiffs and the AG which SGM had opposed), the November 18, 2019 Order (which purported to declare that Plaintiffs had satisfied their closing condition in Section 8.6), and the November 27, 2019 Order (which purported to declare that Plaintiffs had satisfied all conditions to closing the APA and that SGM was obligated to close on December 5, 2019) (collectively, the "Orders"). SGM timely filed notices appealing these three Orders. These three orders are attached as **Exhibits "2", "3" and "4"** respectively to the Klausner Declaration.

10. While the Bankruptcy Court entered the November 14 Order over

SGM's objection and after a court hearing, the November 18 and November 27 Orders were both entered *sua sponte*, without any advance notice or opportunity for SGM to file briefs, present evidence or otherwise have a meaningful opportunity to be heard. Thus, they were entered without regard to SGM's due process rights and without consideration of any arguments by SGM concerning the merits of the disputed issues. SGM contends that they were also erroneous as a matter of law.

11. On November 26, 2019, the Bankruptcy Court conducted a status conference at Plaintiffs' request on Plaintiffs' then-pending disclosure statement (the "Status Conference"). At the Status Conference, the Bankruptcy Court did not solicit argument, or take evidence. Instead, following its *in camera* review of documents filed by Plaintiffs less than 48 hours prior to the Status Conference (*i.e.*, the "Breach Letters," which the Plaintiffs had submitted to the Bankruptcy Court "under seal" and over SGM's objection; and the Plaintiffs' status report and "Plan B" regarding their planned disposition of their assets in the event that the Sale to SGM did not close also filed "under seal", and which has never been disclosed to SGM, effectively constituting an improper *ex parte* communication), the Bankruptcy Court pronounced that all of the conditions for closing the Sale had been satisfied, and that SGM would be in breach of the APA if it did not promptly close the Sale. SGM was never offered the opportunity to brief the contentions or provide evidence to contradict the assertions made by the Plaintiffs or the Court's pronouncement at the November 26 Status Conference.

12. On November 27, 2019, the Bankruptcy Court, *sua sponte*, issued its November 27 Memorandum Decision and Order. The November 27 Memorandum Decision, similar to the Bankruptcy Court's oral statements at the Status Conference, made clear that the Bankruptcy Court had already reached substantive conclusions with respect to the dispute between SGM and the Plaintiffs, which had been described in the Breach Letters.

13. Among other things, the November 27 Memorandum Decision stated

the following:

> "None of SGM's allegations come close to showing a Material Adverse Effect . . . presenting non-meritorious arguments as to why it is not obligated to close . . . . All . . . conditions precedent to closing were satisfied as of November 19, 2019 . . . . Article 1.3 obligates SGM to close the sale 'promptly but no later than ten (10) days following the satisfaction' of all conditions precedent. As all conditions precedent were satisfied on November 19, 2019, SGM is obligated to close the sale by no later than December 5, 2019."

(November 27 Order, 6-7). Further, the Bankruptcy Court's Order of November 27 stated, in pertinent part, the following:

> "Pursuant to § 1.3 of the APA, SGM is obligated to close the SGM Sale by no later than December 5, 2019."

(November 27 Order, 2). A true and correct copy of the November 27 Memorandum Decision is attached as **Exhibit "5"** to the Klausner Declaration.

14. The effect of the Orders was to provide Plaintiffs with the Bankruptcy Court's advisory opinion, *in advance of any litigation and without any consideration of countervailing evidence or legal argument concerning the issues,* that the Plaintiffs had satisfied all of their conditions to closing, and that SGM was obligated to close the Sale on or before December 5, 2019, or be in breach of the APA.

15. SGM did not close the sale on December 5, 2019, and contends that it was under no obligation to do so.

16. Plaintiffs' Complaint was filed on January 3, 2020, while the Appeals before the District Court were pending, and relies extensively on the Orders in alleging its claims against the Defendants. (Complaint ¶¶ 83-90). A true and correct copy of the Complaint (excluding exhibits) is attached as **Exhibit "6"** to the Klausner Declaration.

