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Debtors In Possession

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA -
WESTERN DIVISION - LOS ANGELES

In re

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

Debtors and Debtors In Possession.

District Court Case No. 2:20-cv-00613-DSF
Hon. Dale S. Fischer
Lead Bankruptcy Case No. 2:18-bk-20151-ER
Jointly Administered With:
CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20181-ER
Adversary No. 2:20-ap-01001-ER

Case 2:20-cv-00613-DSF Document 21 Filed 02/24/20 Page 1 of 10 Page ID #:211

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1820151200302000000000036

☒ Affects All Debtors

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

Debtors and Debtors In Possession.

DEBTORS' MOTION FOR LEAVE BASED ON NEW FACTS AND CIRCUMSTANCES UNDER FEDERAL RULE OF CIVIL PROCEDURE 15(d) TO SUPPLEMENT THE DEBTORS' OPPOSITION TO STRATEGIC GLOBAL MANAGEMENT INC.'S MOTION TO WITHDRAW THE REFERENCE OF ADVERSARY PROCEEDING NO. 2:20-ap-01001-ER FROM THE UNITED STATES BANKRUPTCY COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA [RELATED TO DOCKET NO. 11]

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

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MANAGEMENT, LLC, a California Limited Liability Company, and DOES 1 through 500,

Defendants.

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Verity Health System of California, Inc. and the affiliated debtors, the debtors and debtors in possession (collectively, the "Debtors") in the above-captioned chapter 11 bankruptcy cases (the "Cases"), and plaintiffs in the above-captioned adversary proceeding, hereby file this Motion for Leave ("Motion for Leave") under Rule 15(d) of the Federal Rules of Civil Procedure ("Civil Rule 15(d)") (incorporated into adversary proceedings pursuant to Rule 7015 of the Federal Rules of Bankruptcy Procedure) to supplement the Debtors' opposition (the "Opposition") [Docket No. 11] to Strategic Global Management, Inc.'s ("SGM") motion (the "Motion") [Docket No. 1] to withdraw the reference of Adversary Proceeding No. 2:20-ap-01001-ER (the "Adversary Proceeding") from the United States Bankruptcy Court for the Central District of California (the "Bankruptcy Court"). In support of the Motion for Leave, the Debtors respectfully state as follows:

I.
INTRODUCTION

The Debtors seek leave to bring this Court's attention to the following opinion and Bankruptcy Court filings (collectively, the "Events") that transpired after the filing of the Opposition that are relevant to the Motion and Opposition: (i) the Third Circuit decision titled, *In re Somerset Regional Water Resources, LLC,* -- F.3d. --, No. 19-1874, 2020 WL 628542 (3d Cir. Feb. 11, 2020) (the "*Somerset* Decision") regarding core vs. non-core jurisdiction, a critical element of the Motion; (ii) the Bankruptcy Court order denying SGM's request to stay the Adversary Proceeding, in which the Bankruptcy Court explained the limited function and future application of the orders that form the basis for SGM's arguments in the Motion; and (iii) the filing by all Defendants, including the non-SGM Defendants, in the Bankruptcy Court of: (1) a motion to strike; and (2) a motion to dismiss the Adversary Proceeding, thereby furthering their consent to Bankruptcy Court jurisdiction. Copies of these Court papers are attached hereto as Exhibits "A" to "C." Based on the foregoing, and as fully set forth below, the Debtors respectfully request that the

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Court grant the Motion for Leave.

II.

RELEVANT FACTS

1. On January 3, 2020, the Debtors commenced an adversary proceeding (the "Adversary Proceeding") by filing a complaint against the Defendants.[1] Thereafter, SGM filed the Motion and the Debtors filed the Opposition in response thereto. The Motion is currently under submission.

2. Since the Debtors filed the Opposition, three discrete and notable Events have transpired, each of which justify supplementing the Opposition under Civil Rule 15(d).

III.

ARGUMENT

Civil Rule 15(d) specifically allows the filing of supplemental pleadings to allege new facts that occur after the filing of original pleadings. Civil Rule 15(d) states that "[o]n motion and reasonable notice, the court may, on just terms, permit a party to serve a supplemental pleading setting out any transaction, occurrence, or event that happened after the date of the pleading to be supplemented." Fed. R. Civ. P. 15(d). Civil Rule 15(d) "is intended to give district courts broad discretion in allowing supplemental pleadings" to promote "judicial economy and convenience." *Keith v. Volpe*, 858 F.2d 467, 473 (9th Cir. 1988); *see also San Luis & Delta-Mendota Water Auth. v. U.S. Dep't of Interior*, 236 F.R.D. 491, 496 (E.D. Cal. 2006) ("Leave should be freely given"). Supplemental pleadings should be allowed as a matter of course "unless some particular reason for disallowing them appears." *Keith*, 858 F.2d at 473 (citation omitted).

The Debtors seek to supplement the Opposition to bring this Court's attention the Events; each event is addressed in turn below.

[1] All capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the Opposition.

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A. The *Somerset* Decision.

On February 11, 2020, the Third Circuit released the *Somerset* Decision, which it marked as "PRECEDENTIAL." This decision is relevant to the issues raised in the Motion and Opposition as the Third Circuit held that the bankruptcy court had "core" subject matter jurisdiction to enter a final order against a nondebtor third-party by virtue of its participation in the relevant bankruptcy case. *Somerset* arose out of a $1 million postpetition loan to the debtor by a lender supported by collateral, in the form of tax refunds, pledged by the debtor's owner Mr. Mostoller. After the case converted to Chapter 7, Mr. Mostoller sought the refunds for himself. The bankruptcy court ruled against Mr. Mostoller, and the decision was affirmed on appeal by the District Court and then the Third Circuit.

In reaching its decision, the Third Circuit addressed a threshold issue of whether the bankruptcy court had subject matter jurisdiction to enter a final order. *Somerset* Decision at 9 ("Unless the parties consent, bankruptcy courts have jurisdiction to enter final judgments only in 'core proceedings.'") (citing 28 U.S.C. § 157(b), (c); *Stern v. Marshall*, 564 U.S. 462, 473-74, 482 (2011); *Wellness Int'l Network, Ltd. v. Sharif*, 125 S. Ct. 1932, 1949 (2015). *Stern* is referenced in the Motion at 11 and *Wellness* in the Motion at 12 and 13 and the Opposition at 11, 12 and 13. The Third Circuit found the matter was core under 28 U.S.C. § 157(b)(2)(D) and "because this dispute could have arisen only in bankruptcy, the bankruptcy court's exercise of jurisdiction did not offend Article III." *Somerset* Decision at 10. For the reasons stated above, the *Somerset* Decision supports the Debtors' argument on the issues of bankruptcy court core jurisdiction and Defendant consent as contained in the Opposition at sections III.B 1, 2 and 3, and contradicts SGM's call for a broad application of *Stern*. *See* Opposition at 11, lines 8-20 and 23-27; at 12, lines 1-12; at 14, lines 3-8. A copy of the *Somerset* Decision is attached hereto as **Exhibit A**.

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B. The Bankruptcy Court Order Denying SGM's Motion to Stay the Adversary Proceeding.

On February 14, 2020, the Bankruptcy Court entered the *Order Denying Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding* [Bankr. Adv. No. 20-01001, Docket No. 35] (the "Stay Denial Order").

As a result of the Stay Denial Order, the Adversary Proceeding continues to progress in the Bankruptcy Court. The Bankruptcy Court's entry of the Stay Denial Order supports the Debtors' argument on the issues of bankruptcy court core jurisdiction and Defendant consent as contained in the Opposition at sections III.B 1, 2 and 3 at 11, lines 8-20 and 23-27; at 12, lines 1-12; and at 14, lines 3-8, as the Bankruptcy Court continues to exercise its core jurisdiction over the Adversary Proceeding, and the Defendants continue to actively participate in the process. A copy of the Stay Denial Order is attached hereto as **Exhibit B**. *See also* Tentative Ruling on SGM's Motion to Stay the Adversary Proceeding (adopted as final) at 59 (providing for the limited nature of the orders forming the basis for the Motion and reciting that "[t]he Orders do not adjudicate whether SGM had breached the APA, nor do the Orders contain findings that compel the Court to rule in the Debtors' favor with respect to the Complaint's breach of contract claim. […] The SGM Sale is dead and cannot be resuscitated. The findings in the Orders—which the Court made only to facilitate the closing of the SGM Sale—cannot spring back to life in the entirely different context of the Debtors' breach of contract claim."). The progression of the Adversary Proceeding in the Bankruptcy Court, coupled with the Defendants' continued active participation therein, provides further support for the propositions that: (i) the dispute underlying the Adversary Proceeding is core; and (ii) the Defendants have consented to exclusive Bankruptcy Court jurisdiction of the Adversary Proceeding.

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C. The Defendants' Filing of their (i) Motion to Strike and (ii) Motion to Dismiss the Adversary Proceeding in the Bankruptcy Court.

On February 19, 2020, SGM, Kali P. Chaudhuri, M.D., KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc. and KPC Global Management, LLC filed (i) the *Defendants' Special Motion to Strike Plaintiff's Complaint Pursuant to Cal. Civ. Proc. Code § 425.16* [Bankr. Adv. No. 20-01001, Docket No. 39]; and (ii) the *Defendants' Motion to Dismiss Plaintiffs' Complaint* [Fed. R. Civ. Proc. 12(b)(1) & 12(b)(6)] [Bankr. Adv. No. 20-01001, Docket No. 40] (the "Motion to Dismiss"). As set forth on its face, the Motion to Dismiss was brought by all Defendants, *including the non-SGM Defendants*. *See* Motion to Dismiss at 1, lines 2-7. While the Defendants purport to reserve their rights and avoid Bankruptcy Court jurisdiction in the Motion to Dismiss, a mere reservation of rights does not undo the Defendants' participation in the Bankruptcy Court and implied consent thereunder. *See Depaola v. Sleepy's LLC (In re Prof'l Facilities Mgmt. Inc.),* No. 14-31095-WRS, 2015 WL 6501231, at *4 (Bankr. M.D. Ala. Oct. 27, 2015) (finding that a counterclaimant implicitly consented to bankruptcy court jurisdiction through its actions, despite the counterclaimant's unequivocal statements in its affirmative defenses that it did not consent to the bankruptcy court's jurisdiction); *see also Conti v. Perdue Bioenergy, LLC (In re Clean Burn Fuels, LLC),* 540 B.R. 195, n.2 (Bankr. M.D. N.C. 2015) ("In its Amended Answer, Perdue did not consent to [the Bankruptcy] Court's entry of a final judgment. […] However, Perdue later requested this Court to enter final judgment in its Motion for Summary Judgment. […] To prevent […]. gamesmanship […] this Court will interpret Perdue's Motion for Summary Judgment as its consent to this Court's entry of a final judgment.") Indeed, such express participation further

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demonstrates consent to Bankruptcy Court jurisdiction of the Adversary Proceeding.[2] *See Richardson v. JP Morgan Chase Bank, N.A. (In re Jordan),* 543 B.R. 878, 882 (Bankr. C.D. Ill. 2016) (finding implied consent to bankruptcy court jurisdiction where defendant moved to dismiss and, in so doing, asked the bankruptcy court "to enter a final order of dismissal").

Moreover, such action runs in contravention to the statements in footnote 2 of SGM's Reply to Debtors' Opposition to Motion to Withdraw the Reference [Docket No. 18] (the "Reply") where SGM seems to imply a mistaken separateness of SGM from the non-SGM Defendants. The issue of consent has been raised in the Motion at section III.A 2 and in the Opposition at sections III.B 2 and 3. *See* Motion at 16, lines 15-18; Opposition at 12, lines 1-12; at 14, lines 3-8. Thus, the active participation in the Adversary Proceeding in the Bankruptcy Court further supports the Debtors' position that the Motion should be denied. Copies of both the Motion to Strike and Motion to Dismiss are attached hereto as **Exhibit C**.

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IV.

CONCLUSION

WHEREFORE, for all of the above reasons, the Debtors respectfully request leave to supplement the original Opposition in the above-captioned matter.

Dated: February 24, 2020

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EXHIBIT A

EXHIBIT A

PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 19-1874

IN RE: SOMERSET REGIONAL WATER RESOURCES, LLC

LARRY L. MOSTOLLER; CONNIE J. MOSTOLLER,
Appellants

On Appeal from the United States District Court
for the Western District of Pennsylvania
(D.C. No. 3:18-cv-00204)
District Judge: Honorable Marilyn J. Horan

Submitted Under Third Circuit L.A.R. 34.1(a)
on November 14, 2019

Before: AMBRO, KRAUSE, and BIBAS, *Circuit Judges*

(Opinion Filed: February 11, 2020)

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OPINION OF THE COURT

BIBAS, *Circuit Judge*.

When a lender insists on collateral, it expects the collateral to be worth something. Larry Mostoller's company was in bankruptcy and about to fold. Its largest creditor was willing to lend another $1 million to keep it afloat, but only if Mr. Mostoller pledged a forthcoming personal tax refund as collateral. Everyone who negotiated the deal expected that the refund would amount to roughly $1 million—the net amount owed to Mr. Mostoller based on his company's substantial 2015 losses, which he could use to offset his taxable income in 2013, 2014, and 2015.

But now that Mr. Mostoller has the loan and the tax-refund check, he urges a reading of the agreement that he never mentioned during negotiations: that he pledged as collateral his refund on taxes that he paid for 2015 *alone*, excluding any refund on his 2013 and 2014 taxes. Yet he admits that his reading would make the collateral worthless.

The bankruptcy court rightly rejected Mr. Mostoller's novel reading of the agreement. Its description of the collateral was ambiguous, so the court enforced it as the parties understood it: to produce a million-dollar refund. Without that security, the lender would never have made so risky a loan. And because Mr. Mostoller owned almost the entire refund separately from his wife, the court properly rejected his argument that his pledge was unenforceable without her consent. So like the District Court before us, we will affirm.

I. BACKGROUND

A. The bankruptcy

Mr. Mostoller solely owned Somerset Regional Water Resources, LLC (the Debtor), a water-transportation business that serviced oil and gas wells. The Debtor used to be profitable. But when oil prices plummeted in mid-to-late 2014, the oil and gas industry suffered. The Debtor and its customers were no exception. Its losses mounted and its balance sheet plunged into the red.

The Debtor's largest creditor was Somerset Trust Company, to which it owed more than $3 million. The Trust's loans were secured by a blanket lien on most of the Debtor's assets and a personal guarantee by Mr. Mostoller.

In late 2015, the Debtor faced a severe cash-flow shortage and the likely termination of one of its leases. To stop the bleeding, it voluntarily petitioned for reorganization under Chapter 11 of the Bankruptcy Code.

B. The emergency loan, its collateral, and the default

Chapter 11 lets struggling companies reorganize so that they can exit bankruptcy, keep operating, and pay as much as possible to their creditors. *In re Armstrong World Indus., Inc.*, 432 F.3d 507, 518 (3d Cir. 2005). But the Debtor faced a dire liquidity crisis; it stood little chance of surviving a Chapter 11 reorganization without an immediate cash infusion. And because the Debtor was overleveraged, it would find it hard to attract new lenders in what little time it had.

The Trust, however, had a unique incentive to lend more: if a new loan could keep the Debtor afloat, it would more likely be able to repay the Trust in full. Still, to encourage new lending, the Debtor would have to pledge to the Trust substantial new collateral. But the Debtor had already pledged most of its assets to the Trust as security; it had little left to offer.

Thus, the Debtor's management turned to Mr. Mostoller to see if he would pledge some personal assets to secure a loan to save his business. To entice the Trust to lend more money, the Debtor's Chief Restructuring Officer proposed that Mr. Mostoller "assign his interests in the net proceeds of [an anticipated] federal tax refund." 3 App. 1179.

A taxpayer is entitled to a refund if he pays more taxes than he has to. *See* 26 U.S.C. § 6402(a) (2012). And Mr. Mostoller had overpaid over several years. As an S Corporation, the

Debtor was a pass-through entity for tax purposes. *See* 26 U.S.C. § 1363(a) (2012). Its taxable income and losses passed through to Mr. Mostoller, its sole owner. *See id.* § 1366(a)(1)(A). He filed his taxes jointly with his wife in 2013, 2014, and 2015. In 2013 and 2014, when the Debtor was thriving, the Mostollers had paid millions of dollars in federal taxes on that income.

But by 2015, the business was struggling. Under a provision of the Internal Revenue Code in effect at the time, he could file amended 2013 and 2014 tax returns to carry back the Debtor's 2015 losses, which would offset his taxable income for those two years and trigger a refund. 26 U.S.C. § 172(a), (b)(1)(A)(i) (2012), *repealed in relevant part by* The Tax Cuts and Jobs Act, Pub. L. No. 115-97, tit. I, § 13302(b), 131 Stat. 2054, 2122 (2017). Because the Debtor had lost millions of dollars in 2015, the Debtor, the Trust, and their advisors expected that Mr. Mostoller would get a net tax refund of close to $1 million. And the parties understood that Mr. Mostoller could pledge this amount as collateral for an emergency loan.

In the hasty negotiations that followed, the parties reached an agreement. Mr. Mostoller was involved in the negotiations and signed the agreement. In paragraph 6 of that agreement, he pledged as collateral "any rights or interest in the 2015 Federal tax refund due to him individually, but attributable to the operating losses of the Debtor." 2 App. 56–57 ¶6. In exchange, the Trust would lend the Debtor $1 million.

Without that valuable collateral, the Trust would not have lent the Debtor more money. The tax refund was "a central part of [the] collateral package" and was "insisted upon by [the]

Trust." 3 App. 1068. But the agreement left open the details about executing the tax filings needed to trigger the expected refund. The parties expected that an accountant would handle these details later. Soon after the parties struck the deal, the bankruptcy court approved the agreement and entered it on its docket as a consent order (the Loan Order). 2 App. 51–75.

But even this cash infusion could not save the Debtor. It soon defaulted on the emergency loan. Without a new source of financing to keep the business afloat, the Debtor converted its bankruptcy from a Chapter 11 reorganization to a Chapter 7 liquidation.

C. The tax-refund dispute

Right after the Debtor defaulted on the emergency loan, Mr. Mostoller tried to hang onto the collateral that he had pledged. At first, he apparently refused to file his 2015 tax return and amended 2013 and 2014 tax returns, which were needed to generate the tax refund. So the Trust moved to compel him to do that. At the hearing on this motion, Mr. Mostoller told the bankruptcy court that he had filed those tax returns. And he testified that he "agree[d] that [the] Trust gets half of the tax refund, minus the federal taxes due," with the other half going to his wife. 3 App. 969. The Trust later agreed to that proposal.

But when the tax refund came, Mr. Mostoller tried to keep all of it for himself. His accountant received the $1.12 million refund check from the IRS and followed the bankruptcy court's order by promptly depositing it with the court. Yet when the

Trust moved to claim Mr. Mostoller's share of the pledged collateral, he cross-moved, seeking the entire refund.

In briefing on those motions, Mr. Mostoller argued for the first time that paragraph 6 of the Loan Order was limited to any tax refund owed to him because of income offset in the 2015 tax year and did not include any refund from income offset in prior tax years. In the alternative, he argued that because he and his wife owned the refund as tenants by the entirety under Pennsylvania law, and because his wife had not signed the Loan Order, the Trust could not seize the refund proceeds.

In response, the Trust argued that paragraph 6 is ambiguous, that extrinsic evidence from the negotiations showed that refunds derived from offsetting the Mostollers' 2013 and 2014 income against the Debtor's 2015 losses were included, and that the Mostollers' property interests in the refund were separate. In support, the Trust submitted affidavits from the Trust's Senior Vice President, the Debtor's Chief Restructuring Officer, and a lawyer who helped the Debtor negotiate the emergency loan. Each affiant had taken part in the negotiations and maintained that paragraph 6 encompassed refunds derived from the offset of taxable income from prior years, not just from 2015. At an evidentiary hearing, each affiant testified to the same.

For his part, Mr. Mostoller maintained that paragraph 6 is unambiguous, though he chose at the last minute not to testify.