17. Despite the pendency of the Appeals and the fact that Plaintiffs have not satisfied their obligations to close, Plaintiffs advised SGM on December 17, 2019, that they were terminating the APA, effective December 27, 2019, as a result of

SGM's failure to close the Sale on December 5, 2019.

18. On January 3, 2020, the Plaintiffs' filed a "*Notice Re Termination Of Asset Purchase Agreement With Strategic Global Management, Inc.*" [Doc. No. 3899] (the "Termination Notice"), stating that they were terminating the APA effective as of December 27, 2019. A true and correct copy of the Termination Notice is attached as **Exhibit "7"** to the Klausner Declaration.

III. ARGUMENT

A. GOOD CAUSE EXISTS FOR THE IMMEDIATE WITHDRAWAL OF THE ADVERSARY PROCEEDING.

In *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S. Ct. 2858 (1982) ("*Marathon*"), the United States Supreme Court held that the bankruptcy system that permitted non-Article III bankruptcy judges to enter final orders on state law breach of contract claims was unconstitutional. In response, in 1984, Congress overhauled the bankruptcy court system, and, *inter alia*, adopted 28 U.S.C. §§ 1334(a) and (b), which gave the district courts original jurisdiction over bankruptcy cases and proceedings, and 28 U.S.C §157(a), which authorized the district courts to "refer" bankruptcy cases and proceedings to the bankruptcy courts. When cases are referred to the bankruptcy court, the bankruptcy judge's statutory authority depends on whether Congress has classified the matter as "core" or "non-core." *Wellness, infra* at 1939.

28 U.S.C. § 157(b)(1) provides that bankruptcy judges may hear and determine all cases under title 11 and all "core" proceedings arising under title 11, or arising in a case under title 11, and may enter orders and judgments in those cases. 28 U.S.C. § 157(b)(2) sets forth a list of matters that are "core" proceedings.

With respect to "non-core" matters, Congress gave bankruptcy courts more limited authority. 28 U.S.C. § 157(c)(1) states that a bankruptcy judge may hear a non-core matter if it is related to title 11 case, but is limited to making proposed findings of fact and conclusions of law, which are subject to review by the district

court. 28 U.S.C. § 157 (c)(1). Further, any final order or judgment shall be entered by the district court only after considering the bankruptcy judge's proposed findings and conclusions and after reviewing *de novo* those matters to which any party has timely and specifically objected. *Id.* In addition, 28 U.S.C. § 157(e) provides that a bankruptcy court may conduct a jury trial only with the consent of all parties. *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 64 (1989).

If all parties do not consent to having the bankruptcy court hear and determine the matter and enter orders and judgments, a party may move to have the district court withdraw the reference from the bankruptcy court and have the "non-core" matter heard and tried in the district court. 28 U.S.C. §157(d); *In re Addison*, 240 B.R. 47, 49-50 (C.D. Cal. 1999) ("The first sentence of section 157(d) sets forth the standard for permissive withdrawal. Permissive withdrawal is permitted "for cause shown."); *see also* Adversary Committee Notes to Fed. R. Bankr. P. 5011 ("Permissive withdrawal of reference may be granted upon a showing of cause, including a right to jury trial and a refusal by a party to consent to jury trial before the bankruptcy judge.").[3]

Good cause for withdrawal of the reference of the Adversary Proceeding is shown by the following.

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[3] Since *Marathon* was decided, the Supreme Court has revisited the subject of bankruptcy court jurisdiction on several occasions, and has consistently held that absent the filing of a proof of claim, and absent consent by a party being sued, the Bankruptcy Court may not adjudicate state law claims against a defendant. *See Stern v. Marshall*, 564 U.S. 462, 503, 131 S. Ct. 2594, 2620, 180 L. Ed. 2d 475 (2011) ("The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor's proof of claim."); *Wellness Intern. Network, Ltd. v Sharif*, 575 U.S. 665, 135 S. Ct. 1932 (2015) (Bankruptcy Court may constitutionally adjudicate a non-core matter only with the consent of the parties).