D. Procedural history

After supplemental briefing, the bankruptcy court held for the Trust on all grounds. *Somerset Tr. Co. v. Mostoller* (*In re Somerset Reg'l Water Res., LLC*), 592 B.R. 38 (Bankr. W.D. Pa. 2018). It credited the Trust's witnesses and the "overwhelming evidence" of the parties' intent in holding that "the deal was to pledge the entirety of the refund generated by the [Debtor's] 2015 operating losses." *Id.* at 62. So it read paragraph 6 of the Loan Order to include refunds from 2013 through 2015—that is, the full amount at issue. *Id.* at 57–60. It also rejected the Mostollers' claim that they owned the refund as tenants by the entirety, holding that under federal tax law their interests were divisible. *Id.* at 63–64. After factoring in the Trust's concession that Mrs. Mostoller could keep half of the refund, the bankruptcy court ordered the release of the remaining $536,894 held in escrow to the Trust. *See id.* at 60, 64. On appeal, the District Court affirmed.

The Mostollers now appeal to our Court. They raise three arguments: first, that the bankruptcy court lacked subject-matter jurisdiction to decide the dispute; second, that paragraph 6 of the Loan Order is unambiguously limited to the refund from only the 2015 tax year; and third, that they owned the whole $1.12 million refund as tenants by the entirety, so the Trust cannot seize any of those funds.

On appeal, "we 'stand in the shoes' of the District Court" and apply the same standard of review. *In re Glob. Indus. Techs., Inc.*, 645 F.3d 201, 209 (3d Cir. 2011) (en banc) (quoting *IRS v. Pransky* (*In re Pransky*), 318 F.3d 536, 542 (3d Cir. 2003)). We review the bankruptcy court's legal determinations

de novo, its factual findings for clear error, and its discretionary decisions for abuse of discretion. *Schepis v. Burtch* (*In re Pursuit Capital Mgmt., LLC*), 874 F.3d 124, 133 n.14 (3d Cir. 2017). And because the bankruptcy court heard testimony from witnesses who participated in the negotiations, we give "due regard to the opportunity of that court to judge first-hand the[ir] credibility." *Fellheimer, Eichen & Braverman, P.C. v. Charter Techs., Inc.*, 57 F.3d 1215, 1223 (3d Cir. 1995) (internal quotation marks omitted).

II. THE BANKRUPTCY COURT HAD JURISDICTION TO DECIDE THE DISPUTE

The Mostollers argue that the bankruptcy court lacked subject-matter jurisdiction to decide the dispute over the tax refund. Bankruptcy courts have limited statutory jurisdiction under the Bankruptcy Code and limited constitutional jurisdiction under Article III. *Stern v. Marshall*, 564 U.S. 462, 473–74, 482 (2011). Unless the parties consent, bankruptcy courts have jurisdiction to enter final judgments only in "core proceedings." 28 U.S.C. §157(b), (c)(1); *Stern*, 564 U.S. at 474–75; *see Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1949 (2015).

Here, the bankruptcy court entered a final judgment on the parties' cross-motions and ordered the Mostollers to give up half of the tax refund. They argue that the court exceeded its statutory and constitutional jurisdiction because the refund dispute is not a core proceeding. *See Stern*, 564 U.S. at 482 (analyzing Bankruptcy Code and Article III jurisdiction separately); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 135–36 (3d Cir. 2019) (same). Not so.

First, the dispute falls within the bankruptcy court's statutory jurisdiction over core proceedings. While the bankruptcy court held that it had statutory jurisdiction under several provisions of 28 U.S.C. § 157(b)(2), we need discuss only one here. Section 157(b)(2)(D) confers jurisdiction over "orders in respect to obtaining credit." That is the issue here: the reach and scope of paragraph 6 of the Loan Order, a court-approved agreement that gave the Debtor a new loan. Because the Loan Order "authorized the agreement[] at issue in this case," the parties "assert[] rights that were established in connection with one of the [b]ankruptcy [c]ourt's core functions—here, the approval of [the Debtor's] requests for more credit." *KeyBank Nat'l Ass'n v. Franklin Advisers, Inc.*, 600 B.R. 214, 228 (S.D.N.Y. 2019) (citing 28 U.S.C. § 157(b)(2)(D)); *see also Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242, 1245 n.1 (3d Cir. 1994) ("Post-petition transactions are more likely to be core proceedings.").

Second, because this dispute could have arisen only in bankruptcy, the bankruptcy court's exercise of jurisdiction did not offend Article III. *See Stern*, 564 U.S. at 499 (holding that a bankruptcy court's exercise of jurisdiction poses no constitutional problems if "the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process"). Without the court's Loan Order, the Debtor most likely could not have gotten the emergency financing it needed to try to survive Chapter 11 reorganization. And once the court entered the Loan Order, it "plainly had jurisdiction to interpret and enforce it[]" against its signatories, including Mr. Mostoller. *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 151 (2009). As a leading treatise recognizes, "[t]here has never

been any doubt" about bankruptcy courts' jurisdiction over "matters of administration," like entering and enforcing "orders in respect to obtaining credit." 1 *Collier on Bankruptcy* ¶3.02[3][a] (16th ed. 2019).

The bankruptcy court thus properly exercised core-proceeding jurisdiction over the tax-refund dispute under 28 U.S.C. § 157(b)(1)–(2). The District Court in turn had jurisdiction under 28 U.S.C. §§ 157(a) and 158(a). And we have jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291. Having settled this threshold issue, we proceed to the merits.

III. THE BANKRUPTCY COURT RIGHTLY FOUND AMBIGUITY AND CONSTRUED IT IN FAVOR OF THE TRUST

The crux of this appeal is the phrase "the 2015 Federal tax refund due to [Mr. Mostoller] individually, but attributable to the operating losses of the Debtor" in paragraph 6 of the Loan Order. 2 App. 56–57 ¶6. The parties dispute whether that phrase is ambiguous and, if so, which side's reading controls. The Loan Order is a consent decree formalizing the parties' agreement, so we interpret it as a contract. *McDowell v. Phila. Hous. Auth.*, 423 F.3d 233, 238 (3d Cir. 2005). The parties agree that Pennsylvania law governs.

The bankruptcy court found that paragraph 6 is ambiguous because it is "subject to multiple reasonable interpretations." 592 B.R. at 52. After considering documentary evidence and credible testimony from the negotiators, it resolved that ambiguity by adopting the Trust's reading. It rejected the Mostollers' contrary reading, which it found would lead to

unreasonable results and which Mr. Mostoller never expressed throughout the loan negotiations. All of that reasoning is sound.

A. Paragraph 6 of the Loan Order is ambiguous

Whether an agreement is ambiguous is a question of law, so we review de novo. *Pacitti ex rel. Pacitti v. Macy's*, 193 F.3d 766, 773 (3d Cir. 1999) (applying Pennsylvania law). Under Pennsylvania law, "[a] contract is ambiguous if it is reasonably susceptible of different constructions and capable of being understood in more than one sense." *Schwab v. Pennsummit Tubular, LLC* (*In re Old Summit Mfg., LLC*), 523 F.3d 134, 137 (3d Cir. 2008) (quoting *Hutchison v. Sunbeam Coal Corp.*, 519 A.2d 385, 390 (Pa. 1986)). Paragraph 6 is ambiguous because it is subject to at least three reasonable, competing readings:

First, "2015 Federal tax refund" could mean a tax refund paid to the Mostollers in the 2015 calendar year. Natural persons generally must use the calendar year as their tax year and do not file their tax returns until the next year. *See* 26 U.S.C. §441(g) (2012). So a tax refund issued in 2015 would be for the 2014 tax year. None of the parties urges us to adopt this reading, but it is reasonable on its face.

Second, that phrase could mean a refund received at any time on only the Mostollers' 2015 taxes (which they paid later on), triggered by the Debtor's losses in the 2015 tax year. The Mostollers urge us to adopt this reading. And the bankruptcy court agreed that it was reasonable on its face. Because the Debtor's profits were their chief source of income, and the

parties expected the Debtor to incur millions of dollars in losses in 2015, this reading would produce a relatively small tax refund.

Third, paragraph 6 could refer to a tax refund owed to the Mostollers because of the Debtor's 2015 losses, even if the Mostollers used those losses to offset their 2015 income and income from past years. In other words, the phrase "2015 Federal tax refund … attributable to the operating losses of the Debtor" might refer to *any refund* paid because of losses that the Debtor incurred in 2015. 2 App. 56–57 ¶6. The Trust advances this reading. And the bankruptcy court agreed that it was reasonable on its face too. That reading would include refunds owed because of the Debtor's multi-million-dollar losses in 2015, which the Mostollers could use to offset their taxable income from 2015 as well as from 2013 and 2014 (the two years within the carryback period). *See* 26 U.S.C. § 172(b)(1)(A)(i) (2012).

Because paragraph 6 is subject to each of these reasonable, competing readings, we agree with the bankruptcy court that it is ambiguous.

B. The Trust's reading best resolves that ambiguity

To resolve a contract's ambiguity, we look to extrinsic or parol evidence—that is, "[e]vidence relating to a contract but not appearing on the face of the contract because it comes from other sources, such as statements between the parties or the circumstances surrounding the agreement." *Extrinsic Evidence*, *Black's Law Dictionary* (11th ed. 2019). Whether the ambiguity is patent or latent, we may look to parol evidence all the

same. *Zuber v. Boscov's*, 871 F.3d 255, 258 (3d Cir. 2017) (citing *Kripp v. Kripp*, 849 A.2d 1159, 1163 (Pa. 2004)). And we may use parol evidence "to show both the intent of the parties and the circumstances attending the execution of the contract." *Osial v. Cook*, 803 A.2d 209, 214 (Pa. Super. Ct. 2002).

We now turn to the bankruptcy court's reading of the parol evidence. "[T]he resolution of conflicting parol evidence" is a question of fact that we review for clear error. *In re Old Summit*, 523 F.3d at 137 (quoting *Hutchison*, 519 A.2d at 390). The bankruptcy court found that the parol evidence of the parties' intent "overwhelming[ly]" favors the Trust's reading. 592 B.R. at 62. We agree.

1. *The parol evidence of the Loan Order negotiations.* The Trust submitted affidavits and later live testimony from three witnesses who helped negotiate the loan: the Trust's Senior Vice President, the Debtor's Chief Restructuring Officer, and a lawyer for the Debtor. We defer to the bankruptcy court's finding that each of these witnesses was credible. *Fellheimer*, 57 F.3d at 1223. Their testimony about the negotiations made three things clear:

First, without valuable new collateral, the Trust would not have lent the Debtor more money. That makes sense. Because of the Debtor's financial distress, it was at great risk of default. To secure such a risky loan, someone needed to put up valuable new collateral.

Second, everyone expected that, after offsetting other tax-related liabilities, Mr. Mostoller could pledge close to $1 million of his tax refund as collateral. This understanding was

based on preliminary estimates from an accountant who had prepared the Debtor's and the Mostollers' taxes. Given the fast pace of negotiations, those estimates were the best the parties could get.

Third, the parties chose not to specify the details of how they would execute filing the Mostollers' new and amended tax returns. Because the negotiations were moving so fast, they left those specifics to a professional accountant. So neither the negotiations nor the Loan Order touched on *how* the Debtor's 2015 losses would create a refund. But all the parties expected that the resulting refund would be worth around $1 million. Thus, the parties understood that the "2015 refund" referred generally to any refund generated by the Debtor's 2015 losses.

2. *The Trust's reading tracks the actual refund.* Only the Trust's reading squares with this extrinsic evidence. The Trust reads the key phrase to mean any tax refund owed to Mr. Mostoller because of losses incurred by the Debtor in 2015, even if those losses produced further and larger refunds after being carried back to the 2013 and 2014 tax years. Otherwise, the eventual tax refund would fall far short of the parties' expectations. To show how, we must reconstruct the Mostollers' tax filings for those three years.

a. *Tax year 2015.* In 2015, the Debtor incurred roughly $6.3 million in losses, dwarfing the Mostollers' other taxable income. Because it was a pass-through entity, Mr. Mostoller claimed the Debtor's losses on his and his wife's joint personal tax return. After factoring in these losses, the Mostollers paid zero taxes for the 2015 tax year. Because these losses more than offset their other taxable income, they got a refund of

about $126,000 for that year. The Mostollers ask us to stop there; the Trust urges us to march on.

After satisfying other tax-related obligations, around $4.9 million of the Debtor's 2015 net operating losses remained. At the time, the Internal Revenue Code let the Mostollers use those leftover losses to offset taxable income in the two preceding tax years: 2013 and 2014. *See* 26 U.S.C. § 172(b)(1)(A)(i) (2012). So march on we must, back to 2013 first. *See id.* § 172(b)(2) (requiring taxpayers to carry losses back "to the earliest of the taxable years" available under § 172(b)(1)(A)(i)).

b. *Tax year 2013*. In 2013, the Debtor was making money and the Mostollers had about $490,000 in taxable income. Carrying back the Debtor's 2015 losses on an amended tax return, the Mostollers were entitled to a refund of about $143,000 for that tax year. That brought their total refund to roughly $269,000. Still, more than $4.4 million of the Debtor's 2015 losses were left to carry over to the 2014 tax year.

c. *Tax year 2014*. In 2014, the Debtor thrived. The Mostollers earned more than $7.3 million and paid about $2.9 million in federal income taxes. Through another amended tax return, the Mostollers used the Debtor's remaining 2015 losses to offset more than half of their 2014 income. That produced a refund of roughly $1.8 million, bringing the total gross refund to just over $2 million.

d. *Adding it all up*. The IRS subtracted roughly $900,000 in other tax obligations from those refunds. Ultimately, the Mostollers got a tax-refund check of about $1.12 million,

which matched the parties' expectations when they executed the Loan Order. But if paragraph 6 referred to a refund on taxable income earned during the 2015 tax year alone, the refund would have fallen well short of those expectations. Only through the amended 2013 and 2014 tax returns could the refund reach the anticipated size, one large enough to secure the million-dollar emergency loan. So only the Trust's reading of paragraph 6 tracks the Mostollers' actual refund, as anticipated by extrinsic evidence of the parties' intent.

3. *The Mostollers' reading of paragraph 6 fails.* By contrast, the parol evidence contradicts the Mostollers' reading, which limits the phrase "2015 Federal tax refund" to a refund of only their 2015 taxes and excludes refund proceeds from 2013 and 2014. As noted, that reading of paragraph 6 would have foreseeably produced a refund too small to induce and secure the risky loan.

Worse still, the Mostollers admit that under their reading, the agreed-upon refund "would be valueless." Appellants' Br. 4; *accord id.* at 15. Their other tax obligations would swallow up the 2015-only refund, leaving no value in the collateral to secure the emergency loan. It strains credulity to think that such evidently worthless collateral would have enticed the Trust to make so risky a loan. We reject this commercially unreasonable reading. *See Starling v. Lake Meade Prop. Owners Ass'n*, 162 A.3d 327, 345 (Pa. 2017) (noting the "prohibition on any interpretation" of a contract "that leads to an absurd result").

To be clear, we do not let parol evidence about ethereal expectations trump the text. Here, the text itself is ambiguous and

is open to several reasonable readings. And "the extrinsic evidence proffered by [the Trust] concerns the parties' objectively manifested linguistic reference regarding certain terms of the contract, rather than merely their [subjective] expectations." *Bohler-Uddeholm Am., Inc. v. Ellwood Grp., Inc.*, 247 F.3d 79, 99 (3d Cir. 2001). Thus, the parol evidence helps us to resolve ambiguity, not to create ambiguity where none exists.

In sum, the Trust's reasonable reading tracks the parol evidence that the bankruptcy court found credible. And the Mostollers' reading conflicts with both the parties' understanding and basic commercial sense. So we will affirm the bankruptcy court's reading.

C. The bankruptcy court rightly rejected the Mostollers' unexpressed reading

Even if the Mostollers' reading better tracked the extrinsic evidence, we would still affirm on another ground. The bankruptcy court rightly applied the "central principle of contract interpretation that if a party knew or had reason to know of the other parties' interpretation of terms of a contract, the first party should be bound by that interpretation." *Bohler-Uddeholm*, 247 F.3d at 97, 99 (applying Pennsylvania law); *accord* Restatement (Second) of Contracts §201(2)(b) (Am. Law Inst. 1981).

During the negotiations, the Debtor's and the Trust's representatives repeatedly put Mr. Mostoller on notice that they read paragraph 6 as requiring him to pledge around $1 million of the tax refund as collateral for the emergency loan. But Mr. Mostoller never told them of his contrary reading

at the time. He kept them in the dark until after the Trust had relied on the collateral to extend a risky loan. By then it was, as the Mostollers aptly put it, "too late." Appellants' Br. 4.

To prevent a silent party from later ambushing his unwitting opponents, we reject the silent party's unexpressed reading. *See, e.g.*, *Bohler-Uddeholm*, 247 F.3d at 99; *Emor, Inc. v. Cyprus Mines Corp.*, 467 F.2d 770, 775–76 (3d Cir. 1972) (applying Pennsylvania law). We agree with the bankruptcy court that Mr. Mostoller is "seeking to take advantage of both sides of the coin." 592 B.R. at 62. So the court was right to apply this doctrine here.

IV. THE MOSTOLLERS' INTERESTS IN THE 2015 TAX REFUND ARE SEPARATE

In a last-ditch effort to keep the collateral, the Mostollers argue that they owned the tax refund as tenants by the entirety under Pennsylvania law. If that is right, then the Trust could not seize those funds because only Mr. Mostoller, not Mrs. Mostoller, signed the Loan Order. "Pursuant to Pennsylvania law, property owned as tenants by the entirety cannot be accessed by the creditors of only one spouse." *Clientron Corp. v. Devon IT, Inc.*, 894 F.3d 568, 575 (3d Cir. 2018).

But Pennsylvania law is only part of this equation. It is federal tax law that determines who owns what portion of a federal tax refund and how they own it. And federal tax law provides that spouses' ownership of a refund depends on how they owned the income that generated that refund under state property law.

Under Pennsylvania law, the Mostollers held separate interests in the Debtor's income because Mr. Mostoller alone owned the Debtor. So the Mostollers' interests in the refund were separate too. And they never merged those separate interests into entireties interests. Thus, the bankruptcy court rightly rejected this argument.

A. Federal tax refunds are separately owned if the income is separately owned

As we shall explain, a mixture of federal and state law governs ownership of federal tax refunds. We discuss each in turn.

1. *Federal tax law*. The Internal Revenue Code does not automatically treat refunds from joint marital returns as jointly owned. Rather, each spouse owns a portion of the refund separately, according to his or her share of the tax overpayment. *See* 26 U.S.C. § 6402(a) (2012) (authorizing the IRS to "credit the amount of [any] overpayment … against any [tax] liability … *on the part of the person who made the overpayment* and … [to] refund any balance to such person" (emphasis added)). So the ownership of the spouses' income determines how they own a tax refund on that income. If the income is separate going in, then the refund is separate coming out. Merely filing a joint tax return does not change that.

Our sister circuits concur. The Fifth Circuit, for instance, has held that if the income leading to a tax overpayment belongs to one spouse, then, even if the two file a joint tax return, the refund does not belong jointly to both spouses. *Ragan v. Comm'r*, 135 F.3d 329, 333 (5th Cir. 1998). As Judge Higginbotham explained for the court, "[a] joint income tax

return does not create new property interests for the husband or wife in each other's income tax overpayment." *Id.* Because the income was the husband's alone under Texas law, the wife had no interest in the resulting refund. *Id.*

Nor is the Fifth Circuit alone. In the words of the Ninth Circuit: "A joint return does not itself create equal property interests for each party in a refund. Spouses who file a joint return have *separate* interests in any overpayment, the interest of each depending upon his or her relative contribution to the overpaid tax." *United States v. Elam*, 112 F.3d 1036, 1038 (9th Cir. 1997). Thus, "fil[ing] a joint tax return ... does not change the underlying property interests at stake." *Id.*; *see also Callaway v. Comm'r*, 231 F.3d 106, 117 (2d Cir. 2000) ("[T]he filing of a joint return does not have the effect of converting the income of one spouse into the income of another." (citing *McClelland v. Massinga*, 786 F.2d 1205, 1210 (4th Cir. 1986)); *Gordon v. United States*, 757 F.2d 1157, 1160 (11th Cir. 1985) ("Where spouses claim a refund under a joint return, the refund is divided between the spouses, with each receiving a percentage of the refund equivalent to his or her proportion of the withheld tax payments."); *cf.* Rev. Rul. 74-611, 1974-2 C.B. 399, 399 ("Court decisions have consistently held that a husband and wife who file a joint return do not have a joint interest in an overpayment; each has a separate interest.").

We now join our sister circuits in adopting this rule. Thus, when the Mostollers got their refund check, each spouse acquired a separate interest in it proportional to his or her contribution to the overpayments. If the income was jointly owned, then the Mostollers had a common interest in the

refund. But if it was separately owned by Mr. Mostoller, then his wife had no interest in the refund when it arrived.

To figure out who owned what (and how), we turn to Pennsylvania law. *See United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985) ("[S]tate law controls in determining the nature of the legal interest which the taxpayer had in the property. . . . [F]ederal statute[s] create[ ] no property rights but merely attach[ ] consequences, federally defined, to rights created under state law." (internal quotation marks omitted)).

2. *State property law*. Under Pennsylvania law, Mr. Mostoller owned most of the spouses' income in 2013, 2014, and 2015, because he separately owned the main producer of that income: the Debtor. So he also owned most of the refund when it arrived.

In Pennsylvania, spouses ordinarily own property in one of three ways: separately, as tenants in common, or as tenants by the entirety. In the first, only one spouse owns the property; the other does not. The second means that each spouse possesses the property but has "separate and distinct" legal title to it. *In re Estate of Quick*, 905 A.2d 471, 474 (Pa. 2006). And the third gives each spouse a joint, singular interest in "'the whole or the entirety,' and not a 'share, moiety or divisible part'" of the property. *Clientron Corp.*, 894 F.3d at 579 (quoting *In re Brannon*, 476 F.3d 170, 173 (3d Cir. 2007)). Creditors of one spouse can attach separate or common interests of that spouse, but they cannot attach jointly held entirety interests without the other spouse's consent. *See id.* at 575. To win, the Mostollers must show that they owned their income as tenants by the entirety.

For a tenancy by the entirety, Pennsylvania requires the traditional common-law elements: a marriage, plus the "four unities" of time, title, possession, and interest. *In re Estate of Quick*, 905 A.2d at 474. To satisfy those unities, the spouses must (1) have their interests "vest at the same time," (2) "obtain[] their title by the same instrument," (3) have "an undivided interest in the whole," and (4) own interests "of the same type, duration and amount." *In re Estate of Rivera*, 194 A.3d 579, 586–87 (Pa. Super. Ct. 2018) (quoting *Fenderson v. Fenderson*, 685 A.2d 600, 607 (Pa. Super. Ct. 1996)).

Here, none of the unities was present. Because Mr. Mostoller was the Debtor's sole owner, he alone had legal title to, possession of, and an interest in its income when it accrued. Thus, he owned that income as separate property. As the Mostollers had no other significant source of income, the Debtor accounted for the lion's share of their taxable income from 2013 to 2015. So under federal tax law, Mr. Mostoller owned most of the refund separately.

B. The Mostollers never merged their separate interests into entireties interests

After spouses get a refund, they can change their ownership of that money under state property law. For instance, spouses can merge their separate interests into entireties interests over time, as long as they satisfy the four unities needed for a tenancy by the entirety. *Cf. In re Estate of Brose*, 206 A.2d 301, 304 (Pa. 1965). But when the IRS issued the Mostollers' refund check, Mr. Mostoller owned almost all of it separately through his sole ownership of the Debtor's income, even though the check was made out to both spouses. While the unities of time

and title were satisfied by then, the unities of possession and interest were still missing. *See In re Estate of Rivera*, 194 A.3d at 586. And the Mostollers could not have merged their interests: their accountant immediately deposited the refund check with the bankruptcy court before they could commingle the proceeds.

Because their interests both started and remained separate, Mr. Mostoller validly pledged his share on his own. Thus, the bankruptcy court properly ordered the Mostollers to turn over half of the refund to the Trust.

* * * * *

Now that he has his loan, Mr. Mostoller wants to water down his pledge. He admits that, on his novel reading of the loan agreement, the promised collateral "would be valueless." Appellants' Br. 4. But the bankruptcy court rightly found that the Loan Order's description of the collateral was ambiguous and that the Trust's reading tracked the parties' understanding. It also rightly held that, under federal tax law, the Mostollers owned the tax refund separately, so Mr. Mostoller alone could pledge it. Finally, in doing so, it properly exercised its jurisdiction over core proceedings. The District Court affirmed in all respects. So too will we.

EXHIBIT B

EXHIBIT B

FILED & ENTERED

FEB 14 2020

CLERK U.S. BANKRUPTCY COURT
Central District of California
BY gonzalez DEPUTY CLERK

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA—LOS ANGELES DIVISION

In re: Verity Health System of California, Inc., *et al.*,

Debtors and Debtors in Possession.

☒Affects All Debtors

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

Debtors and Debtors in Possession.

Lead Case No.: 2:18-bk-20151-ER
Adv. Case. No.: 2:20-ap-01001-ER

Jointly Administered With:
Case No. 2:18-bk-20162-ER;
Case No. 2:18-bk-20163-ER;
Case No. 2:18-bk-20164-ER;
Case No. 2:18-bk-20165-ER;
Case No. 2:18-bk-20167-ER;
Case No. 2:18-bk-20168-ER;
Case No. 2:18-bk-20169-ER;
Case No. 2:18-bk-20171-ER;
Case No. 2:18-bk-20172-ER;
Case No. 2:18-bk-20173-ER;
Case No. 2:18-bk-20175-ER;
Case No. 2:18-bk-20176-ER;
Case No. 2:18-bk-20178-ER;
Case No. 2:18-bk-20179-ER;
Case No. 2:18-bk-20180-ER;
Case No. 2:18-bk-20181-ER;

Chapter 11 Cases.

ORDER DENYING STRATEGIC GLOBAL MANAGEMENT, INC.'S EMERGENCY MOTION TO STAY ADVERSARY PROCEEDING

[RELATES TO ADV. DOC. NO. 19]

Verity Health System of California, Inc., et al.,

Plaintiffs,

v.

Strategic Global Management, Inc., et al.,

Defendants

Date: February 11, 2020
Time: 10:00 a.m.
Location: Ctrm. 1568
Roybal Federal Building
255 East Temple Street
Los Angeles, CA 90012

1820151200214000000000004

The Court conducted a hearing on *Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding* (the "Motion") [Adv. Doc. No. 19] at the above-captioned date and time. For the reasons set forth in the amended tentative ruling [Adv. Doc. No. 29], which the Court adopts as its final ruling and which is incorporated herein by reference, **IT IS HEREBY ORDERED** that the Motion is **DENIED**.

IT IS SO ORDERED.

###

Date: February 14, 2020

Ernest M. Robles
United States Bankruptcy Judge

United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Tuesday, February 11, 2020 **Hearing Room 1568**

10:00 AM
2:18-20151 Verity Health System of California, Inc. **Chapter 11**
Adv#: 2:20-01001 VERITY HEALTH SYSTEM OF CALIFORNIA, INC., a Califo v.

#17.00 Hearing set re [15] *Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding*

Docket 0

Matter Notes:

2/11/2020

The tentative ruling will be the order.
Party to lodge order: As set forth in the Amended Tentative Ruling

POST PDF OF TENTATIVE OR AMENDED TENTATIVE RULING TO CIAO

Tentative Ruling:

2/11/2020

(Amended after hearing in RED.) For the reasons set forth below, SGM's motion to stay this adversary proceeding (the "Stay Motion") is DENIED. Subject to any additional argument that may be presented at the hearing, the Committee's emergency motion to intervene, for the limited purpose of opposing the Stay Motion, is GRANTED.

Pleadings Filed and Reviewed:
1) Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding (the "Stay Motion") [Adv. Doc. No. 19]
2) Debtors' Opposition to Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding [Adv. Doc. No. 24]
3) Official Committee of Unsecured Creditors' Opposition to Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding [Adv. Doc. No. 25]

United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Tuesday, February 11, 2020 **Hearing Room 1568**

10:00 AM

CONT... Verity Health System of California, Inc. **Chapter 11**

4) Reply to Oppositions to "Strategic Global Management, Inc.'s … Motion to Stay Adversary Proceeding" [Adv. Doc. No. 26]
5) Official Committee of Unsecured Creditors' Emergency Notice of Motion and Motion to Intervene Re: Strategic Global Management, Inc.'s Emergency Motion to Stay Adversary Proceeding (the "Intervention Motion") [Adv. Doc. No. 27]

I. Facts and Summary of Pleadings

On August 31, 2018 (the "Petition Date"), Verity Health System of California ("VHS") and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The Debtors' cases are being jointly administered. *See* Doc. No. 17.

As of the Petition Date, the Debtors operated six acute care hospitals in the state of California. On December 27, 2018, the Court authorized the Debtors to sell two of their hospitals—O'Connor Hospital and Saint Louise Regional Hospital—to Santa Clara County (the "Santa Clara Sale"). The Santa Clara Sale closed on February 28, 2019.

A. The Asset Purchase Agreement Between the Debtors and Strategic Global Management

On February 6, 2019, the Court conducted a hearing to establish bidding procedures for the auction of the Debtors' four remaining hospitals—St. Francis Medical Center ("St. Francis"), St. Vincent Medical Center (including St. Vincent Dialysis Center) ("St. Vincent"), Seton Medical Center ("Seton"), and Seton Medical Center Coastside ("Seton Coastside") (collectively, the "Hospitals"). That hearing required the Court to determine whether to approve an Asset Purchase Agreement (the "APA") between the Debtors and Strategic Global Management ("SGM"). The APA provided that SGM would serve as the stalking-horse bidder for the auction of the Hospitals.

At the February 6, 2019 hearing, the Court found that the termination rights granted to SGM in the APA were unduly broad. In response to the Court's concerns, the Debtors renegotiated the APA to limit SGM's termination rights. On February 19, 2019, the Court entered an order establishing bidding procedures for the auction of the Hospitals and approving the renegotiated APA (the "Bidding Procedures Order") [Bankr. Doc. No. 1572].

The renegotiated provision of the APA—set forth in Section 8.6—pertained to SGM's ability to terminate the transaction in the event that the California Attorney

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CONT... Verity Health System of California, Inc. **Chapter 11**

General (the "Attorney General") sought to impose conditions on the sale that were not substantially consistent with those conditions that SGM had agreed to accept (the "Purchaser Approved Conditions"). In the event that the Attorney General sought to impose conditions materially different from the Purchaser Approved Conditions (the "Additional Conditions"), the APA provided the Debtors an opportunity to seek an order from the Court that the Hospitals could be sold free and clear of the Additional Conditions under § 363(f) of the Bankruptcy Code (an order granting such relief, the "Supplemental Sale Order").

Notwithstanding thorough marketing efforts, the Debtors did not receive any qualified bids for all of the Hospitals. The Debtors received one bid to purchase only St. Vincent and one bid to purchase only St. Francis. After consulting with the Official Committee of Unsecured Creditors (the "Committee") and the largest secured creditors, the Debtors determined not to conduct an auction. On May 2, 2019, the Court entered an order finding that SGM was the winning bidder and approving the sale of the Hospitals to SGM for $610 million (the "SGM Sale"). *See* Bankr. Doc. No. 2306 (the "Sale Order").

B. The Supplemental Sale Order

Pursuant to Cal. Corp. Code § 5914, the Debtors submitted the SGM Sale to the Attorney General for review. On September 25, 2019, the Attorney General consented to the SGM Sale, subject to Additional Conditions that were materially different from the Purchaser Approved Conditions. In response, the Debtors moved for entry of a Supplemental Sale Order. On October 23, 2019, the Court issued a *Memorandum of Decision Granting the Debtors' Emergency Motion to Enforce the Sale Order* (the "Sale Enforcement Memorandum") [Bankr. Doc. No. 3446]. The Sale Enforcement Memorandum found that the Debtors were entitled to entry of a Supplemental Sale Order, on the ground that § 363 of the Bankruptcy Code authorized the Debtors to sell the Hospitals free and clear of the Additional Conditions. The Sale Enforcement Memorandum directed the Debtors to lodge a proposed form of the Supplemental Sale Order.

Between October 23 and November 8, 2019, the Debtors, the Attorney General, and SGM attempted to negotiate a consensual form of the Supplemental Sale Order. *See* Bankr. Doc. No. 3573 (Debtors' description of attempts to arrive upon a consensual form of order). The Debtors reached an agreement with the Attorney General, under which the Attorney General would not appeal the Supplemental Sale Order, but only if the Court entered the Supplemental Sale Order in the exact form

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negotiated by the Debtors and the Attorney General.

SGM objected to the form of order negotiated between the Debtors and the Attorney General. On November 13, 2019, the Court conducted a hearing on SGM's objections. The Court overruled SGM's objections and entered the Supplemental Sale Order in the form negotiated between the Debtors and the Attorney General. *See* Doc. Nos. 3620 (transcript of hearing addressing SGM's objections) and 3611 (form of the Supplemental Sale Order entered by the Court). On November 29, 2019, SGM appealed the Supplemental Sale Order. *See* Bankr. Doc. No. 3726 (Notice of Appeal). The appeal is currently pending before the District Court (Case No. 2:19-cv-10352-DSF).

C. The Section 8.6 Memorandum of Decision and Order

At the hearing on SGM's objections to the form of the Supplemental Sale Order, SGM argued that after entry of the Supplemental Sale Order, it would have 21 business days to evaluate, in the exercise of its reasonable business judgment, whether the Supplemental Sale Order was acceptable (the "Evaluation Period"), pursuant to § 8.6 of the APA.

On November 18, 2019, the Court entered a memorandum of decision and accompanying order rejecting SGM's argument that it was entitled to the Evaluation Period. *See* Bankr. Doc. Nos. 3632 (the "Section 8.6 Memorandum") and 3633 (the "Section 8.6 Order"). The Court found that under the plain language of the APA, SGM was entitled to the Evaluation Period only if the Supplemental Sale Order was subject to a pending appeal. *See* Section 8.6 Memorandum at 3. The Court further found that based upon representations SGM had made at a February 6, 2019 hearing regarding the purpose of § 8.6 of the APA, SGM was judicially estopped from asserting that it was entitled to the Evaluation Period. *Id.* at 3–4. The Section 8.6 Order provided in relevant part: "The Debtors have complied with their obligation under the APA to obtain a final, non-appealable Supplemental Sale Order. Consequently, SGM is now obligated to promptly close the SGM Sale, provided that all other conditions to closing have been satisfied." Section 8.6 Order at ¶ 1.

On November 29, 2019, SGM appealed the Section 8.6 Order. *See* Bankr. Doc. No. 3727 (Notice of Appeal). The appeal is currently pending before the District Court, and has been consolidated with SGM's appeal of the Supplemental Sale Order.

D. The Material Adverse Effect Memorandum of Decision and Order

On November 27, 2019, the Court entered a memorandum of decision and

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accompanying order rejecting SGM's allegation that the Debtors had failed to comply with certain of the conditions and obligations imposed upon them by the APA, and that these alleged failures to perform had resulted in a Material Adverse Effect which relieved SGM of its obligation to close the SGM Sale. *See* Bankr. Doc. Nos. 3723 (the "Material Adverse Effect Memorandum") and 3724 (the "Material Adverse Effect Order"). The Court stated: "Article 1.3 [of the APA] obligates SGM to close the sale 'promptly but no later than ten (10) business 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." Material Adverse Effect Memorandum at 7. The Material Adverse Effect Order provided in relevant part: "Pursuant to § 1.3 of the APA, SGM is obligated to close the SGM Sale by no later than December 5, 2019." Material Adverse Effect Order at ¶ 1.

On December 3, 2019, SGM appealed the Material Adverse Effect Order. *See* Bankr. Doc. No. 3746 (Notice of Appeal). The appeal is currently pending before the District Court, and has been consolidated with SGM's appeals of the Section 8.6 Order and Supplemental Sale Order.

E. The Memorandum of Decision and Order Denying the Debtors' Application for Issuance of an Order Requiring SGM to Show Cause Why it Failed to Close the SGM Sale

SGM did not close the SGM Sale by December 5, 2019. On December 6, 2019, the Debtors moved for issuance of an order requiring SGM to show cause why it had failed to close the sale. *See* Bankr. Doc. No. 3773. On December 9, 2019, the Court issued a memorandum of decision and accompanying order denying the Debtors' application for an Order to Show Cause. *See* Bankr. Doc. Nos. 3783 (the "OSC Memorandum") and 3784 (the "OSC Order"). The Court held:

> Requiring SGM's representatives to testify as to SGM's reasons for not closing the SGM Sale would not increase the likelihood of the sale actually closing. By failing to close, SGM risks the loss of its $30 million good-faith deposit as well as the possibility of damages for breach of contract in an amount of up to $60 million. Being compelled to offer testimony will not motivate SGM to close where the threat of the loss of up to $90 million has failed to accomplish that end. In the future, the Debtors will have the opportunity to litigate the issues of whether SGM has breached the APA and whether the Debtors are entitled to retain SGM's good-faith deposit. In the

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meantime, the Debtors' efforts would be better spent ensuring the health and safety of the patients at the affected Hospitals.

OSC Memorandum at 2.

F. The Debtors' Complaint

On January 3, 2020, the Debtors filed a *Complaint for Breach of Contract, Promissory Fraud, and Tortious Breach of Contract (Breach of Implied Covenant of Good Faith and Fair Dealing)* (the "Complaint") [Adv. Doc. No. 1] against SGM, KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., KPC Global Management, LLC, and Kali P. Chaudhuri, M.D. (collectively, the "Defendants," and all KPC entities collectively, "KPC"). The material allegations of the Complaint may be summarized as follows:

Debtors entered into the APA with SGM based upon SGM's representations that it would have the ability to pay the $610 million purchase price and that it would work diligently to close the sale. Complaint at ¶¶ 40–45. SGM never anticipated that the Debtors would obtain a final, non-appealable Supplemental Sale Order. *Id.* at ¶ 58. Instead, SGM believed that even if the Debtors obtained the Supplemental Sale Order, that order would remain subject to an appeal, triggering the Evaluation Period under § 8.6 of the APA and giving SGM the option to withdraw from the transaction and/or coerce the Debtors to agree to a substantially reduced purchase price. *Id.* at ¶ 76. Had the Debtors known that SGM was not serious about paying the $610 million purchase price, they would have pursued other options for the sale and disposition of the Hospitals. *Id.* at ¶ 45.

Debtors expended tremendous time, expenses, and resources to prepare for and close the SGM Sale in reliance on the APA and Sale Order. *Id.* at ¶ 59. Among other things, Debtors (a) sent "WARN Notices" to approximately 4,900 employees, pursuant to the Worker Adjustment and Retraining Notification Act of 1988, at three different times, as KPC continued to postpone the closing date; (b) spent months facilitating an efficient close of the sale, with approximately twenty different workstreams, meeting at least weekly with employees of KPC to ensure a smooth transition of operations and continued care of patients; (c) successfully negotiated and finalized modified collective bargaining agreements with the six unions representing the Hospitals' employees; and (d) coordinated changes in insurance coverages and insurance policies to ensure seamless coverage for employees and patients. *Id.* at ¶ 60.

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Despite the Debtors' good faith efforts to work towards a prompt closing of the SGM Sale, Defendants dragged their feet and frustrated Debtors' efforts. Defendants failed to ensure that financing, resources, management, and personnel were in place for Defendants to assume operations of the Hospitals in 2019. Defendants did so knowing that the Debtors were continuing to operate at a loss of approximately $450,000 a day. *Id.* at ¶ 78. Among other things, Defendants (a) failed to timely engage with the Hospitals' primary revenue providers—health plans and physician groups—to provide assurances that their business relationships with the Hospitals would continue after the closing date; (b) failed to onboard a sufficient management team to run the Hospitals, and engaged in eleventh-hour efforts to hire away key members of the Debtors' management team; and (c) delayed decisions on the assumption or rejection of thousands of executory contracts, which created uncertainty for the counterparties to those contracts. *Id.* at ¶¶ 79–81.