1. The Bankruptcy Court Lacks Jurisdiction to Hear any Aspect of the Adversary Proceeding.

By virtue of the pending Appeals from the Bankruptcy Court's November 14 and 18 Orders (relating to the Plaintiffs' compliance with APA section 8.6) and November 27 Order (in which the Bankruptcy Court ruled that SGM was "obligated" to close the sale on December 5), the Bankruptcy Court has been divested of jurisdiction over the subject matter of the Adversary Proceeding. As noted above, the Complaint relies on the Bankruptcy Court Orders of November 14, November 18, and November 27, 2019 to support the allegations of the Complaint. *See* (Complaint, ¶¶ 83-90).

"The general rule is that once a notice of appeal has been filed, the lower court loses jurisdiction over the subject matter of the appeal." *Combined Metals*, 557 F.2d at 200 ("'The filing of a timely and sufficient notice of appeal has the effect of immediately transferring jurisdiction from the district court to the court of appeals with respect to any matters involved in the appeal. . . . Thus, after a notice of appeal is timely filed, the district court has no power to vacate the judgment, or to grant the appellant's motion to dismiss the action without prejudice, or to allow the filing of amended or supplemental pleadings.'") (*quoting* 9 Moore's Federal Practice, 2d ed., P 203.11, pp. 734-36) (further citations omitted); *see also Griggs*, 459 U.S. at 58 ("The filing of a notice of appeal is an event of jurisdictional significance-it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal.").

While bankruptcy courts have "wide latitude to reconsider and vacate its prior decisions, so long as the proceedings have not been terminated," they are nevertheless bound by the general rule that an appeal divests the lower court of the power to modify the order or decision being appealed. *Combined Metals Reduction Co*., 557 F.2d at 200-201. A different result "would permit bankruptcy courts to divest the courts of appeals of jurisdiction over appeals." *Id*. at 201; *accord, e.g., In re Bialac*,

694 F.2d 625, 627 (9th Cir. 1982) (following *Combined Metals*); *Midwest Properties No. Two v. Big Hill Inv. Co., Inc*., 93 B.R. 357, 360 (N.D. Tex. 1988) ("The rule is well established that the taking of an appeal transfers jurisdiction from the Bankruptcy Court to the Appellate Court with regard to any matters involved in the appeal and divests the Bankruptcy Court of jurisdiction to proceed further with such matters[.]"); *Matter of Urban Development Ltd., Inc*., 42 B.R. 741, 744 (Bankr. Fla. 1984) ("While the bankruptcy court has a wide latitude to reconsider and vacate its own prior decisions, it may not do anything which has any impact on the order on appeal."); *In re Butcher Boy Meat Market, In*c., 10 B.R. 258, 259 (Bankr. Pa. 1981).

"This [jurisdictional] rule is clearly necessary to prevent the procedural chaos that would result if concurrent jurisdiction were permitted." *Matter of Urban Development Ltd., Inc*., 42 B.R. 741 (Bankr. M.D. Fla. 1984) (citing *Combined Metals, supra*); see also *In re Kendrick Equipment Corp*., 60 B.R. 356, 358 (Bankr. W.D. Va. 1986) ("The divestment of jurisdiction is a judicial rule to avoid confusion and waste of time that might flow from putting the same issue before two courts at the same time.").

In its November 27 Order, the Bankruptcy Court ruled that the Plaintiffs had complied with all of the conditions required of it for closing the SGM sale and concluded that SGM was obligated to close that sale on December 5, 2019, pursuant to the Plaintiffs' Closing Demand. SGM respectfully, but strongly, disagrees with the November 27 Order, and the Bankruptcy Court's factual conclusions underpinning the Order. For example, SGM contends that Section 8.7 of the APA was not satisfied at the time the November 27 Order was entered, or on November 20 when Plaintiffs made their Closing Demand, because Plaintiffs had failed to enter into the type of agreement with Medi-Cal required by Section 8.7. As a result of the timely filing of the notice of appeal, this Court now has exclusive jurisdiction to determine whether the November 27 Order should be affirmed, or whether it should be reversed or vacated.