On November 18, 2019, SGM's CEO, Peter Baranoff, telephoned Carsten Beith, at the Debtors' investment banker Cain, and stated that SGM could not obtain sufficient financing to close the SGM Sale. *Id.* at ¶ 86. Recognizing that the existence of financing is not a condition to close, SGM resorted to making unfounded and self-serving assertions that the Debtors breached the APA. *Id.* at ¶ 87. On November 22, 2019, SGM sent the Debtors letters setting forth issues that SGM asserted amounted to a Material Adverse Effect (the "November 22, 2019 Letters"). *Id.* at ¶ 88. The issues that SGM raised were not new—they were all known or discoverable during the diligence period that had expired at least nine months earlier. *Id.* And none of the issues altered SGM's obligation to close the SGM Sale by December 5, 2019, because the APA provided that the sale was "as is, where is." *Id.* Even after the Bankruptcy Court entered the Material Adverse Effect Order, which provided that SGM was required to close the SGM Sale by December 5, 2019, SGM refused to close the sale. *Id.* at ¶ 97.

Based upon the foregoing allegations, the Complaint asserts claims for breach of contract, promissory fraud, and tortious breach of contract for breach of the implied covenant of good faith and fair dealing. In Count I, for breach of contract, Debtors allege that the Defendants have materially and continually breached the APA by (a) failing to consummate and close the SGM Sale in accordance with the APA; (b) failing to have funds available to close the SGM Sale at the price set forth in the APA; (c) representing in § 3.9 of the APA and elsewhere that they had the ability to obtain "funds in cash in amounts equal to the purchase price"; (d) attempting to coerce the

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Debtors to agree to a substantially reduced purchase price; (e) failing to cooperate with the Debtors and move with alacrity towards closing the SGM Sale; (f) making unfunded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an "Evaluation Period" when no such period existed after entry of the Sale Enforcement Order, the Section 8.6 Order and the Material Adverse Effect Order; (h) appealing the Sale Enforcement Order to avoid its obligation to close and despite the APA's requirement that the Defendants cooperate to render it a final, nonappealable order; and (i) filing meritless and frivolous Notices of Appeal. *Id.* at ¶ 100.

In Count II, for promissory fraud, Debtors allege that at the time Defendants entered into the APA, Defendants had no intention of performing in accordance with the APA, and that Defendants concealed their true intention not to fund the $610 million purchase price for the purpose of holding the estate, creditors, and patients at the Hospitals hostage in an attempt to extort a lower purchase price. *Id.* at ¶ 102.

In Count III, for tortious breach of contract, Debtors allege that Defendants tortiously breached the APA and the implied covenant of good faith and fair dealing by (a) entering into the APA with no intention to perform their obligations thereunder; (b) failing to consummate and close the SGM Sale in accordance with the APA; (c) failing to have funds available to close the SGM Sale at the $610 million purchase price set forth in the APA; (d) attempting to coerce Plaintiffs to engage in a re-trade at a lower price; (e) failing to cooperate with Debtors and move with alacrity towards closing the SGM Sale; (f) making unfounded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an Evaluation Period to which Defendants were not entitled; (h) filing meritless Notices of Appeal; and (i) failing to respond to Debtors' inquiries regarding SGM's intent and financial ability to perform under the APA. *Id.* at ¶ 107.

G. SGM's Emergency Motion to Stay the Adversary Proceeding

On January 16, 2020, SGM filed an emergency motion to stay the adversary proceeding that had been commenced by the filing of the Complaint (the "Stay Motion"). The Court declined to set a hearing on the Stay Motion on 48 hours' notice, as requested by SGM. Instead, the Court *sua sponte* extended the deadline for Defendants to respond to the Complaint to February 19, 2020, to enable the Stay Motion to be heard on regular notice. *See* Doc. No. 15.

In the Stay Motion, SGM asserts that the Court lacks jurisdiction to adjudicate the adversary proceeding until final resolution of SGM's appeals of the Sale Enforcement

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Order, the Section 8.6 Order, and the Material Adverse Effect Order (collectively, the "Orders"). SGM argues that the issues raised by the Orders touch directly on the issues raised in the adversary proceeding. SGM contends that the Complaint relies heavily on the finding in the Material Adverse Effect Order that the Debtors had complied with all the conditions required for closing and that SGM was obligated to close on December 5, 2019. SGM further maintains that the Complaint overlaps with the Orders because the Complaint alleges that SGM breached the APA by (a) asserting entitlement to an Evaluation Period when no such period existed after entry of the Orders; (b) appealing the Sale Enforcement Order to avoid its obligation to close and despite the APA's requirement that Defendants cooperate to render the Sale Enforcement Order final and non-appealable; and (c) filing meritless and frivolous Notices of Appeal of the Orders.

H. The Debtors' Opposition to the Stay Motion

The Debtors arguments in opposition to the Stay Motion may be summarized as follows:

The divestiture rule provides that the filing of a notice of appeal "confers jurisdiction on the court of appeals and divests the district court of those aspects of the case involved in the appeal." *Griggs v. Provident Consumer Discount Co.*, 459 U.S. 56, 58 (1982). The Ninth Circuit has held:

> The "divestiture of jurisdiction rule is not based upon statutory provisions or the rules of civil or criminal procedure. Instead, it is a judge made rule originally devised in the context of civil appeals to avoid confusion or waste of time resulting from having the same issues before two courts at the same time." *United States v. Claiborne*, 727 F.2d 842, 850 (9th Cir. 1984). Though *Griggs* referred to the "divestiture rule" as jurisdictional, the Supreme Court has since made clear that "[o]nly Congress may determine a lower federal court's subject-matter jurisdiction." *Hamer v. Neighborhood Hous. Services of Chicago*, —— U.S. ——, 138 S.Ct. 13, 17, 199 L.Ed.2d 249 (2017) (quoting *Kontrick v. Ryan*, 540 U.S. 443, 452, 124 S.Ct. 906, 157 L.Ed.2d 867 (2004)). Accordingly, "jurisdictional" rules derived from sources other than Congress are more accurately characterized as "mandatory claim-processing rules" that may be applied in a "less stern" manner than true jurisdictional rules.

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Rodriguez v. Cty. of Los Angeles, 891 F.3d 776, 790–91 (9th Cir. 2018).

As a pragmatic rule, divestiture (a) does not preclude the Court from exercising jurisdiction over all other matters that it must undertake to implement or enforce the judgment or order, and (b) in the absence of a stay pending appeal, only prohibits modification of the order on appeal. A careful reading of the Orders and the Complaint shows that application of the divestiture rule is not appropriate here. The Orders cover discrete issues concerning the Debtors' efforts to close the now-terminated SGM Sale. The Orders are not dispositive of the claims asserted in the Complaint. The Court acknowledged as much in the OSC Memorandum, which stated that "[i]n the future, the Debtors will have an opportunity to litigate the issues of whether SGM has breached the APA and whether the Debtors are entitled to retain SGM's good-faith deposit." OSC Memorandum at 2. The divestiture rule only prohibits the Court from altering or amending the Orders, and the Complaint does not seek such relief. *See Sherman v. SEC (In re Sherman)*, 491 F.3d 948, 967 (9th Cir. 2007) (internal citation omitted) (holding that where divestiture applies, the "bankruptcy court retains jurisdiction over all other matters that it must undertake 'to implement or enforce the judgment or order,' although it 'may not alter or expand upon the judgment.' If a party wants to stay all of the proceedings in bankruptcy court while an appeal is pending, it must file a motion for a stay.").

The divestiture rule is not properly invoked with respect to the Section 8.6 Order and Material Adverse Effect Order, because both orders are interlocutory. "Filing an appeal from an unappealable decision does not divest the district court of jurisdiction." *United States v. Hickey*, 580 F.3d 922, 928 (9th Cir. 2009). The Section 8.6 Order is interlocutory because its findings were limited to the Debtors' satisfaction of § 8.6 of the APA, and it did not address whether other conditions to closing had been satisfied. *See* Section 8.6 Order at 2 (finding that "SGM is now obligated to promptly close the SGM Sale, *provided that* all other conditions to closing are satisfied") (emphasis added). The Material Adverse Effect Order is interlocutory because it did not compel SGM to close the SGM Sale. Rather, it interpreted the Material Adverse Effect clause and closing conditions in the APA, determined that those provisions were satisfied, and, in light of those findings and the Debtors' outstanding contractual demand, determined that December 5, 2019 was the closing date under § 1.3 of the APA.

Even if the divestiture rule did apply—which it does not—the Court could still adjudicate the Complaint because the divestiture rule is subject to exceptions. As explained by the United States District Court for the Northern District of California:

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> [T]here are generally three situations where a notice of appeal does not divest the district court of jurisdiction: (1) where the issue before the district court is separate from, or collateral to, the matter involved in the appeal; (2) where application of the divestiture of jurisdiction rule would wholly undermine its purpose; and (3) where the appeal is clearly defective or frivolous, usually by reason of untimeliness, lack of essential recitals, or reference to a nonappealable order.

Ashker v. Cate, No. 09-cv-05796-CW, 2019 WL 1558932, at *3 (N.D. Cal. Apr. 10, 2019)
(quotations omitted).

The appeals of the Orders are constitutionally and equitably moot. As a result, the appeals are clearly defective and frivolous, and application of the divestiture rule would wholly undermine its purpose.

The relief set forth in each of the Orders contemplates the effectiveness and closing of the SGM Sale pursuant to the APA. The Court cannot grant relief with respect to closing the SGM Sale given the dramatic change in circumstances after SGM's refusal to close. The APA was terminated on December 27, 2019. The Debtors obtained orders authorizing them to undertake alternative transactions and authorizing the closure of St. Vincent Medical Center. It is no longer possible for the Debtors to close the transaction contemplated by the APA. Consequently, the Orders—which each pertain to the closing of the SGM Sale—are moot.

Finally, SGM has waived its ability to assert that the divestiture rule applies. The APA provides that disputes regarding the occurrence of a Material Adverse Effect "shall be exclusively settled by a determination made by the Bankruptcy Court …." APA at § 9.1(c). This provision constitutes an enforceable contractual appeal waiver. *See Minesen Co. v. McHugh*, 671 F. 3d 1332, 1339 (D.C. Cir. 2012) (extensive case law permits voluntary waivers of rights to appeal); *Slattery v. Ancient Order of Hibernians in Am.*, No. 97-7173, 1998 WL 135601, at *1 (D.C. Cir. Feb. 9, 1998) (dismissing appeal where parties "agree[d] not to appeal any decision by the district court relating to defendants' motion for attorneys' fees"). Because SGM has waived its appellate rights with respect to Material Adverse Effect determination, it cannot invoke the divestiture rule.

Section 12.3 of the APA provides that "the parties irrevocably elect, as the sole judicial forum for the adjudication of any matters arising under or in connection with

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the Agreement, and consent to the exclusive jurisdiction of, the Bankruptcy Court." As a result of this waiver, SGM cannot invoke the divestiture rule with respect to the Sale Enforcement Order or the Section 8.6 Order.

I. The Committee's Opposition to the Stay Motion and the Committee's Motion to Intervene

The Official Committee of Unsecured Creditors (the "Committee") filed an opposition to the Stay Motion (the "Committee Opposition"). In its reply briefing, SGM asserted that the Committee Opposition should be stricken because the Committee (1) is not a party to the adversary proceeding, (2) has not obtained Court permission to intervene in the adversary proceeding, and (3) has no standing to participate in the adversary proceeding.

The Court authorized the Committee to notice a hearing on an emergency motion to intervene (the "Intervention Motion") concurrently with the hearing on the Stay Motion. The Committee seeks to intervene for the limited purpose of opposing the Stay Motion. The Committee has not yet decided whether it will move to intervene as to the remainder of the adversary proceeding.

In support of the Intervention Motion, the Committee argues that multiple circuit courts have held that, under § 1109(b), a creditors' committee may appear and be heard in *any proceeding* in the bankruptcy court—including adversary proceedings. *See, e.g.*, *In re Caldor Corp.*, 303 F.3d 161, 175-76 (2nd Cir. 2002) (term loan holder committee had unconditional right under Section 1109(b) to intervene in adversary proceeding against Chapter 11 debtors); *Matter of Marin Motor Oil, Inc.*, 689 F.2d 445, 451–54 (3rd Cir. 1982) (under Section 1109(b), creditors' committee had "absolute right" to intervene in adversary proceeding). In the alternative, the Committee asserts that it meets the requirements for intervention as of right under Civil Rule 24(a)(2). Specifically, the Committee maintains that it has a significant protectable interest in this matter, given that the Debtors' claims against SGM for breach of contract represent a significant source of money that might be available to provide a recovery to unsecured creditors.

The Committee's arguments in opposition to the Stay Motion may be summarized as follows:

The Stay Motion is nothing more than an attempt by SGM to indefinitely delay resolution of the Complaint. SGM's breach of the APA cost the estates not less than $100 million, resulted in a material loss of jobs, and adversely impacted local access

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to healthcare.

The Committee is concerned that, in the course of the delay that SGM seeks, SGM's principals will strip SGM of its assets, negating its ability to satisfy a future judgment.

SGM's misconduct is illustrated by its appeal of the Supplemental Sale Order. The rationale for § 8.6 of the APA was that it might prove risky for SGM to close the sale if the Supplemental Sale Order was appealed, given that an appeal could expose SGM to the more onerous Additional Conditions that it had not agreed to accept. To that end, § 8.6 gave SGM the option to walk away if an appeal of the Supplemental Sale Order remained pending at the time of closing. It was never contemplated that SGM itself could trigger such optionality (i.e., grant itself a right to walk away) by filing an appeal of the very Supplemental Sale Order it needed for comfort. But this now appears to be precisely SGM's position.

J. SGM's Reply in Support of the Stay Motion

SGM's arguments in reply to the Debtors' opposition may be summarized as follows:

The divestiture rule applies where, as here, the issues in the lower court "involve aspects of the case that are the subject of the pending appeal." *Mercado-Guillen v. McAleenan*, 2019 WL 1995331, at *2 (N.D. Cal. May 6, 2019). At base, the Complaint seeks to hold SGM liable for failing to close the SGM Sale in accordance with the APA. Complaint at ¶ 100. However, it is undisputed that SGM had no duty to close the SGM Sale until the Debtors had satisfied all conditions precedent to closing. SGM has appealed the Material Adverse Effect Order, which found that the Debtors had satisfied all conditions precedent. The Bankruptcy Court cannot adjudicate the issue of whether the Debtors had satisfied the conditions precedent to closing while that same issue is being considered by the District Court in connection with the appeal.

The Debtors assert that the Court need not stay the adversary proceeding because SGM did not seek a stay of any of the appealed Orders. However, the Orders from which SGM appealed are not enforceable orders; if they were, the Debtors would not have filed the Complaint to obtain damages. SGM had no need to seek a stay until the Debtors filed the Complaint, which created the prospect of two courts ruling on the same issues at the same time.

The Debtors assert that the divestiture rule does not apply because SGM's appeals

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are frivolous. It is not appropriate for the Bankruptcy Court to determine whether the appeals are frivolous; such a determination would usurp the authority of the District Court.

Along similar lines, the Debtors assert that the divestiture rule does not apply because the Orders were interlocutory. Questions about the District Court's jurisdiction over the appeals should be left to the District Court. However, the Debtors' contention that the Orders were interlocutory is mistaken. The Material Adverse Effect Memorandum unambiguously and finally decided that "all conditions precedent to closing have been satisfied" and that "SGM is obligated to close the sale by no later than December 5, 2019." Material Adverse Effect Memorandum at 7. This was a final order—after its entry, there were no other sale conditions left for the Court to interpret, and SGM was obligated to close the sale.

If SGM is not permitted to proceed with its appeals of the Orders prior to adjudication of the Complaint, then SGM will be subject to the Debtors' argument that the Orders preclude SGM from contesting the Complaint's allegations—in particular, the allegation that SGM failed to timely close the sale notwithstanding its obligation to do so. This would enable the Debtors to obtain a judgment in their favor on their breach of contract claims without the Defendants ever having had the opportunity to present evidence in defense of those claims.

There is no merit to the Debtors' contention that the appeals are moot because the APA has been terminated. It is true that it is no longer possible for the sale contemplated by the APA to close. But that has nothing to do with the Complaint, which requires a determination over which party breached the APA.

The Debtors' argument that SGM waived its rights to appeal or to invoke the divestiture rule are likewise without merit. The waiver of a right to appeal must be express. *In re Deepwater Horizon*, 785 F.3d 986, 997 (5th Cir. 2015). The "exclusively settled" and "sole judicial forum" language in §§ 9.3(c) and 12.3 of the APA simply provides the forum in which disputes arising under the APA would be adjudicated. Nothing in either section can reasonably be interpreted as an express waiver of the right to appellate review.

II. Findings and Conclusions

A. The Committee is Authorized to Intervene for the Limited Purpose of Opposing the Stay Motion

The Committee is authorized to intervene for the limited purpose of opposing the Stay Motion. The Court declines SGM's request to strike the Committee Opposition.

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The Second and Third Circuits have both held that, pursuant to § 1109(b), a creditors' committee has an unconditional right to intervene in an adversary proceeding within a Chapter 11 case. *See Term Loan Holder Committee v. Ozer Group, LLC (In re Caldor Corp.)*, 303 F.3d 161, 176 (2d Cir. 2002) and *Committee v. Michaels (Matter of Marin Motor Oil, Inc.)*, 689 F.2d 445, 451 (3d Cir. 1982).

Here, the Committee has sought authorization to intervene solely for the purposes of opposing the Stay Motion. SGM acknowledges that the Committee has the authority to be heard on issues arising in the main bankruptcy case, but contends that the Committee's right to be heard does not apply to the instant adversary proceeding. However, SGM initially filed the Stay Motion in the main bankruptcy case; it re-filed the Stay Motion in the adversary proceeding only after being ordered to do so by the Court. SGM's decision to initially file the Stay Motion in the main bankruptcy case severely undercuts its assertion that the Committee lacks standing with respect to the Stay Motion.

Even if the Stay Motion had not initially been filed in the main bankruptcy case, the Court would find it appropriate to permit the Committee to intervene for the limited purpose of opposing the Stay Motion. The timing of the adjudication of the Complaint will significantly affect the creditors that the Committee represents. In the event the Debtors prevail, the creditors that the Committee represents may be entitled to a portion of the recovery. The Committee has an interest in assuring that the Complaint is not stayed pending the outcome of SGM's appeals of the Orders. That interest is significant enough to confer standing upon the Committee to oppose the Stay Motion.

In the event the Committee wishes to be heard in connection with future issues arising in this adversary proceeding, the Committee shall file a further motion to intervene.

B. The Stay Motion is Denied

"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." *Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58, 103 S.Ct. 400, 74 L.Ed.2d 225 (1982).

The premise of the Stay Motion is that the Orders contain findings which (a) preclude SGM from defending itself against the Complaint's allegations and (b) require the Court to enter judgment in the Debtors' favor on the breach of contract claim. Based upon this premise, SGM asserts that the adversary proceeding must be

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stayed until the completion of its appeals of the Orders.

SGM's premise is not correct. The Orders do not adjudicate whether SGM had breached the APA; nor do the Orders contain findings that compel the Court to rule in the Debtors' favor with respect to the Complaint's breach of contract claim. The Orders were entered "[t]o facilitate an expeditious and successful resolution of these cases," Section 8.6 Order at 2. To that end, the Orders contained various findings necessary to allow the SGM Sale to proceed. The sole purpose of those findings was to provide the framework necessary for the Debtors and SGM to promptly close the SGM Sale. The findings were not intended to create a springboard for a claim for breach of contract against SGM.

Significantly, nothing in the Orders determined SGM's liability, if any, for breach of the APA. The limited scope of the Orders was made clear in the OSC Memorandum, in which the Court emphasized that the issue of whether SGM had breached the APA had not yet been decided: "*In the future*, the Debtors will have the opportunity to litigate the issues of whether SGM has breached the APA and whether the Debtors are entitled to retain SGM's good-faith deposit." OSC Memorandum at 2.

The APA was terminated on December 27, 2019. St. Vincent, one of the Hospitals whose sale was contemplated by the APA, has now closed. The SGM Sale is dead and cannot be resuscitated. The findings in the Orders—which the Court made only to facilitate the closing of the SGM Sale—cannot spring back to life in the entirely different context of the Debtors' breach of contract claim. The Orders do not preclude SGM from contesting the Debtors' allegation that SGM breached the APA. SGM remains free to present evidence in this proceeding in support of its position that as of December 5, 2019, it was not obligated to close the SGM Sale. The corollary is that the Debtors cannot rely solely upon the Material Adverse Effect Order to support their allegation that SGM was obligated to close as of December 5, 2019.

Because the findings in the Orders were limited to the failed SGM Sale, those findings are not dispositive of the claims asserted in the Complaint. Consequently, SGM's appeal of the Orders has not divested this Court of jurisdiction over the separate issues arising in the Complaint.

~~An additional reason for the inapplicability of the divestiture rule is that SGM has waived its right to appeal the Orders. To prevent abusive appeals undertaken "to run up an adversary's costs or to delay trial," the Court may decline to apply the divestiture rule if it certifies that an appeal has been waived. *Rodriguez v. Cty. of Los Angeles*, 891 F.3d 776, 791 (9th Cir. 2018). SGM has waived its right to appeal any of the Orders. With respect to the Material Adverse Effect Order, the APA provides that~~

United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Tuesday, February 11, 2020 **Hearing Room 1568**

10:00 AM
CONT... Verity Health System of California, Inc. **Chapter 11**

~~"any dispute between Purchaser [SGM] and Sellers [the Debtors] as to whether a Material Adverse Effect has occurred for any purpose under this Agreement *shall be exclusively settled* by a determination made by the Bankruptcy Court." APA at § 9.1(c) (emphasis added). With respect to the Sale Enforcement Order and the Section 8.6 Order, § 12.3 of the APA provides that "the parties irrevocably elect, *as the sole judicial forum* for the adjudication of any matters arising under or in connection with the Agreement, and consent to *the exclusive jurisdiction of*, the Bankruptcy Court …." The Court will certify to the District Court that SGM has waived its right to appeal the Orders. For this additional reason, the divestiture rule does not apply.~~

Based upon the foregoing, the Stay Motion is DENIED. The Court will prepare and enter an order denying the Stay Motion and an order granting the Intervention Motion. ~~and a certification that SGM has waived its right to appeal the Orders.~~

No appearance is required if submitting on the court's tentative ruling. If you intend to submit on the tentative ruling, please contact Carlos Nevarez or Daniel Koontz, the Judge's Law Clerks, at 213-894-1522. **If you intend to contest the tentative ruling and appear, please first contact opposing counsel to inform them of your intention to do so.** Should an opposing party file a late opposition or appear at the hearing, the court will determine whether further hearing is required. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, no later than one hour before the hearing.

Party Information

Debtor(s):

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United States Bankruptcy Court
Central District of California
Los Angeles
Judge Ernest Robles, Presiding
Courtroom 1568 Calendar

Tuesday, February 11, 2020 **Hearing Room 1568**

10:00 AM

CONT... Verity Health System of California, Inc. **Chapter 11**

Defendant(s):

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Strategic Global Management, Inc.,	Pro Se
KPC Healthcare Holdings, Inc., a	Pro Se
KPC Health Plan Holdings, Inc., a	Pro Se
KPC Healthcare, Inc., a Nevada	Pro Se
KPC Global Management, LLC, a	Pro Se
Does 1 through 500	Pro Se

Plaintiff(s):

ST. VINCENT MEDICAL	Represented By Samuel R Maizel Tania M Moyron
St Vincent Dialysis Center, Inc., a	Represented By Samuel R Maizel Tania M Moyron
ST. FRANCIS MEDICAL	Represented By Samuel R Maizel Tania M Moyron
Seton Medical Center, a California	Represented By Samuel R Maizel Tania M Moyron
Verity Holdings, LLC, a California	Represented By Samuel R Maizel Tania M Moyron
VERITY HEALTH SYSTEM OF	Represented By Samuel R Maizel Tania M Moyron

EXHIBIT C

EXHIBIT C

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KPC Global Management, LLC

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA – LOS ANGELES DIVISION

In re

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

Debtors and Debtors in Possession.

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

CHAPTER 11

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

Jointly Administered With:
CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20181-ER

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

DEFENDANTS' NOTICE OF MOTION AND SPECIAL MOTION TO STRIKE PLAINTIFF'S COMPLAINT PURSUANT TO CAL. CIV. PROC. CODE § 425.16; MEMORANDUM OF POINTS AND AUTHORITIES

Date: March 11, 2020
Time: 10:00 a.m.
Judge: Ernest Robles
Place: Department 1568
255 E. Temple Street
Los Angeles, CA 90012

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.

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TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that Defendants Strategic Global Management, Inc. ("SGM"), Kali P. Chaudhuri, M.D., KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., and KPC Global Management, LLC, (collectively, the "Non-SGM Defendants"), hereby move for an order striking, pursuant to section 425.16 of the California Code of Civil Procedure, each claim in the Adversary Complaint filed by plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, and Verity Holdings, LLC (collectively, "Plaintiffs" or "Debtors").

PLEASE TAKE FURTHER NOTICE that the Motion is based on this Notice of Motion and Motion, the accompanying Request for Judicial Notice, the arguments of counsel at any hearing on the Motion, and any other admissible evidence brought before the Court.

PLEASE TAKE FURTHER NOTICE that pursuant to Local Bankruptcy Rule 9013-1(f), any party that wishes to oppose the relief requested in the Motion must file not later than 14 days prior to the scheduled hearing date, with the Clerk of the Bankruptcy Court, located at 255 East Temple Street, Los Angeles, California, and serve upon Defendants' counsel, located at the address indicated on the upper left corner of the first page of this notice, "[a] complete written statement of all reasons in opposition thereto . . . , declarations and copies of all evidence on which the responding party intends to rely, and any responding memorandum of points and authorities."

PLEASE TAKE FURTHER NOTICE that, pursuant to Local Bankruptcy Rule 9013-1(h), failure to file and serve a timely response may be deemed consent to the relief requested in the Motion.

Dated: February 19, 2020

By: _____
Kevin D. Rising
L. Rachel Lerman
Joel R. Meyer
Counsel for Strategic Global Management, Inc.; Kali P., Chaudhuri, M.D.; KPC Healthcare Holdings, Inc.; KPC Healthcare, Inc., KPC Global Management, LLC

MEMORANDUM OF POINTS AND AUTHORITIES

Defendants Strategic Global Management, Inc. ("SGM"), Dr. Kali P. Chaudhuri, KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., and KPC Global Management, LLC (excluding SGM, "Non-SGM Defendants") submit this memorandum in support of their special motion to strike pursuant to section 425.16 of the California Code of Civil Procedure, which seeks to strike each claim in the Adversary Complaint filed by plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, and Verity Holdings, LLC (collectively, "Plaintiffs" or "Debtors").[1]

I. INTRODUCTION

Ever since SGM started to argue that Plaintiffs had not complied with their obligations under the parties' Asset Purchase Agreement ("APA"), Plaintiffs have attempted to punish SGM for having the audacity to assert its rights. Plaintiffs' Adversary Complaint is no different.

In their Complaint, Plaintiffs allege, among other things, that SGM allegedly breached the APA by not closing the transaction. However, Plaintiffs also contend that SGM breached the APA by essentially refusing to concede that it was obligated to close the $610 million transaction. Lest there be any doubt, Plaintiffs' breach of contract claim directly targeted SGM's advocacy including by "making unfounded and untimely assertions of alleged Material Adverse Effects," "asserting entitlement to an 'Evaluation Period' following entry of the Enforcement Order," "filing meritless and frivolous appeals," and "failing to cooperate with Plaintiffs and move with alacrity towards closing the SGM Sale." Compl. ¶ 100.

Plaintiffs also attempt to tortify this contract dispute by alleging that SGM did not intend to comply with the APA at the time it entered into the contract. This would likely be the first time

---

[1] This Motion is being filed solely for the purpose of raising the defenses herein, which generally must be raised in the initial response to the Complaint. By filing this Motion and in accordance with Fed. R. Bankr. P. 7012(b), Defendants are not consenting to the jurisdiction of Bankruptcy Court over this adversary proceeding, and dispute the Bankruptcy Court's authority to enter final judgment in connection with this Adversary Proceeding. All Defendants are hereby reserving all rights, claims, and defenses.

anyone has ever deposited $30 million while at the same time planning to breach the contract that would forfeit that $30 million.

Although Plaintiffs admit in their own Complaint that they were well aware of the Non-SGM Defendants and their respective relationships with SGM at the time Plaintiffs agreed to contract with just SGM (Compl. ¶ 41), Plaintiffs also sued these additional parties based on a disingenuous theory of alter-ego liability.

California's anti-SLAPP statute is a procedural remedy designed to discourage and quickly dispose of lawsuits and claims brought to chill the valid exercise of constitutional rights of petition or free speech. Cal. Civ. Pro. §425.16. Although the procedures are somewhat different, California's anti-SLAPP statute applies to state law claims brought in federal court. *Price v. Stossel,* 590 F. Supp. 2d 1262, 1267 (C.D. Cal. 2008).[2] To invoke the protection of the anti-SLAPP statute, the moving party simply must establish "that the challenged lawsuit arose from an act ... in furtherance of [the] right of petition or free speech." *Equilon Enterprises v. Consumer Cause, Inc.,* 29 Cal. 4th 53, 61 (2002).

Plaintiffs' claims here all arise from Defendants' alleged protected activity in the bankruptcy proceeding and are thus covered by the anti-SLAPP statute. *See Crossroads Inv'rs, L.P. v. Fed. Nat'l Mortg. Assn.,* 13 Cal. App. 5th 757, 781 (2017); *see also Briggs v. Eden Council for Hope & Opportunity*, 19 Cal. 4th 1106, 1116 (1999) ("[A]ll that matters is that the First Amendment activity take place in an official proceeding or be made in connection with an issue being reviewed by an official proceeding."). Because the claims arise from protected activity, the claims must be stricken if Plaintiffs cannot substantiate them. Plaintiffs cannot meet their burden for numerous reasons.

---

[2] In the Ninth Circuit's decision in *Planned Parenthood Fed'n of Am., Inc. v. Ctr. for Med. Progress*, 890 F.3d 828, 834 (9th Cir.), amended, 897 F.3d 1224 (9th Cir. 2018), the Court of Appeals explained the rule regarding Plaintiffs' burden to substantiate their claims. If the anti-SLAPP motion challenges the legal sufficiency of the claims, as Defendants do here, then the FRCP Rule 12(b)(6) standard applies.

As an initial matter, Plaintiffs' claims all fail because they depend on Plaintiffs first establishing that they satisfied all conditions to close the sale. If they did not satisfy the conditions to close, Plaintiffs cannot establish that they were at all wronged by Defendants or suffered any damages as a result of any the alleged breaches or alleged misrepresentation. Here, the pleadings show that Plaintiffs had not satisfied the condition in APA Section 8.7 before they sent their demand to close on November 20, 2019.

Plaintiffs' claim for promissory fraud also fails for two additional reasons. **First**, Defendants' alleged misrepresentations were made during the course of the bankruptcy proceeding and are thus covered by the litigation privilege. Cal. Civ. Code. §47(b). **Second**, even if the alleged false promise was not privileged (it is), Plaintiffs' false promise claim also fails because Plaintiffs' specific allegations negate Plaintiffs' fraud theory. Plaintiffs' fraud theory is that Defendants intended to breach the contract from the time they entered it. Compl. ¶ 102. Yet, Plaintiffs' specific allegations reveal that is not true. Plaintiffs allege that Defendants "never anticipated" that Plaintiffs would satisfy the conditions in the contract and "believed they would never be obligated to pay the full purchase price." Compl. ¶ 58. This allegation conclusively shows that Defendants just had the opinion they would never be obligated to pay, as opposed to a belief that they would be obligated and an intention to breach that obligation. Because Plaintiffs allege Defendants never anticipated the obligation arising, Defendants could not have the fraudulent intent necessary for a fraud claim.

Plaintiffs' claim for tortious breach of contract also fails because the law does not recognize a claim for "tortious breach of the implied covenant of good faith and fair dealing" in arms-length transactions such at the one at issue here. *See Pension Tr. Fund for Operating Engineers v. Fed. Ins. Co.*, 307 F.3d 944, 955 (9th Cir. 2002). Even if this was a valid claim, the allegations are also covered by the litigation privilege.

Plaintiffs' claims against the Non-SGM Defendants fail because Plaintiffs cannot substantiate their alter-ego allegations. Courts do not allow plaintiffs to invoke the alter-ego doctrine as a substitute for obtaining contractual guarantees from alleged alter-egos that the plaintiffs knew existed at the time of contracting. *See Lynch v. McDonald*, 155 Cal. 704, 706–07

(1909). Here, Plaintiffs admit in their Complaint that they had extensive knowledge of the relationship between SGM and the Non-SGM Defendants before they entered into the APA. *See* Compl. ¶¶ 41-44. With that knowledge, Plaintiffs agreed to contract solely with SGM, likely believing SGM's $30 million deposit gave them adequate security. Plaintiffs cannot circumvent this negotiated relationship with manufactured and false allegations of alter-ego.

For these reasons, Defendants request that the Court strike all of Plaintiffs' claims and enter judgment in favor of Defendants.

II. PLAINTIFFS' ALLEGATIONS

A. SGM's Offer to Purchase the Hospitals

After 25 years of substantial operating losses and any number of attempts to rescue their hospitals, Plaintiffs filed their bankruptcy petition on August 31, 2018 and instituted a process to sell most of their assets. Compl. ¶ 37.

SGM made an offer to purchase four of Plaintiffs' hospitals. Plaintiffs quoted large portions of SGM's offer in their Complaint. Compl. ¶ 41. Notably, the offer letter discussed in detail the relationship between SGM and various other affiliated companies. *Id.* Regarding SGM, it stated:

> Strategic Global Management Inc. ("SGM or "Strategic") is a venture company used to acquire assets and businesses, through companies which are affiliated or associated (through common ownership and otherwise) with SGM, but which are not subsidiaries of SGM.

Id. The letter also explains that defendant KPC HealthCare, Inc. is owned by employees, and not Dr. Chaudhuri or another affiliated entity: "KPC Health has been sold to an Employee Stock Ownership Plan ("ESOP") and now operates for the benefits of its employees but remains managed by SGM affiliates under a long-term agreement." *Id.*

To support its offer, SGM also provided a letter that showed that Dr. Chaudhuri had a certain amount of liquid assets personally. Compl. ¶ 42.

After various meetings with SGM representatives, the Debtors ultimately selected SGM to serve as the stalking-horse bidder. Compl. ¶ 43.

B. The Asset Purchase Agreement

With knowledge of these various related entities, Plaintiffs agreed to enter into an APA with just SGM. Compl., Exh. A ("APA"). The APA was subject to numerous conditions that would need to occur first before SGM would have an obligation to close. Some examples include:

- Because SGM was the stalking-horse bidder, Plaintiffs had the ability to find a buyer (or buyers) who would outbid SGM and then could, of course, choose to sale the assets to the other buyer and cancel the agreement with SGM (APA § 6.1);
- The APA was subject to Bankruptcy Court Approval (APA §§ 7.6 & 8.2);
- The APA needed approval by the California Attorney General (APA § 8.6); and
- The Debtors had to reach agreements with CMS and DHCS that would allow the transfer of the Medicare and Medical provider agreements free and clear of all known and unknown potential future claims. APA § 8.7.

When it entered into the contract, SGM also made a "good faith deposit" of $30 million that could be lost if SGM did not comply with an obligation to close. APA § 1.2. Of course, Plaintiffs were obligated to return the deposit if they did not comply with their obligations. APA §§ 1.2 & 11.2.

C. Defendants' Alleged Mindset When Agreeing to APA

Plaintiffs contend that Defendants believed that the Plaintiffs would never be able to satisfy the conditions in the APA and thus Defendants would never be obligated to close at the price set forth in the agreement. Compl. ¶ 58. Plaintiffs alleged:

> In particular, it now appears that **Defendants never anticipated** that Debtors would obtain agreement from the Attorney General of California not to impose conditions on the sale transaction that materially differed from the conditions SGM developed and agreed to in Section 8.6 and Schedule 8.6 of the APA. Rather, **Defendants believed they would never be obligated to pay the full purchase price** (comprised of a cash payment $610 million, plus cure costs and assumption of liabilities) and instead concluded they would eventually be positioned to either walk away from the transaction or coerce the Debtors into a re-trade at a significantly lower purchase price.

Compl. at Preliminary Statement; ¶ 58 (emphasis added).

D. Court Rejects California Attorney General's Additional Conditions

On September 25, 2019, the Attorney General consented to the sale but included conditions that were "materially different" than those SGM agreed to in the APA. Compl. ¶ 70. On October 23, 2019, the Bankruptcy Court issued a memorandum of decision finding that the materially different conditions the AG had imposed were not enforceable under the Bankruptcy Code. *Id.* ¶71. After this ruling, Plaintiffs and the AG reached a stipulation wherein the AG released its rights to appeal the ruling in return for the Bankruptcy Court setting aside this decision that could potentially be used as precedent that would weaken the AG in the future. Compl. ¶ 72; Request for Judicial Notice "RJN", Ex. F. SGM objected to the proposed order submitted by the AG and Plaintiffs. Compl. ¶ 72, RJN, Ex. I. On November 14, 2019, the Bankruptcy Court entered the order that the property could be sold free and clear without any additional conditions. Compl. ¶¶ 73-74.

Plaintiffs again alleged that "**SGM did not anticipate** such a favorable order would be entered, but instead anticipated that a supplemental sale order would trigger the Evaluation Period under Section 8.6 of the APA, which would give SGM the option to withdraw from the transaction and/or coerce the Plaintiffs to agree to a substantially reduced purchase price." Compl. ¶ 76 (emphasis added).

E. Plaintiffs' Alleged Attempt to Satisfy Section 8.7

Section 8.7 of the APA obligated Plaintiffs to transfer their Medicare and Medi-Cal provider agreements to SGM pursuant to "settlement agreements" with CMS (Medicare) and DHCS (Medi-Cal). Such transfers are critical because the purchasing entity cannot obtain payment for services to patients covered by Medicare and Medi-Cal without a provider agreement. Section 8.7 provides:

> Sellers shall transfer their Medicare provider agreements pursuant to a settlement agreement . . . with the California Department of Health Care Services ("DHCS"), 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 . . . DHCS . . . has against the Seller or Purchaser for monetary liability arising under the . . . Medi-Cal provider agreements before the Effective Time; provided, however, that Purchaser acknowledges that it will

> succeed to the quality history associated with the relevant . . . Medi-Cal provider agreements assigned and shall be treated, for purposed of survey and certification issues as if it is the relevant Seller and no change of ownership occurred.

APA § 8.7.

For background, the Plaintiffs had accumulated substantial liabilities to DHCS, which administers Medi-Cal in California, for unpaid Hospital Quality Assurance Fees ("HQA Fees"), and for Medi-Cal fee-for-service overpayments. On March 22, 2019, DHSC filed an objection to the proposed sale to SGM, arguing that the Medi-Cal provider agreements between it and the Plaintiffs were executory contracts that could not be transferred free and clear of claims, interests, and encumbrances unless all defaults were cured, as required by Bankruptcy Code § 365(b). RJN, Ex. M. Thus, according to DHCS, the provider agreements associated with each of the hospitals could not be transferred to SGM unless and until the Plaintiffs cured the unpaid HQAF and fee-for-service overpayments. *Id.* In response to DHCS's objection to the sale on April 10, 2019, the Plaintiffs argued that they did not need do so because the Medi-Cal agreements are non-executory contracts. RJN, Ex. P.