A plain and fair reading of the Complaint compels the conclusion that all of the claims and relief requested directly implicate the matters now on appeal. Jurisdiction thus lies solely in this Court sitting as court of appeals, lest the *status quo be materially and adversely altered* by further proceedings in the Bankruptcy Court that relate to or affect the subject matter of the appeals. For example, if the Bankruptcy Court were to determine that SGM materially breached the APA because it failed to consummate and close the Sale by December 5, 2019 in accordance with the APA and its November 27 Order, it would usurp SGM's right to appellate review and the jurisdiction of this Court and potentially that of the Ninth Circuit.

In sum, so long as the appeals are pending, the Bankruptcy Court lacks jurisdiction to make any rulings relating to or bearing on the alleged breach of the APA, which is the subject of the Adversary Proceeding.[4]

2. The Bankruptcy Court Lacks Jurisdiction to Adjudicate the Adversary Proceeding against the Non-SGM Defendants.

It is undisputed that the Non-SGM Defendants are not parties to the APA, have not filed proofs of claim in the Plaintiffs' bankruptcy cases, have not participated in the Chapter 11 case, or in any manner consented to the jurisdiction of the Bankruptcy Court. As such, the Non-SGM Defendants are not subject to the Bankruptcy Court's jurisdiction. *In re Miller*, No. 06-CV-02701-H (POR), 2007 WL 9776702, at *2–3 (S.D. Cal. Jan. 22, 2007) (" "claims against third parties [in adversary proceeding] [do] not fall under the bankruptcy court's subject matter jurisdiction")

The reference should be withdrawn in light of the constitutional limitations on the Bankruptcy Court's power to adjudicate the claims in the Complaint, especially those claims directed against the Non-SGM Defendants.

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[4] On January 16, 2020, Defendants filed an emergency motion for a stay of the Adversary Proceeding pending the final adjudication of the Appeals. A hearing on the motion has been scheduled for February 11, 2020.

3. The Adversary Proceeding Is A Non-Core Matter.

When considering whether to withdraw the reference, district courts should "***first*** evaluate whether the claim is core or non-core, since it is upon this issue that questions of efficiency and uniformity will turn" and ***then*** "weigh questions of efficient use of judicial resources, delay and costs to the parties, uniformity of bankruptcy administration, the prevention of forum shopping, and other related factors." *In re Orion Pictures Corp.*, 4 F.3d 1095, 1101 (2d Cir. 1993); *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1008 (9th Cir. 1997) (citing *Orion* for withdrawal of reference factors, and observing that in *Orion*, "efficiency was enhanced . . . because non-core issues predominate.").

"Actions that do not depend on bankruptcy laws for their existence and that could proceed in another court are considered 'non-core.'" *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1008 (9th Cir. 1997); see *In re Gurga*, 176 B.R. 196, 199 (9th Cir. BAP 1994) (explaining that when the underlying action is a breach of contract and the proceedings would involve the "turnover" of disputed funds, the action is non-core).

Plaintiffs' Complaint is based on state law claims relating to SGM's alleged breach of the APA: (1) Breach of Contract (Count I), (2) Promissory Fraud (Count II); and a claim labeled "Tortious Breach of Contract" (Count III). As the November 27 Memorandum Decision acknowledges, the "APA is governed by California law." Because all of these claims could be commenced and proceed in another court besides the Bankruptcy Court (*e.g.*, a state or district court), they are "non-core."

Because the adversary proceeding is a non-core matter, the Bankruptcy Court would be limited to conducting pre-trial hearings and making recommended findings. 28 U.S.C. § 157(c)(1). Such findings would be subject to *de novo* review by this Court, which means that this Court might need to conduct an entirely new trial. Further, because the Non-SGM Defendants have not waived their right to a trial by jury, a jury demand would require that the trial be conducted in this Court. Further

action in the Bankruptcy Court would therefore be wasteful and could potentially result in duplicate proceedings.