On May 2, 2019, the Court entered its Sale Order authorizing the sale of the Plaintiffs' assets to SGM free and clear of claims, liens, and encumbrances. RJN, Ex. B. However, the Sale Order expressly carved out Medi-Cal Provider Agreements from the released claims, liens, and encumbrances. Specifically, the Sale Order states: "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 DHCS or a court order resolving the DHCS's objection." *Id.*

On September 11, 2019, DHCS filed a Supplemental Brief regarding its unresolved objection to the Sale of the hospitals free and clear of Debtors' Medi-Cal Provider Agreements. RJN, Ex. C. The Plaintiffs contested DHCS's characterization of the Medi-Cal Provider Agreements as executory contracts. In its Supplemental Brief, DHCS claimed that it was owed in excess of $70 Million for unpaid HQA Fees and for reimbursement of fee for service overpayments which would have to be "cured" in order for the Provider Agreements to be transferred to SGM. RJN Ex C at 7-11. The Plaintiffs filed a Reply Brief in which they once

again argued that the Provider Agreements could be transferred free and clear of any liens and claims without compliance with Bankruptcy Code § 365, while recognizing the need to provide SGM with such a transfer to satisfy its contractual obligations. RJN, Ex. D at 13.

On September 26, 2019, the Bankruptcy Court entered its Memorandum of Decision in which it agreed with the Debtors contention that the Medi-Cal Provider Agreements could be transferred without compliance with Bankruptcy Code § 365(b). At the same time, the Court expressly acknowledged that APA Section 8.7 obligated the Debtors to transfer the Provider Agreements free and clear of any DHCS claims of liability. RJN, Ex. E at 3 ("Each of the Hospitals has executed a Provider Agreement with DHCS. The Asset Purchase Agreement (the "APA") [Dkt. No. 2305-1] 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.").

Despite the Court's statement in its Memorandum of Decision that it was not deciding the recoupment issue, on October 8, 2019, Plaintiffs lodged a proposed order seeking to prevent Medi-Cal from recouping payments from future SGM receivables in connection with the transfer of the Medi-Cal Provider Agreements. RJN, Ex. O. The next day, DHCS objected to the Debtors' proposed order, noting that "the proposed order is not 'consistent' with the Memorandum [of Decision]" and that "it overreaches by inserting gratuitous terms, to, for example, prohibit the Department's recoupment after the sale." RJN, Ex. G.

On October 11, 2019, the Court agreed with DHCS that the Plaintiffs' proposed order was overreaching, stating that: "the Memorandum Decision did not determine whether DHCS' recoupment rights against SGM (if any) are extinguished by the transfer of the Provider Agreements free and clear of claims, interests, and encumbrances." RJN, Ex. H at fn. 2. When entering the Order on October 11, 2019, the Court deleted the word "recoup" from the section providing for a transfer of the Medi-Cal Provider Agreements free and clear of claims, and expressly stated that it was reserving the issue of DHCS's recoupment rights for future adjudication. *Id.* The Court thus left open the question of whether the Medi-Cal Provider Agreements can be transferred free of recoupment rights.

Nevertheless, in their Complaint, the Plaintiffs argued (notwithstanding: (1) § 8.7's requirement of a "settlement agreement"; and (2) the reservation of "recoupment in the October 11 order) that the Court's orders satisfied section 8.7 because they "afforded equal or better protection to SGM than any settlement could have…." Compl. ¶ 77.

F. Plaintiffs Send Notice of Closing

On November 20, 2019, Plaintiffs sent SGM a letter representing that they had satisfied the conditions to close on November 19, 2019 and unilaterally noticed a closing of the transaction for December 5, 2019. Compl. ¶ 85. Defendants responded by explaining, among other things, that Plaintiffs had not complied with the conditions to close. *Id.* at ¶ 87.

G. Plaintiffs' Claims

Plaintiffs filed this Adversary Action on January 3, 2020. Plaintiffs assert three causes of action: (1) breach of contract; (2) promissory fraud; and (3) a claim described as "tortious breach of contract (breach of the implied covenant of good faith)."

Plaintiffs allege that SGM breached the APA by:

> (a) failing to consummate and close the Sale transaction in accordance with the APA; (b) failing to have funds available to close the Sale at the price set forth in the APA; (c) representing in Section 3.9 of the APA and elsewhere that they had the ability to obtain "funds in cash in amounts equal to the purchase price;" (d) attempting to coerce Plaintiffs to agree to a substantially reduced purchase price, (e) failing to cooperate with Plaintiffs and move with alacrity towards closing the SGM Sale; (f) making unfounded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an "Evaluation Period" when no such period existed after the entry of the Enforcement Order, the Section 8.6 Order and the Closing Order; (h) appealing the Enforcement Order to avoid its' obligation to close and despite the APA's requirement that Defendants cooperate to render it a final, nonappealable order; and (i) filing meritless and frivolous Notices of Appeal.

For their promissory fraud claim, Plaintiffs contend that at the time SGM entered into the APA, "Defendants had no intention of performing in accordance with the APA, including (without limitation) by paying the $610 million purchase price." Compl. ¶ 102.

Plaintiffs also assert a claim for tortious breach of contract, which is largely duplicative of its breach of contract claim. Compl. ¶¶ 106-110.

Based on allegations of alter-ego, agency, and conspiracy, Plaintiffs assert the same three

claims against the Non-SGM Defendants also. *See* Compl. ¶¶ 18-26.

III. THE COURT SHOULD GRANT DEFENDANTS' SPECIAL MOTION TO STRIKE.

California's anti-SLAPP statute, California Code of Civil Procedure section 425.16, "is designed to protect citizens in the exercise of their First Amendment constitutional rights of free speech and petition." *Church of Scientology of Cal. v. Wollersheim,* 42 Cal. App. 4th 628,644 (1996) (disapproved on other grounds by *Equilon Enters. v. Consumer Cause, Inc.,* 29 Cal.4th 53, 68 n.5, 124 (2002)). The California Legislature reasoned "that it is in the public interest to encourage continued participation in matters of public significance…." Cal. Civ. Pro. §425.16(a). Section 425.16(b)(l) provides that "[a] cause of action against a person arising from any act of that person in furtherance of the person's right of petition or free speech under the United States Constitution or the California Constitution in connection with a public issue shall be subject to a special motion to strike, unless the court determines that the plaintiff has established that there is a probability that the plaintiff will prevail on the claim."

California's anti-SLAPP statute applies to state law claims brought in federal court. *Price v. Stossel,* 590 F. Supp. 2d 1262, 1267 (C.D. Cal. 2008). Indeed, the Ninth Circuit has held that the statute should be "construed broadly" in California federal courts in accordance with the statute's mandate. *Mindys Cosmetics, Inc. v. Dakar*, 611 F.3d 590, 595 (9th Cir. 2010) ("we follow the California Legislature's direction that the anti-SLAPP statute be 'construed broadly'").

The application of section 425.16 involves a two-pronged analysis.

Initially, to invoke the protection of the statute, the moving party must establish "that the challenged lawsuit arose from an act ... in furtherance of [the] right of petition or free speech." *Equilon,* 29 Cal. 4th at 61. To make this determination, the court shall consider whether the challenged claim arises from protected activity. *Id.*

After the moving party meets the burden of showing that one or more challenged claims arise from protected activity, the burden then shifts to the plaintiffs to defend the claims. In the Ninth Circuit's decision in *Planned Parenthood Fed'n of Am., Inc. v. Ctr. for Med. Progress*, 890 F.3d 828, 834 (9th Cir.), amended, 897 F.3d 1224 (9th Cir. 2018), the Court modified the rule regarding Plaintiffs' burden to substantiate their claims. If the anti-SLAPP motion challenges the

legal sufficiency of the claims, then the FRCP Rule 12(b)(6) standard applies. On the other hand, when the motion challenges the factual sufficiency of the claims, then the FRCP Rule 56 standard applies. In this Motion, Defendants contend that Plaintiffs' claims fail as matter of law based on the Rule 12(b)(6) standard.

A. Plaintiffs' Claims Arise from Protected Activity.

The anti-SLAPP statutes defines an "act in furtherance of a person's right of petition or free speech" to include: "(1) any written or oral statement or writing made before a ... judicial proceeding ... , [and] (2) any written or oral statement or writing made in connection with an issue under consideration or review by a ... judicial body ...." (Code Civ. Proc., § 425.16, subd. (e)(1), (2); *see also Briggs v. Eden Council for Hope & Opportunity*, 19 Cal. 4th 1106, 1116 (1999) ("[A]ll that matters is that the First Amendment activity take place in an official proceeding or be made in connection with an issue being reviewed by an official proceeding.") "A statement is 'in connection with' an issue under consideration by a court in a judicial proceeding within the meaning of clause (2) of [Code of Civil Procedure] section 425.16, subdivision (e) if it relates to a substantive issue in the proceeding and is directed to a person having some interest in the proceeding. [Citation.]" *Fremont Reorganizing Corp. v. Faigin*, 198 Cal. App. 4th 1153, 1167 (2011).

Indeed, courts have repeatedly applied a broad interpretation to apply the anti-SLAPP statute in numerous proceedings. *See, e.g., Graham-Sult v. Clainos*, 738 F.3d 1131, 1142–1143 (9th Cir. 2013) (finding anti-SLAPP statute applied to claims based on representations made in writing to probate court); *Kibler v. N. Inyo Cty. Local Hosp. Dist.*, 39 Cal. 4th 192, 199 (2006) (finding medical peer review proceedings were covered by anti-SLAPP because they involved a "matter of public significance" – i.e., quality of hospital care).

Based on this broad principle, courts have found that statements and conduct related to a bankruptcy proceeding are covered by the anti-SLAPP statute. *See Crossroads Inv'rs, L.P. v. Fed. Nat'l Mortg. Assn.*, 13 Cal. App. 5th 757, 781 (2017) (finding that Fannie Mae's discovery responses and settlement discussions in an ongoing bankruptcy action arose from protected activity under the anti-SLAPP statute). In *Crossroads*, the Court agreed with Fannie Mae that

even its failure to respond to requests were covered by the anti-SLAPP statute, concluding they "were protected activity because they were made in connection with issues under review in the bankruptcy proceeding." *Id.* at. 779.

Here, Defendants' satisfy the first prong because Plaintiffs' claims all arise from protected activity.

1. Plaintiffs' Breach of Contract and Breach of Implied Covenant Claims All Arise from Protected Activity.

Plaintiffs' claims for breach of contract and breach of the implied covenant of good faith all relate to SGM's alleged statements and conduct in the bankruptcy proceeding and thus arise from protected activity. *See Crossroads Inv'rs,* 13 Cal. App. 5th at 781; *see also Navellier v. Sletten*, 29 Cal. 4th 82, 92-93 (2002) (explaining claims for breach of contract "may also come within constitutionally protected speech of petitioning"). For example, in *Navellier*, the California Supreme Court explained that a party's "negotiation and execution" of a release "involved statement[s] or writing[s] made in connection with an issue under consideration or review by a ... judicial body…." *Navellier*, 29 Cal. 4th 82 at 90.

Here, the contract at issue was negotiated during the bankruptcy proceeding, involved the sale of Plaintiffs' hospitals, and was subject to conditions that expressly required the approvals of both the Bankruptcy Court and the California Attorney General. These facts alone easily show that Plaintiffs' claims all arise from protected activity under the broad standard set forth by the anti-SLAPP statute.

What is more, a majority of the breach allegations arise from Defendants' advocacy during the proceedings. Plaintiffs contend that SGM breached the APA by such activity as: "making unfounded and untimely assertions of alleged Material Adverse Effects," "asserting entitlement to an 'Evaluation Period,'" "filing meritless and frivolous Notices of Appeal," "attempting to coerce Plaintiffs to engage in a retrade," and "failing to respond to Plaintiffs' inquiries…." Compl. ¶ 100 & 107. Indeed, lawsuits arising from such litigation privileged activity fall squarely within the scope of section 425.16. *Healy v. Tuscany Hills Landscape & Recreation Corp.,* 137 Cal. App. 4th 1, 5 (2006) (explaining both the anti-SLAPP statute and the

litigation privilege codified in Section 47(b) of the California Civil Code protect litigants' right of access to the courts without fear of being harassed subsequently by derivative actions); *Briggs v. Eden Council for Hope & Opportunity*, 19 Cal. 4th 1106, 1115 (1999) (finding statements protected by the litigation privilege are "equally entitled to the benefits of section 425.16").

Because Plaintiffs' breach of contract and breach of implied covenant claims directly arise from Defendants' protected activity, Plaintiffs must meet their burden of establishing that the claims have merit.

2. Plaintiffs' Promissory Fraud Claim Arises From An Alleged False Promise Made During the Bankruptcy Proceedings.

It is black letter law that a "misrepresentation or failure to disclose can be protected petitioning activity for purposes of section 425.16." *Suarez v. Trigg Labs., Inc.,* 3 Cal. App. 5th 118, 123–24 (2016); *see also Navellier*, 29 Cal. 4th 82, 92-93 (2002). For example, in *Navalier,* the California Supreme Court applied the anti-SLAPP statute to alleged "misrepresentations and omissions" in connection with the execution of a release agreed to in a federal action. *Id.* at 89. The plaintiff filed a subsequent action alleging the defendant Sletten "had committed fraud in misrepresenting his intention to be bound by the Release…." *Id.* at 87. The plaintiff alleged that Sletten failed to disclose that he was secretly not in agreement with the terms of the release. The California Supreme Court concluded that the defendant's "acts or omissions… falls squarely within the plain language of the anti-SLAPP statute." *Id.* at 90.

Similarly, in *Suarez*, the Court also concluded that claims based on a party's alleged failure to disclose a material fact that allegedly induced the party to agree to a settlement was protected by the anti-SLAPP statute. *Suarez v. Trigg Labs.,* 3 Cal. App. 5th at 123-24. The Court explained that the protection applies "even against allegations of fraudulent promises" made during the proceedings. *Id.* at 123.

The California Court of Appeal addressed analogous false promise allegations in *Navarro v. IHOP Properties, Inc.,* 134 Cal. App. 4th 834, 841-42 (2005). In that case, the plaintiff alleged that the defendant IHOP made false promises to induce the plaintiff to agree to a stipulated judgment in an unlawful detainer action. *Id.* The plaintiff alleged that:

> IHOP never intended to review [the proposed transaction between Navarro and her buyer] 'without undue delay,' and that its true intention was to stall and thereby prevent plaintiff from exercising her right to present an alternative purchaser until the expiration of the deadline for plaintiff to obtain approval of any potential sale of her interest, so that IHOP could regain possession of the Store or for some other reason inconsistent with the good-faith performance of the agreement embodied by the Stipulation.

The Court found that these alleged false promises were covered by the anti-SLAPP statute. *Id.*

Like the cases discussed above, here, Plaintiffs allege that Defendants made false promises to induce Plaintiffs to enter into an agreement during a judicial proceeding. Compl. ¶ 102. They claim that "Defendants concealed their true intention not to fund the $610 million purchase price under the APA, and instead to hold the estates, creditors, and patients of the Plaintiffs Hospitals hostage in an attempt to extort a lower purchase price." *Id.* These alleged false promises made during the bankruptcy proceeding fall squarely within the ambit of the anti-SLAPP statute.

Because Plaintiffs' claims all arise from protected activity, Plaintiffs must establish that the claims have merit in accordance with the second prong of the anti-SLAPP statute.

B. Plaintiffs Cannot Establish Their Claims Have Merit.

1. Plaintiffs' Claims All Fail Because Plaintiffs Cannot Establish they Satisfied Section 8.7 of the APA.

Plaintiffs' claims for breach of contract, breach of the implied covenant of good faith, and fraud all depend on Plaintiffs' first establishing that they satisfied all of the conditions to close the sale. If they did not satisfy the conditions to close, Plaintiffs cannot prove that any of the harm they have suffered was in anyway attributable to SGM.[3] Of course, Plaintiffs have the burden to establish that all conditions precedent have been satisfied. *Consolidated World Investments, Inc. v. Lido Preferred Ltd.,* 9 Cal. App. 4th 373, 380 (1992) ("[W]here defendant's duty to perform under the contract is conditioned on the happening of some event, the plaintiff must prove the

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[3] Resulting damages is an element of breach of contract and fraud claims. *See Richman v. Hartley*, 224 Cal.App.4th 1182, 1186 (breach of contract requires "resulting damages"); *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996) (stating same for fraud elements).

event transpired.").

Here, Plaintiffs cannot establish that they satisfied the condition stated in section 8.7 of the APA. APA Section 8.7 obligated Plaintiffs to transfer their Medi-Care and Medi-Cal provider agreements to SGM pursuant to settlements with the CMS and DHCS. Section 8.7 provided:

> Sellers shall transfer their Medicare provider agreements pursuant to a settlement agreement with the Centers for Medicare and Medicaid Services ("CMS") and shall transfer their Medi-Cal provider agreements pursuant to a settlement agreement with the California Department of Health Care Services ("DHCS"), which such settlement agreements shall result 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 under the Medicare or Medi-Cal provider agreements, whether known or unknown, that CMS or DHCS, as applicable, has against the Seller or Purchaser for monetary liability arising under the Medicare or Medi-Cal; provider agreements before the Effective Time; provided, however, that Purchaser acknowledges that it will succeed to the quality history associated with the relevant Medicare or Medi-Cal provider agreements assigned and shall be treated, for purposed of survey and certification issues as if it is the relevant Seller and no change of ownership occurred.

On November 20, 2019, Plaintiffs sent Defendants a letter representing that all conditions to close had been satisfied on November 19, 2019 and that the sale should close by December 5, 2019. Compl. at ¶ 85. For that notice of closing to be valid, Plaintiffs need to have satisfied section 8.7 before November 20, 2019. However, Plaintiffs cannot meet this burden because Plaintiffs admit in their Complaint that they had not satisfied section 8.7 because they had not obtained a settlement agreement with DHCS before November 20, 2019. *Id.* at ¶ 77. Plaintiffs admit that, at the earliest, this agreement was not reached until November 22, 2019 (which, as discussed more below, is also not true). Nevertheless, because Plaintiffs admit their notice of closing was invalid, Defendants never had an obligation to close the transaction.

In their Complaint, Plaintiffs argue that they satisfied Section 8.7 even though they did not obtain a settlement agreement with DHCS. Plaintiffs contend they secured an "Order [Docket No. 3372] from the Bankruptcy Court authorizing the transfer free and clear of any interests asserted by DHCS, in addition to the Sale Order which terminated any creditor's recoupment rights [Docket No. 2306]. Plaintiffs' contend those "Orders afforded equal or greater protection to SGM

than any settlement could have, thereby satisfying Section 8.7." This argument fails for multiple reasons.

a. Only A Settlement Agreement Satisfies Section 8.7

Section 8.7 unambiguously requires Plaintiffs to reach a "Settlement Agreement" with DHCS. There is nothing in Section 8.7 that allows Plaintiffs to satisfy this condition through some alternative means that Plaintiffs unilaterally decide is as good as a Settlement Agreement. SGM bargained for a Settlement Agreement that would guarantee that it would not have liability or a potential fight with DHCS. At best, the alleged orders that protected SGM would just give SGM an argument in a future dispute with DHCS. An argument is not an equal trade for a Settlement Agreement that would fully mitigate any risk and the need for making any argument at all.

b. The Court Orders Do Not Afford "Equal or Better Protection" Than A Settlement Agreement.

A review of the Orders also disputes Plaintiffs' characterization that these Orders "afforded equal or better protection" than a Settlement Agreement. Specifically, the Court's order on October 11 – the order at Docket No. 3372 referenced in the Complaint – expressly stated that the Court was reserving the issue of DHCS's recoupment rights for future adjudication. Accordingly, the risk of having the DHCS recoup from SGM the in excess of $70 million dollars of its claims against the Debtors, was the opposite of the full release and discharge required by §8.7.

On March, 22 2019, the California Department of Health Care Services filed an objection with the Bankruptcy Court to the Plaintiffs' proposed sale to SGM arguing that the Medi-Cal provider agreements between it and Plaintiffs were executory contracts under Bankruptcy Code §365, which could not be transferred to SGM free and clear of claims, interests, and encumbrances. RJN, Ex. M. Thus, according to DHCS, the Provider Agreements associated with each Hospital could not be transferred to SGM unless and until the Debtors cured the unpaid Hospital HQA Fees and fee-for-service overpayments as required by Bankruptcy Code §365(b).