The Second Circuit's opinion in *Orion*, 4 F.3d 1095, is instructive. There, the non-debtor defendant (Showtime) moved to withdraw the reference to an adversary proceeding commenced by the debtor-plaintiff (Orion). The adversary proceeding claimed "anticipatory breach of an agreement between Orion and Showtime, declaratory relief setting forth the parties' rights and obligations in connection with their agreement, and specific performance of Showtime's obligations to make payments under the agreement, or, alternatively, $77 million in damages for breach of contract." *Id*. at 1097. Showtime moved to withdraw the reference, but the district court refused, based on its conclusion that the breach of contract lawsuit was a "core" matter.

This left the bankruptcy court with two matters pending before it: (1) Orion's lawsuit against Showtime for breach of contract, and (2) Orion's motion to assume the pre-petition Orion-Showtime agreement pursuant to 11 U.S.C. § 365. The bankruptcy court first addressed Orion's motion to assume the Showtime agreement, which Showtime opposed on the ground that Orion had breached the agreement regarding certain "key man" clauses. In ruling on Orion's motion to assume the Showtime contract, the bankruptcy court ruled that Orion had not breached any "key-man" clause, and authorized Orion to assume the agreement. The bankruptcy court then ruled that, because "resolution of the key-man clause" was the sole issue in the pending adversary proceeding, the adversary proceeding would be dismissed "without prejudice as moot." *Id*. at 1097.

On appeal, the Second Circuit reversed the district court's decision not to withdraw the reference based on its conclusion that the district court had mischaracterized the breach of contract action as a "core" matter. *Id*. at 1102. The Second Circuit also held that the bankruptcy court had improperly adjudicated the underlying contract dispute between Orion and Showtime *outside the context of an*

adversary proceeding. *Id*. at 1099-1100. Accordingly, the Second Circuit vacated the bankruptcy court's orders allowing Orion to assume the Showtime contract and dismissing the adversary proceeding.

Like the bankruptcy court in Orion, the Bankruptcy Court here erred in purporting to adjudicate SGM's obligation to close the sale on December 5, 2019, and SGM's liability for breach of contract outside the context of an adversary proceeding. The error is exacerbated here by the failure of due process.

Although district courts may grant motions to withdraw the reference but allow the bankruptcy court to retain jurisdiction for all matters preceding trial, this Court should not do so here. Any action taken or rulings made by the Bankruptcy Court over the Non-SGM Defendants' jurisdiction challenge would subject the Bankruptcy Court's rulings to appeals and constitutional challenges for the reasons set forth above, *see* Section III.A.4 *infra*. Leaving the Adversary Proceeding in the Bankruptcy Court would also subject SGM and the Non-SGM Defendants to having issues critical to the case decided by a court that had already effectively ruled that SGM had breached.

Plaintiffs assert in the Complaint that the Adversary Proceeding is "core" based on 28 U.S.C. § 157(b)(2)(A), (M), (N), and (O). But, none of these subsections applies here.

Sections 157(b)(2)(M) and (N) provide that "core" matters include "orders *approving* the use or lease of property, including the use of cash collateral" and "orders *approving* the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate" respectively. 11 U.S.C. § 157(b)(2)(M)&(N) (emphasis added.). These provisions are inapplicable, because the Adversary Proceeding does not seek an order approving a sale or lease of property of the estate—a fundamental core function. What is being litigated is whether the conditions for SGM's closing of the Sale of the Hospitals, pursuant to the APA, have been satisfied. These claims are straightforward breach

of contract claims to be determined under California law, without regard to any particular statutory provision of the Bankruptcy Code. Similarly, Plaintiffs' claims for tortious breach of contract are based on state law and do not involve any bankruptcy-specific issues. Plaintiffs have not asserted any claims requiring interpretation of the Bankruptcy Code.