In response, on April 10, 2019, despite its obligations to SGM to reach a settlement with

DHCS, Plaintiffs argued in its brief to the Bankruptcy Court that it not need do so, because the Medi-Cal agreements are non-executory contracts. RJN, Ex. P.

On May 2, 2019, the Bankruptcy Court entered its Sale Order authorizing the sale of Plaintiffs' assets to SGM free and clear of claims, liens, and encumbrances. RJN, Ex. B. Rather than resolve the executory contract dispute, the Sale Order expressly carved out Medical Provider Agreements from the released claims, liens, and encumbrances. Specifically, the Sale Order states: "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 DHCS or a court order resolving the DHCS's objection." RJN, Ex. B.

On September 11, 2019, DHCS again objected to the sale of the hospitals free and clear of Debtors' Medi-Cal Provider Agreements. On September 26, 2019, the Bankruptcy Court issued its Memorandum of Decision Authorizing Debtors to Sell Medi-Cal Provider Agreements, Free and Clear of Interests Asserted by The California Department of Health Care Services, Pursuant to § 363(F)(5). RJN, Ex. E. In the Order, the Court ruled that the Medi-Cal Provider Agreements are not executory contracts and could be sold free and clear of liens, claims, and interests. However, importantly, the Court specifically stated that it was declining to decide the issue of applicability of recoupment subsequent to the transfer of Medi-Cal Provider Agreements. RJN, Ex. H at p. 4, fn. 2.

Plaintiffs' lodged a proposed order with respect to the Memorandum of Decision on October 8, 2019. RJN Ex. O. Despite the Court's clear statement that it was not deciding the recoupment issue, Plaintiffs' proposed order sought to prohibit recouping payments owed to SGM in connection with the transfer of the Medi-Cal Provider Agreements. *Id.*

Unsurprisingly, the next day, on October 9, 2019, DHCS objected to Plaintiffs' proposed order, noting that "the proposed order is not 'consistent' with the Memorandum [of Decision] and that "it overreaches by inserting gratuitous terms, to, for example, prohibit the Department's recoupment after the sale." RJN Ex. G.

On October 11, 2019, the Court agreed with DHCS that Plaintiffs' proposed order was overreaching. The Bankruptcy Court stated "the Memorandum Decision did not determine

whether DHCS' recoupment rights against SGM (if any) are extinguished by the transfer of the Provider Agreements free and clear of claims, interests, and encumbrances." RJN Ex. H at fn. 2. As such, when entering the Order, the Court deleted the word "recoup" from the section providing for a transfer of the Medi-Cal Provider Agreements free and clear, and expressly stated that it was reserving the issue of DHCS's recoupment rights for future adjudication. The Court explained:

> Provided, however, that nothing in this paragraph shall be construed to limit whatever rights DHCS may or may not have to withhold, under principles of equitable recoupment, payments owed by DHCS 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 HQAF Program. *Id.*

DHCS appealed from the Court's October 11 Order. Thus, as of the entry of the Court's October 11 Order, the Debtors (1) had no "settlement agreement" with DHCS to satisfy the closing condition of § 8.7, (2) the only court order permitting the Debtors to transfer their the Medi-Cal Provider Agreements to SGM expressly left open DHCS's right to recoup from future SGM receivables and (3) the order authorizing the transfer was not final.

Even if Plaintiffs could substitute its obligation to obtain a settlement agreement with DHCS with an alleged better court order, Plaintiffs cannot meet their burden of establishing that this order offered equal protection because the Court expressly reserved the issue regarding DHCS's recoupment rights. In other words, had SGM closed the sale on December 5 as the Debtors had demanded, SGM would have been at risk for DHCS's recoupment from SGM's accounts receivables acquired in the sale for what had become $80 million of claims.

c. Plaintiff's Alleged November 22, 2019 Settlement Agreement With DHCS Does Not Save Plaintiffs.

Plaintiffs also allege that Plaintiffs reached a settlement agreement with DHCS on November 22, 2019. Compl. ¶ 77. As an initial matter, even if Plaintiffs did obtain a settlement agreement with DHCS on November 22, 2019, this would not justify its improper notice of closing that it sent two days earlier on November 20. That said, Plaintiffs have admitted in prior Court proceedings that they did not have any such agreement with DHCS.

Indeed, at a Court hearing on November 26, 2019, Plaintiffs' counsel stated: "While we believe we have satisfied the asset purchase agreement's obligation with regard to Medi-Cal [referring to the prior court orders], we also have continued to negotiate for a settlement and believe we have a settlement in principle, which we are now negotiating the terms of a written settlement agreement." RJN Ex. L at p. 10. Plaintiffs thus admitted that they did not have a final enforceable settlement agreement with DHCS as of November 26, 2019. Plaintiffs cannot seriously argue that "a settlement in principle" satisfied section 8.7. Again, at best, this would just leave SGM with an argument – and a bad one – that DHCS had released its claims.[4]

Because Plaintiffs cannot establish they satisfied section 8.7, Plaintiffs' claims should all be stricken.

2. Plaintiffs' Claim for Promissory Fraud Also Fails For Additional Reasons.

As explained below, Plaintiffs' claim for promissory fraud fails for two separate and distinct reasons. First, Plaintiffs' claim fails because the alleged false promises are protected by the litigation privilege. Second, even if the claims were not privileged, Plaintiffs' claims also fail because Plaintiffs' specific allegations contradict Plaintiffs' fraud theory.

a. The Alleged Fraudulent Representation is Protected by the Litigation Privilege.

One of the many purposes of the litigation privilege codified in section 47(b) of the California Civil Code is to "promote[] the effectiveness of judicial proceedings by encouraging 'open channels of communication and the presentation of evidence…." *Silberg v. Anderson*, 50 Cal. 3d 205, 213 (1990) (quoting *McClatchy Newspapers, Inc. v. Superior Court*, 189 Cal. App. 3d 961, 970 (Ct. App. 1987). Courts have explained that "such open communication is 'a

[4] Although they have not asserted this in their Complaint, Defendants believe that Plaintiffs may attempt to change their theory and argue that Plaintiffs' December 9, 2019 settlement with DHCS somehow satisfies Section 8.7. Such an argument would also fail for numerous reasons. First, a settlement agreement executed on December 9, 2019 cannot have required SGM to close *four days earlier* on December 5, 2019. Second, Plaintiffs' settlement with DHCS did not satisfy the requirements of Section 8.7 because it did not release all known and *unknown* claims as required by Section 8.7. Shortly after, on December 17, 2019, Plaintiffs sent notice that they were terminating the APA. Compl. at ¶98.

fundamental adjunct to the right of access to judicial and quasi-judicial proceedings.'" *Id.* (quoting *Pettitt v. Levy*, 28 Cal. App. 3d 484, 490-491, 104 (1972)). To be protected, the communications just need to "have some connection or logical relation to the action." *Id.* at 212; *see also Sacramento Brewing Co.*, 75 Cal. App. 4th 1082, 1089 (1999) ("The privilege should be denied only where it is so palpably irrelevant to the subject matter of the action that no reasonable person can doubt its irrelevancy.").

"To effectuate its vital purposes, the litigation privilege is held to be absolute in nature." *Silberg*, 50 Cal. 3d at 215. And, like the anti-SLAPP statute, "the litigation privilege is broadly applied and doubts are resolved in favor of the privilege." *Ramalingam v. Thompson*, 151 Cal. App. 4th 491, 500 (2007) (citations omitted).

It is also well-settled that a "bankruptcy proceeding is a judicial proceeding within the scope of California's litigation privilege." *In re Cedar Funding, Inc.*, 419 B.R. 807, 825 (B.A.P. 9th Cir. 2009); *see also Sacramento Brewing Co.*, 75 Cal. App. 4th 1082, 1086 (1999) (finding privilege applied to statement made in a motion filed in a bankruptcy proceeding); *Shoemaker v. Siegel*, No. 1:17-BK-015182-GM, 2017 WL 3671154, at *3 (C.D. Cal. Aug. 25, 2017), *aff'd sub nom. In re Shoemaker*, 749 F. App'x 565 (9th Cir. 2019) (finding that litigation privilege applied to claims of fraud and negligent misrepresentation arising from statements made in connection with a bankruptcy proceeding).

Of course, given its absolute nature, sections 47(b) provides a complete defense to claims arising from protected speech including claims of fraud. *Id.* (citing a litany of supporting cases). This includes claims for promissory fraud claims. *See, e.g., Navarro,* at 841-42 (2005) (finding Plaintiffs' claims that IHOP did not intend to comply with the release was also barred by the litigation privilege).

Here, like *Navarro*, plaintiffs' claims for promissory fraud arise from representations made during the course of a judicial proceeding. They are immune from tort liability based on the litigation privilege. The Court should thus strike Plaintiffs' fraud claim for this reason alone.

b. Plaintiffs' Allegations Do Not Support Fraud.

The elements of fraud are: "(a) misrepresentation (false representation, concealment, or

nondisclosure); (b) knowledge of falsity (or 'scienter'); (c) intent to defraud, i.e., to induce reliance; (d) justifiable reliance; and (e) resulting damage." *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996) (quoting Witkin, Summary of Cal. Law (9th ed. 1988) Torts § 676)). In general, statements about the future are considered to be opinions or predictions, not statements or fact, and are thus not actionable. *See Mueller v. San Diego Entm't Partners, LLC*, 260 F. Supp. 3d 1283, 1296 (S.D. Cal. 2017). That said, "an action for promissory fraud may lie where a defendant fraudulently induces the plaintiff to enter into a contract." *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996). However, importantly, to be actionable fraud, the plaintiff must establish that the defendant did not intend to comply with the contract at the time the defendant entered the contract. *Magpali v. Farmers Group, Inc.*, 48 Cal. App. 4th 471, 481 (1996) ("A promise of future conduct is actionable as fraud only if made without a present intent to perform.")

Here, Plaintiffs' own factual allegations contradict its claim that Defendants intended to breach the APA. According to Plaintiffs, Defendants "**never anticipated that** Plaintiffs would obtain agreement from the Attorney General of California not to impose conditions on the sale transactions" and thus "Defendants believed **they would never be obligated to** pay the full purchase price…." Compl. at Preliminary Statement; ¶58 (emphasis added). According to Plaintiffs' own allegations, Defendants did not intend to breach a contractual obligation; rather, Defendants just erroneously failed to anticipate the possibility that Plaintiffs would be able to satisfy the conditions in the contract. This is not fraud. Plaintiffs' allegations, at best, show that Defendants misjudged Plaintiffs' ability to satisfy the contract's conditions. However, because Defendants "never anticipated that they would be obligated to pay the full purchase price," Plaintiffs cannot establish that Defendants *intended* to breach an alleged obligation to pay that price. As Plaintiffs allege, Defendants never even imagined the possibility that would be obligated to pay the price and thus could not have planned to breach that obligation. Defendants thus did not have the requisite fraudulent intent as a matter of law.

Plaintiffs' fraud theory is also nonsensical as a practical matter. SGM made a good faith deposit of $30 million when it entered into the APA. If SGM did not comply with an obligation to

close the sale, that $30 million deposit would be lost. It defies credulity to believe that any party would deposit $30 million if it intended to not comply with an obligation to close.

Because Plaintiffs' allegations conclusively establish that Defendants did not have a present intent to not perform under the contract, Plaintiffs' claim for promissory fraud fails as a matter of law and should be stricken.

3. Many of the Alleged Breaches Are Also Covered by the Litigation Privilege.

The litigation privilege will also bar breach of contract claims if the contract does not "clearly prohibit" the challenged activity. *Vivian v. Labrucherie*, 214 Cal. App. 4th 267, 276 (2013); *see also Feldman v. 1100 Park Lane Assocs.,* 160 Cal. App. 4th 1467, 1497-98 (2008) (finding litigation privilege applied to breach claim arising from defendants' allegedly threatening and initiating litigation); *McNair v. City & Cty. of San Francisco*, 5 Cal. App. 5th 1154, 1171 (2016) (barring breach of contract claim when protected activity was not clearly prohibited by contract).

Plaintiffs allege numerous alleged breaches that are standard hallmarks of litigation protected activity as they all relate to SGM advocating its position that it was not obligated to close the transaction. Cal. Civ. Code § 47*; see also Silberg v. Anderson*, 50 Cal. 3d 205, 213-214 (1990) (explaining litigation privilege is intended to, among other things, encourage attorneys to "zealously protect" their client' interests and to afford litigants "utmost freedom of access" to courts). Plaintiffs' alleged breaches include: "(d) attempting to coerce Plaintiffs to agree to a substantially reduced purchase price, (e) failing to cooperate with Plaintiffs and move with alacrity towards closing the SGM Sale; (f) making unfounded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an "Evaluation Period" when no such period existed after the entry of the Enforcement Order, the Section 8.6 Order and the Closing Order; (h) appealing the Enforcement Order to avoid its' [sic] obligation to close and despite the APA's requirement that Defendants cooperate to render it a final, nonappealable order; and (i) filing meritless and frivolous Notices of Appeal." Compl. at ¶100.

This activity is also not specifically prohibited by the APA. Indeed, Plaintiffs tacitly

acknowledge that this alleged activity is not specifically prohibited by the APA by including these same allegations in their claim for breach of the "implied" covenant. Compl. at ¶107.

Because this activity is all covered by the litigation privilege, these breaches should be stricken for this additional reason.

4. Plaintiffs' Claim for Breach of the Implied Covenant Fails for Multiple Reasons.

Plaintiffs' claim for tortious breach of the implied covenant of good faith should be stricken because it is both (1) not a cognizable claim and (2) the alleged breaches are either covered by its breach of contract claim or covered by the litigation privilege.

a. Plaintiff's Claim or Tortious Breach is Not a Cognizable Claim.

Plaintiffs' third cause of action for "Tortious Breach of Contract (Breach of the Implied Covenant of Good Faith and Fair Dealing" is not a cognizable claim under California law and must be stricken.

It is well known that in California, a "person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations." *Stop Loss Ins. Brokers, Inc. v. Brown & Toland Medical Group*, 143 Cal. App. 4th 1036, 1041 (2006). For decades, the California Supreme Court has recognized that there is no such claim as "tortious breach of contract." *See Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503, 514 (1994) ("One contracting party owes no general tort duty to another not to interfere with performance of the contract; its duty is simply to perform the contract according to its terms."). For that reason, the law *does not recognize* a claim for "tortious breach of the implied covenant of good faith and fair dealing" in arms-length transactions such at the one at issue here. *See Pension Tr. Fund for Operating Engineers v. Fed. Ins. Co.*, 307 F.3d 944, 955 (9th Cir. 2002); *Denholm v. Houghton Mifflin Co.*, 912 F.2d 357, 361 (9th Cir. 1990). Under California law, "no cause of action for the tortious breach of the implied covenant of good faith and fair dealing can arise unless the parties are in a special relationship with fiduciary characteristics. Thus, the implied covenant tort is not available to parties of an ordinary commercial transaction where the parties deal at arms' length." *Pension Tr. Fund for Operating Engineers*, 307 F.3d at 955 (internal citations omitted); *see also*

Velazquez v. GMAC Mortg. Corp., 605 F. Supp. 2d 1049, 1072 (C.D. Cal. 2008) (dismissing claim for "tortious breach of the implied covenant of good faith and fair dealing" and recognizing that "*tort* recovery for breach of the covenant … is available only in limited circumstances, generally involving a special relationship between contracting parties.") (internal citation omitted, emphasis in original); *California Joint Powers Ins. Auth. v. Munich Reinsurance Am., Inc.*, 2008 WL 1885754, at *2 (C.D. Cal. Apr. 21, 2008) ("Because the covenant of good faith and fair dealing essentially is a contract term that aims to effectuate the contractual intentions of the parties, compensation for its breach has almost always been limited to contract rather than tort remedies.")

Plaintiffs have not (because they cannot) alleged that the parties had any "special relationship," such as that of an insurer and insured or fiduciary and beneficiary, that would permit them to assert a claim for tortious breach of the duty of good faith and fair dealing. As this Court has already held:

> ***Arm's Length Transaction***. The APA and other documents and instruments (the "Transaction Documents") related to and connected with this transaction (the "Transaction") and the consummation thereof were negotiated and entered into by the Debtors and Strategic Global Management, Inc. ("SGM"), as Purchaser under the APA without collusion, in good faith ***and through an arm's length bargaining process***. RJN Ex. B.

In sum, Plaintiffs' "tortious breach" claim is nothing but an impermissible attempt to "tortify" its breach of contract claim in a futile attempt to plead entitlement to punitive damages and must be stricken.

b. Plaintiff's Allegation of Breach of the Implied Covenant are Protected by the Litigation Privilege.

Where, as here, a claim for breach of the implied covenant of good faith and fair dealing merely reiterates the cause of action for breach of contract; it is legally superfluous and should be dismissed. *See Careau & Co. v. Security Pacific Business Credit, Inc*. 222 Cal. App. 3d 1371, 1394–95 (1990); *Wilson v. Gateway, Inc.*, 2010 WL 11520532, at *3 (C.D. Cal. Jan. 25, 2010).

Plaintiffs' allegations of breach of the implied covenant include:

(a) entering the APA with no intention to perform their obligations

> thereunder;(b) failing to consummate and close the Sale transaction in accordance with the APA; (c) failing to have funds available to close the Sale at the Purchase Price set forth in the APA; (d) attempting to coerce Plaintiffs to engage in a re-trade; (e) failing to cooperate with Plaintiffs and move with alacrity towards closing the SGM Sale; (f) making unfounded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an "Evaluation Period" following entry of the Enforcement Order, Section 8.6 Order and Closing Order; (h) filing meritless and frivolous Notices of Appeal; and (i) failing to respond to Plaintiffs inquiries regarding SGM's intent and financial ability to perform the APA.

Compl. ¶ 107.

The only allegations of breach of the implied covenant that are arguably not covered by the litigation privileged activity discussed above include the allegations in subparts (b) and (c) above -- *i.e.,* not closing the transaction and not having the necessary funds. Both of these relate to SGM's alleged failure to comply with the actual terms of the APA. Revealingly, these are Plaintiffs' first two allegations of breach in Plaintiffs' breach of contract claim. Compl. at ¶100. Because all of the remaining allegations are covered by the litigation privilege, and these two remaining allegations are covered by the breach of contract claim, this claim should be dismissed for this additional reason.

5. Plaintiffs' Claims Against the Non-SGM Defendants Also Fail Because Plaintiffs' Cannot Establish Alter-Ego Liability.

To establish alter-ego liability under California law, a plaintiff must establish: (1) that there is "such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist" and (2) that there will be an "inequitable result if the acts in question are treated as those of the corporation alone." *Gerritsen v. Warner Bros. Entm't Inc.*, 116 F. Supp. 3d 1104, 1136 (C.D. Cal. 2015). Plaintiffs cannot establish either element against any of the Non-SGM Defendants. We begin with the second element.

a. Plaintiffs Cannot Use Alter-Ego As a Substitute for Negotiating Contractual Guarantees with Known Related Entities.

To prove the second element, "a plaintiff must plead facts sufficient to demonstrate that

'conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporate form.'" *Tatung Co., Ltd. v. Shu Tze Hsu*, 217 F. Supp. 3d 1138, 1176 (C.D. Cal. 2016). A plaintiff cannot invoke the alter-ego doctrine when the plaintiff had knowledge of the existence of the entity defendant's principal but nevertheless decided to contract solely with the defendants instead of or in addition to the principal. *See Lynch v. McDonald*, 155 Cal. 704 (1909); *see also Finley v. Union Joint Stock Land Bank of Detroit*, 281 Mich. 214, 221–22 (1937) ("A claimant of the subsidiary corporation cannot be said to have been affected by the parent's use of the subsidiary as a mere instrumentality, if with knowledge of all the facts at the time he entered into the transaction with the subsidiary, he accepted or approved the relationship between the two corporations."); *Brunswick Corp. v. Waxman*, 459 F. Supp. 1222, 1231–32 (E.D.N.Y. 1978), aff'd, 599 F.2d 34 (2d Cir. 1979) (holding that the plaintiff was barred from piercing the corporate veil of a no-asset special purpose entity established solely to acquire trade equipment, as the plaintiff was aware of that fact).