The only other alleged bases for the Plaintiffs' "core" designation are 28 U.S.C. § 157(b)(2)(A) and (O), the so-called "catch-all" provisions. Section 157(b)(2)(A) deems matters concerning the *administration* of the estate to be "core" proceedings. But, the Complaint does not involve the "administration" of the estate. Section 157(b)(2)(O) refers to proceedings that affect the liquidation of the assets of the estate or the adjustment of the debtor-creditor relationship. The liquidation of assets is conducted by motions to sell estate property; the Complaint is an action for breach of contract.

The Ninth Circuit has strictly limited the use of these "catch-all" provisions to treat state law contract matters as "core" proceedings. "[S]tate law contract claims that do not specifically fall within the categories of core proceedings enumerated in 28 U.S.C. §157(b)(2(B)-(N) are related proceedings under §157 (c) even if they arguably fit within the literal wording of the two catch-all provisions, sections ¶157(b)(2)(A) and (O)." *Piombo Corporation v. Castlerock Properties (In re Castlerock Properties)*, 781 F.2d 159, 162 (9th Cir. 1986). "To hold otherwise would allow the bankruptcy court to enter final judgments that this court has held unconstitutional." *Id*.; *see also In re Daewoo Motor America, Inc*., 302 B.R. 308, 312 (C.D. Cal. 2003) (the Ninth Circuit espouses the policy of "narrow construction" of the catchall provision). The Ninth Circuit has also admonished that "courts should avoid characterizing a proceeding as 'core' if to do so would raise unconstitutional problems." *Taxel v. Electronic Sports Research (In re Cinematronics, Inc.)*, 916 F.2d 1444, 1450 (9th Cir. 1990).

The Ninth Circuit's decision in *In re Harris*, 590 F.3d 730 (9thCir. 2009), is not to the contrary. There, the Court held that a contract and tort action filed by a debtor and his wife against his bankruptcy trustee and her counsel was a core matter. The case is distinguishable. First, the debtors' lawsuit in *Harris* was based on a court approved settlement agreement involving a fraudulent transfer action brought on behalf of the bankruptcy estate against the debtor and his wife. Fraudulent transfer claims are expressly listed as core claims in 28 U.S.C § 157(b)(2)(H). Second, the Ninth Circuit addressed the limited issue of whether a post-petition contract action brought *against a bankruptcy trustee* relating to a settlement with the trustee was a core or non-core matter. And, third, unlike our case, all of the parties to the lawsuit were parties to the agreement that was the subject of the lawsuit.

Because the Adversary Proceeding here is not a "core" matter, the *In re Cinematronics, Inc.*, 916 F.2d 1444, 1451 (9th Cir. 1990) case strongly supports withdrawal of the reference. There, although the court acknowledged that "withdrawal is generally discretionary," it held that the district court had abused its discretion in refusing to withdraw the reference, because the plaintiff's claims were noncore proceedings and the defendant had a Seventh Amendment right to a jury trial. *Id*. at 1451. The Court reasoned that "grave Seventh Amendment problems would arise if a jury trial is conducted by the bankruptcy court, because section 157(c)(1) requires *de novo* review by the district court of noncore matters . . . . [i]f the district court refused to review bankruptcy court jury verdicts on noncore matters with the *de novo* standard, they would be acting contrary to express statutory mandate, *see* Section 156(c)(1). Yet, if they reviewed the bankruptcy court verdicts *de novo* they would be at odds with the Seventh Amendment." *Id*.

4. <u>Withdrawal of the Reference is Necessary to Protect the Defendants' Due Process Rights.</u>

Even if the Adversary Proceeding were deemed core, § 157(b) permits this Court to withdraw, in whole or in part, any case or proceeding referred under § 157,

which includes both core and non-core matters.

Good cause exists for withdrawal of the reference no matter how it is characterized. For example, the Bankruptcy Court's November 27, 2019 Order states that SGM was obligated to close on December 5, 2019 or be in breach – an unequivocal pronouncement of the merits of this lawsuit before it had been filed.

The Bankruptcy Court reiterated these views, even after the Adversary Proceeding was filed, in its Memorandum Decision of January 9, 2020, which approved the Debtors' emergency motion to close St. Vincent Medical Center. (Bankr. Doc. No. 3933, 3) ("The Court found that pursuant to § 1.3 of the APA, SGM was obligated to close the SGM Sale by no later than December 5, 2019 . . . . SGM did not close the sale by December 5, 2019.").

Not surprisingly, the Plaintiffs rely extensively on the Bankruptcy Court's Orders of November 18 and November 27 in their Complaint. (Complaint, ¶¶ 83-90). Under the circumstances, it would be manifestly unfair to require Defendants to have their liability and potential damages adjudicated by a Court that has made clear its position concerning SGM's breach of contract. By the same token, Defendants should not be required to participate in any pretrial aspects of the litigation, such as discovery and motion practice, in the Bankruptcy Court. Because the Bankruptcy Court could be making "case determinative" rulings – *e.g.*, on motions to dismiss or motions for summary judgment, requiring the Defendants to participate in pretrial proceedings in the Bankruptcy Court would be unfair and lead to more controversy and additional appeals.

As demonstrated above in Part V below, the non-SGM Defendants are entitled to a jury trial and will not consent to a jury trial in the Bankruptcy Court. Accordingly, withdrawal of the reference will expedite the process of getting the Adversary Proceeding adjudicated.

Finally, withdrawal of the reference will eliminate jurisdictional and constitutional challenges, which will delay and ultimately increase the cost of this

litigation. For all of the foregoing reasons, good cause exists for withdrawal of the reference at this time.

5. The Non-SGM Defendants Are Entitled to A Jury Trial.

The Non-SGM Defendants are entitled to exercise their Seventh Amendment right to a jury trial, over which the Bankruptcy Court cannot preside without the Defendants' consent. *See* 28 U.S.C. § 157(e); *Bell v. Lehr*, No. 2:13-CV-02483-MCE, 2015 WL 4602895, at *2 (E.D. Cal. July 28, 2015) ("As Defendants *do not consent to bankruptcy court jurisdiction* and timely demanded a jury trial on this matter, the court finds cause to withdraw the bankruptcy reference."); *In re Palomar Elec. Supply, Inc.*, 138 B.R. 959, 961 (S.D. Cal. 1992) ("The court finds that the defendant has not waived its right to a jury trial and has made a demand for a jury trial as to the non-core causes of action. As a result, causes of action seven through nine cannot be tried in the bankruptcy court and will be withdrawn to the district court."); *In re EPD Inv. Co., LLC*, 594 B.R. 423, 426 (C.D. Cal. 2018) ("Kirkland has a right to a jury trial . . . . Because he has demanded a jury trial, has not filed a proof of claim against the estate, and has not consented to a jury trial in the bankruptcy court, he has a right to a jury trial conducted by the [District] Court. The [District] Court, finding there is good cause, and finding this case is ready for trial, withdraws the reference to the bankruptcy court as to the claims against Kirkland.").

Courts have long recognized that "where a jury trial is required and the parties refuse to consent to bankruptcy jurisdiction, withdrawal to the District Court is appropriate." *Cinematronics*, *supra* at 1451; *In re Guenther*, 65 B.R. 650, 652 (Bankr. D. Colo. 1986); *In re Macon Prestressed Concrete Co. v Duke*, 46 B.R. 727, 730-731 (M.D. Ga. 1985).

6. Withdrawal of the Reference Will Promote Judicial Economy

Permitting the Bankruptcy Court to determine factual issues that will ultimately have to be considered all over again by this Court, *de novo*, would be profoundly wasteful. *See In re Tamalpais Bancorp*, 451 B.R. 6, 11-12 (N.D. Cal.

2011) ("Failure to withdraw the reference at this stage could lead to a future appeal in which a district court will be tasked with reviewing the bankruptcy court's decision *de novo*. The Court therefore concludes that (1) judicial resources would be most efficiently used by withdrawing the reference and (2) unnecessary delay and costs to the parties can be avoided by withdrawing the reference . . . . Neither denying nor granting FDIC's motion will facilitate forum shopping here because a *district court will ultimately need to address the issues*, whether initially or on de novo review of the bankruptcy court. The prevention of forum shopping neither supports nor opposes withdrawal in the present motion.").

Even putting aside the fact that the Bankruptcy Court cannot lawfully exercise jurisdiction over the Non-SGM Parties, the non-core claims in the Adversary proceeding would eventually need to be decided at trial, or reviewed *de novo* by this Court, which would result in a duplication of efforts and a waste of significant time and resources. *See In re Transcon Lines*, 121 B.R. 837, 844-45 (C.D. Cal. 1990) ("defendants do have a right to a jury trial in the District Court . . . . District Court Judge must eventually preside over the jury trial in this matter, it would constitute a tremendous waste of judicial resources to permit the bankruptcy judge to continue to maintain jurisdiction over the issues presented in this litigation.")

7. <u>The Motion to Withdraw the Reference Is Not an Improper Attempt to "Forum Shop."</u>

One of the factors to be considered by the District Court in evaluating a motion to withdraw the reference is whether the defendants are improperly forum shopping. *See Orion*, 4 F.3d at 1101-102.

In accordance with *Marathon*, 28 U.S.C. § 157(d) was adopted to avoid the constitutional problems created by having non-Article III bankruptcy judges render final orders on "non-core," state law matters without the consent of all the litigants. Rather than "forum-shopping," Defendants simply seek to exercise their constitutional right to trial before an Article III judge. *See Everett v. Art Brand*

Studios, LLC, 556 B.R. 437 B.R. 437, 444 (N.D. Cal. 2016) ("In addition, the prevention of forum *shopping is not a concern here* as only this Court has the power to enter final judgment on the fourth and fifth causes of action. Therefore, even if the Bankruptcy Court were to adjudicate these claims, this Court would have to conduct de novo review to the extent that the losing party had any objections.").

The serious due process issues to which Defendants have referred further compels withdrawal of the reference.

IV. CONCLUSION

For all of the foregoing reasons, the Motion should be granted and the reference of the Adversary Proceeding withdrawn immediately.

Dated: January 21, 2020

LEVENE, NEALE, BENDER, YOO & BRILL L.L.P.
By: */s/ Gary E. Klausner*
Gary E. Klausner

Dated: January 21, 2020

BARNES & THORNBURG LLP
By: */s/ L. Rachel Lerman*
L. Rachel Lerman
Counsel for Strategic Global Management, Inc.

CERTIFICATE OF SERVICE
UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Verity Health Systems of California, Inc., et al. v. Strategic Global Management, Inc., et al.

I am employed in the County of Los Angeles, State of California; I am over the age of 18 years and not a party to the within action; my business address is 10250 Constellation Blvd., Suite 1700, Los Angeles 90067.

On January 21, 2020, I served the **NOTICE OF MOTION AND MOTION FOR WITHDRAWAL OF REFERENCE OF ADVERSARY PROCEEDING FROM THE BANKRUPTCY COURT** on the interested parties in this action as follows:

SEE ATTACHED SERVICE LIST

☒ **(BY MAIL)**
I am readily familiar with the business practice of my place of employment in respect to the collection and processing of correspondence, pleadings and notices for mailing with United States Postal Service. The foregoing sealed envelope was placed for collection and mailing this date consistent with the ordinary business practice of my place of employment, so that it will be picked up this date with postage thereon fully prepaid at Los Angeles, California, in the ordinary course of such business.

☐ **(BY OVERNIGHT DELIVERY)**
I enclosed the documents in an envelope or package provided by an overnight delivery carrier and addressed to the persons above. I placed the envelope or package for collection and overnight delivery at an office or a regularly utilized drop box of the overnight delivery carrier.

☒ **(FEDERAL)** I declare under penalty of perjury that the foregoing is true and correct, and that I am employed at the office of a member of the bar of this Court at whose direction the service was made.

Executed on January 21, 2020, at Los Angeles, California.

/s/ Lourdes Cruz
Lourdes Cruz

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