The California Supreme Court's ruling in *Lynch v. McDonald* is instructive. In *Lynch*, the plaintiff entered into a services agreement to serve as the defendant mining company's attorney and expert. *See id*. at 705. The company's president executed the services agreement on behalf of the corporation. *See id*. When a dispute arose between the parties, the plaintiff sued the company and brought an alter-ego claim against the president, claiming that the president owned nearly all of the capital stock in the company and controlled the company's policies. *See id*. The California Supreme Court rejected the plaintiff's alter-ego theory because the plaintiff was thoroughly familiar with all the facts concerning the president's relation to the company. *See id*. at 706. The court reasoned that "[i]f this was an action by a stranger to the facts, who had been injured by ignorance of [the president's] holding of nearly all of the stock of the company, there might by some force in [the plaintiff's] position, and some necessity for the application of the [alter ego doctrine]." *Id*. The court continued that "if [the plaintiff] was content to act under a contract which [the president] refused to sign except as an officer of the company, he cannot complain that [the president], who was not a party signatory to the instrument, is not bound." *Id*.

The Court's ruling in *Brunswick Corp. v. Waxman* further illustrates this principle. In that

case, the Waxmans were general partners interested in expanding their bowling operations and contacted Brunswick Corporation to discuss the purchase of bowling equipment. *See Brunswick Corp. v. Waxman*, 459 F. Supp. at 1224. The Waxmans indicated that they were interested in making the bowling equipment purchases through a no-asset special entity that would act as the purchaser and obligor on any conditional sale agreements. *Id*. Brunswick agreed, and the Waxmans formed the Waxman Construction Corp. ("Construction Corp."), a no-asset corporation to act as signatory on the sale contracts. *See id*. Recognizing that Construction Corp. did not have assets, Brunswick performed due diligence on its principals and considered the location, population, and presence of competitors to the proposed bowling alleys to determine the success of the bowling alleys. *See id*. Based on their due diligence, Brunswick was aware that the Waxmans were successful businessmen who had successfully operated other bowling lanes, and knowingly accepted the no-asset Construction Corp. as the obligor on a series of conditional sale contracts. *See id*.

When Construction Corp. defaulted on its obligations, Brunswick sued the Waxmans for alter ego liability claiming that the Waxmans operated Brunswick's equipment in their individual capacities in complete disregard of corporate formalities and have rendered themselves personally liable for the entities' obligations. *See id.* at 1228. The Waxmans argued, *inter alia*, that Brunswick was fully aware that Construction Corp. lacked capitalization, and with that knowledge consented to contracting solely with that entity. *See id.* at 1231-32. Although Brunswick was able to establish that the Waxmans and Construction Corp. did not follow corporate formalities, the court agreed with the Waxmans and dismissed Brunswick's complaint. *See id.* at 1231-32, 1234. The court relied on the long standing rule that "[t]he plaintiff was not wronged by the fact that the corporation was organized with a trifling capital and could not live except upon borrowed money; nor by the fact that the lenders insisted upon security. [The plaintiff] knew the essential facts and accepted the situation." *Id.* at 1232 (*quoting Hanson v. Bradley*, 298 Mass. 371, 10 N.E.2d 259, 264 (S.J.C.1937)). The court reasoned that undercapitalization might, under some circumstances indicate that the corporate form was being used to mislead creditors and should be pierced, Brunswick had full knowledge of the lack of

capitalization, and consented to it. *See id*. It held that "[w]hen one extends credit to a corporation in the large amounts involved in this case and relies upon that corporation, it is reasonable to assume that he will investigate the corporation's capitalization, its assets and its operations, and that his contract is made on this basis and not on the individual credit of the dominant stockholders." *Id*.

The district court's dismissal was affirmed by the United States Court of Appeals, Second Circuit, which held: "[u]nder these circumstances Brunswick obtained precisely what it bargained for, and it did not bargain for or contemplate the individual liability of the Waxmans which it now seeks to enforce. To pierce the corporate veil here would not in our view accomplish justice or equity but would in fact thwart that end. We therefore refuse to disregard the corporate entity in this case. The creation of the dummy corporation under these circumstances to eliminate personal responsibility should be respected." *Brunswick Corp. v. Waxman*, 599 F.2d 34, 36 (2d Cir. 1979).

The facts presented in this case are strikingly similar to those in *Lynch* and *Brunswick*. Plaintiffs, in conjunction with their multiple attorneys and advisors, including Cain Brothers ("Cain"), reviewed, investigated, and ultimately approved SGM's offer to be the stalking-horse bidder of the Plaintiffs' assets. *See* Complaint ¶ 40. The deal was valued at $610,000,000. *See id*. SGM's offer letter, dated August 13, 2018, was one of the documents that Plaintiffs purportedly relied on in entering into the APA. *See id*. at ¶¶ 40-41. Crucially, that document specified that SGM is a "venture company used to acquire assets and businesses, through companies which are affiliated or associated (through common ownership and otherwise) with SGM, but which are not subsidiaries of SGM." *Id*. at ¶ 41. It was clear to Plaintiffs from SGM's initial offer letter that SGM would serve as a separate entity used to purchase the assets.

As part of the lengthy due diligence process with Plaintiffs and their advisors were, among other things, provided a letter from Dr. Chaudhuri's bank supporting Dr. Chaudhuri's available assets. *See id*. at ¶ 42. Later that month, Plaintiffs, and Plaintiffs' advisors, met with representatives of SGM and the Non-SGM Defendants, including Dr. Chaudhuri, to discuss the sale of the Plaintiffs' assets. *See id*. at ¶ 43. At that juncture, Plaintiffs were thoroughly aware of facts concerning SGM's relationship to Dr. Chaudhuri and the other Non-SGM Defendants.

Relying on their multiple advisors, and having full awareness of the facts concerning SGM's relationship to the Non-SGM Defendants, Plaintiffs chose to contract solely with SGM. *See id*. at ¶¶ 43, 44.

Just like the plaintiffs in *Lynch* and *Brunswick*, the Plaintiffs were thoroughly aware of SGM's relationship to the Non-SGM Defendants, particularly the fact that SGM was a special purpose entity established for the acquisition of assets. Plaintiffs were not strangers to the facts, but rather well informed of all of the facts regarding SGM's relationship to the Non-SGM Defendants.

Plaintiffs were also not left without recourse. Although they did not negotiate for contractual guarantees, SGM made a deposit of $30 million that Plaintiffs could keep if SGM defaulted on an obligation to close the transaction. Plaintiffs likely believed the deposit gave them adequate security. In short, Plaintiffs chose not to exhaust bargaining leverage to obtain additional guarantees from other parties. They cannot now attempt to obtain that same benefit through concocted allegations of alter-ego.

Plaintiffs' decision to contract solely with SGM, despite their thorough understanding of the nature of the relationship with the Non-SGM Defendants, bars them from complaining that the Non-SGM Defendants, non-signatories to the APA, are not bound. Just like the plaintiff in *Brunswick*, Plaintiffs here obtained precisely what they bargained for, and did not bargain for or contemplate the liability of the Non-SGM Defendants. Piercing the corporate veil in these circumstances would thwart the alter ego doctrine's goal of promoting justice and equity. Thus, Plaintiffs' claims against the Non-SGM Defendants should be stricken on this additional basis.

b. Plaintiffs Have Also Not Alleged Sufficient Facts to Support Their Alter-Ego Claims Against the Non-SGM Defendants.

"[T]he corporate form will be disregarded only in narrowly defined circumstances and only when the ends of justice so require." *Eleanor Licensing LLC v. Classic Recreations LLC*, 21 Cal. App. 5th 599, 615 (2018). "Conclusory allegations of "alter ego" status are insufficient to state a claim. Rather, a plaintiff must allege specifically . . . the elements of alter ego liability, as well as facts supporting [those elements]." *Neilson v. Union Bank of Cal., N.A.*, 290 F. Supp. 2d

1101, 1116 (C.D. Cal. 2003).

In paragraphs 18-22 of the Complaint, Plaintiffs ask the Court to disregard SGM's corporate existence because it is alleged that SGM is the alter ego of the "other defendants". Such a claim requires allegations demonstrating that SGM has no legitimate separate existence – that it is are merely an instrumentality for the Non-SGM Defendants – and that inequity will result if its corporate form is recognized. *See id*. at 1117.

Plaintiffs, however, have not identified any facts to support their claim. Plaintiffs offer only a "formulaic recitation" of each factor that courts typically consider in analyzing a request to pierce the corporate veil. They do not provide any meaningful factual allegations that would "allow[] the court to draw the reasonable inference" that the Non-SGM Defendants actually are the mere instrumentality of SGM and that inequity will result if SGM's corporate existence is recognized. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

For example, Plaintiffs allege, on information and belief, as to Dr. Chaudhuri and "KPC", the following conclusions:

> "[Dr. Chaudhuri and KPC] (1) controlled the business and affairs of SGM, including any and all of their affiliates; (2) disregarded legal formalities and failed to maintain arm's length relationships among the corporate entities; (3) inadequately capitalized SGM; (4) used the same office or business location and employed the same employees for the corporate entities; (5) held Chaudhuri himself out as personally liable for the debts of the corporate entities; (6) used the corporate entities as a mere shells, instrumentalities or conduits for Chaudhuri and/or his individual businesses; (7) manipulated the assets and liabilities between the corporate entities so as to concentrate the assets in one and the liabilities in another; (8) used corporate entities to conceal their ownership, management and financial interests and/or personal business activities; and/or (9) used the corporate entities to shield against personal obligations, and in particular the obligations as alleged in this Complaint."

Compl. ¶ 20.

None of the above conclusions are sufficient to create an inference that SGM is the instrumentality of the other defendants. First, Plaintiffs' ubiquitous use of "defendants" makes it impossible to understand the nature of Plaintiffs' allegations. Do Plaintiffs contend the corporate entities are alter egos of Dr. Chaudhuri, SGM, or perhaps the other defendants? Relatedly, the

Plaintiffs use of "and/or" makes it impossible to understand which of the conclusory acts were committed and by which defendants. Plaintiffs' Complaint provides no answers to these issues and thus fails to put the Non-SGM Defendants on notice of the claims against them. By failing to do so, Plaintiffs' alter ego allegations violate the most basic principle underpinning a notice pleading – to provide notice of the claims against each particular defendant.

Plaintiffs' use of soundbites taken from various websites and meetings also do not buttress their alter ego claims against Non-SGM Defendants. The statements merely show that there is a relationship, albeit an arms-length relationship, between the defendants. A relationship is not enough to allege alter-ego. Rather, Plaintiffs must allege facts to establish that there is "such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist." *Mesler v. Bragg Mgmt. Co.*, 39 Cal. 3d 290, 300 (1985). No facts have been alleged that compel a finding that the separate personalities between SGM and the Non-SGM Defendants somehow no longer exist.

To the contrary, Plaintiffs' cites at least one example where an alter ego claim *cannot* exist. Specifically, Plaintiffs admit, in paragraph 41 of their Complaint that Non-SGM Defendant, KPC Healthcare, has been sold to an Employee Stock Ownership Plan that is not owned by Chaudhuri of SGM. *See* Compl. ¶ 41. By the inclusion of this allegation, Plaintiffs acknowledge that KPC Healthcare is not owned by SGM or any of the other defendants and cannot be SGM's alter ego.

Because Plaintiffs have not sufficiently alleged alter-ego against the non-SGM Defendants, Plaintiffs should strike all of the claims against them for this additional reason. Plaintiffs' claims against KPC HealthCare should be stricken for the additional reason that Plaintiffs acknowledge in the Complaint that it is not owned by SGM or Chaudhuri.

c. Plaintiffs' Generic Agency and Conspiracy Allegations Do Not Save Their Claims Against the Non-SGM Defendants.

Plaintiffs' complaint also includes boilerplate agency and conspiracy allegations. However, as a matter of law, these claims cannot make the non-SGM defendants liable for SGM's alleged breach of the APA. *See Automatic Poultry Feeder Co. v. Wedel*, 213 Cal. App. 2d

509, 518 (1963) (explaining that agents are not liable for contracts for a disclosed principal); *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503, 510 (1994) (explaining conspiracy only applies to torts). Plaintiffs have also not alleged any facts establishing how any of the non-SGM Defendants somehow assisted or conspired in SGM's alleged false promise. These alternative theories thus cannot justify any claims against the non-SGM parties.

IV. CONCLUSION

For the reasons discussed above, Defendants request that the Court strike each claim asserted by Plaintiffs and enter judgment in favor of Defendants.

Dated: February 19, 2020

BARNES &THORNBURG LLP

By: _____

Kevin D. Rising
L. Rachel Lerman
Joel R. Meyer
Counsel for Strategic Global Management, Inc.; Kali P., Chaudhuri, M.D.; KPC Healthcare Holdings, Inc.; KPC Healthcare, Inc., KPC Global Management, LLC

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is 10250 Constellation Boulevard, Suite 1700, Los Angeles, CA 90067.

A true and correct copy of the foregoing document entitled **DEFENDANTS' NOTICE OF MOTION AND SPECIAL MOTION TO STRIKE PLAINTIFF'S COMPLAINT PURSUANT TO CAL. CIV. PROC. CODE § 425.16; MEMORANDUM OF POINTS AND AUTHORITIES** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On **February 19, 2020**, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

- James Cornell Behrens jbehrens@milbank.com, gbray@milbank.com;mshinderman@milbank.com;dodonnell@milbank.com;jbrewster@milbank.com;JWeber@milbank.com
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- Kyrsten Skogstad kskogstad@calnurses.org, rcraven@calnurses.org
- United States Trustee (LA) ustpregion16.la.ecf@usdoj.gov

2. SERVED BY UNITED STATES MAIL: On **February 19, 2020**, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

☐ Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on **February 19, 2020**, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

Served via Attorney Service
The Honorable Ernest M. Robles
United States Bankruptcy Court
Edward R. Roybal Federal Building
255 E. Temple Street, Suite 1560
Los Angeles, CA 90012

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

February 19, 2020	Lisa Masse	*/s/ Lisa Masse*
Date	*Type Name*	*Signature*

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KPC Health Plan Holdings, Inc.,
KPC Healthcare, Inc., and
KPC Global Management, LLC

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA – LOS ANGELES DIVISION

In re

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

Debtors and Debtors in Possession.

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

CHAPTER 11

Lead Chapter 11 Case No.: 2:18-bk-20151-ER

Jointly Administered With:
CASE NO.: 2:18-bk-20162-ER
CASE NO.: 2:18-bk-20163-ER
CASE NO.: 2:18-bk-20164-ER
CASE NO.: 2:18-bk-20165-ER
CASE NO.: 2:18-bk-20167-ER
CASE NO.: 2:18-bk-20168-ER
CASE NO.: 2:18-bk-20169-ER
CASE NO.: 2:18-bk-20171-ER
CASE NO.: 2:18-bk-20172-ER
CASE NO.: 2:18-bk-20173-ER
CASE NO.: 2:18-bk-20175-ER
CASE NO.: 2:18-bk-20176-ER
CASE NO.: 2:18-bk-20178-ER
CASE NO.: 2:18-bk-20179-ER
CASE NO.: 2:18-bk-20180-ER
CASE NO.: 2:18-bk-20181-ER

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

DEFENDANTS' NOTICE OF MOTION AND MOTION TO DISMISS PLAINTIFFS' COMPLAINT [Fed. R. Civ. Proc. 12(b)(1) & 12(b)(6)]

Date: March 11, 2020
Time: 10:00 a.m.
Judge: Ernest Robles
Place: Courtroom 1568
255 E. Temple Street
Los Angeles, CA 90012

HOLDINGS, LLC, a California limited liability company;

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.

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that Defendants Strategic Global Management, Inc. ("SGM"), Kali P. Chaudhuri, M.D., KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., and KPC Global Management, LLC, (collectively, the "Non-SGM Defendants"), hereby move for an order dismissing Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, and Verity Holdings, LLC's ("Plaintiffs") Complaint in the above-referenced adversary proceeding.

PLEASE TAKE FURTHER NOTICE that this Motion is made pursuant to Federal Rule of Civil Procedure Rules 12(b)(1) and 12(b)(6), made applicable herein by Rule 7012 of the Federal Rules of Bankruptcy Procedure, on the grounds that: (1) the Court has been divested of jurisdiction due to SGM's pending appeals; (2) the Adversary Proceeding is a non-core matter & the Non-SGM Defendants have not consented to jurisdiction; (3) each of Plaintiffs' causes of action fail to state a claim as a matter of law because Plaintiffs did not satisfy APA Section 8.7; (4) Plaintiffs' second cause of action for fraud fails as a matter of law because: (a) the alleged fraudulent representation is protected by the litigation privilege and (b) Plaintiffs' specific allegations do not support fraud; (5) Plaintiffs' third cause of action for "Tortious Breach of Contract (Breach of the Implied Covenant of Good Faith and Fair Dealing)" is not a cognizable claim in this arm's-length transaction; (6) Plaintiffs' alter-ego claims fail as a matter of law because: (a) Plaintiffs cannot use alter-ego as a substitute for negotiating contractual guarantees with known related entities, (b) Plaintiffs have not alleged sufficient facts to support their alter-ego claims against the Non-SGM Defendants, and (c) Plaintiffs concede facts necessarily defeating their alter-ego claims against KPC healthcare; and (7) Plaintiffs' boilerplate "agency, aiding and abetting, and conspiracy" allegations fail as a matter of law.

PLEASE TAKE FURTHER NOTICE that the Motion is based on this Notice of Motion and Motion, the accompanying Request for Judicial Notice, the arguments of counsel at any hearing on the Motion, and any other admissible evidence brought before the Court.

PLEASE TAKE FURTHER NOTICE that pursuant to Local Bankruptcy Rule 9013-1(f), any party that wishes to oppose the relief requested in the Motion must file not later than 14 days prior to the scheduled hearing date, with the Clerk of the Bankruptcy Court, located at 255 East Temple Street, Los Angeles, California, and serve upon Defendants' counsel, located at the address indicated on the upper left corner of the first page of this notice, "[a] complete written statement of all reasons in opposition thereto . . . , declarations and copies of all evidence on which the responding party intends to rely, and any responding memorandum of points and authorities."

PLEASE TAKE FURTHER NOTICE that, pursuant to Local Bankruptcy Rule 9013-1(h), failure to file and serve a timely response may be deemed consent to the relief requested in the Motion.

Dated: February 19, 2020

By: */s/ Gary E. Klausner*
Gary E. Klausner
Counsel for Strategic Global Management, Inc.; Kali P., Chaudhuri, M.D.; KPC Healthcare Holdings, Inc.; KPC Healthcare, Inc., KPC Global Management, LLC

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MEMORANDUM OF POINTS AND AUTHORITIES

Defendants Strategic Global Management, Inc. ("SGM"), Kali P. Chaudhuri, M.D., KPC Healthcare Holdings, Inc., KPC Health Plan Holdings, Inc., KPC Healthcare, Inc., and KPC Global Management, LLC, (collectively, the "Non-SGM Defendants") submit this motion to dismiss the Adversary Proceedings, Case No. 2:20-ap-01001-ER, filed by Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, and Verity Holdings, LLC ("Plaintiffs").[1]

I. INTRODUCTION

As explained in Defendants' concurrently filed Anti-SLAPP motion, ever since SGM began to assert that Plaintiffs had not complied with their obligations under the parties' Asset Purchase Agreement ("APA"), Plaintiffs have sought to punish SGM for daring to assert its rights. In furtherance of that scorched-earth punishment campaign, Plaintiffs filed a massively overreaching Adversary Complaint against not only SGM, but Kali P. Chaudhuri, M.D. individually, and presumably every other entity that Plaintiffs could find with the letters "KPC" in its name. In doing so, Plaintiffs reveal their true intent, to extract maximum retribution against SGM and Dr. Chaudhuri for their erroneously perceived slight. Plaintiffs' claims all fail as a matter of law.

Plaintiffs' Complaint must be dismissed pursuant to Federal Rule of Civil Procedure 12(b)(1), which is incorporated into Bankruptcy Rule 7012(b)(1), for two independent reasons. First, the Complaint must be dismissed because this Court has been divested of subject matter jurisdiction by the concurrently pending Appeals of the Court's Orders of November 14, 18, and 27, 2019. The contents of these Orders are intertwined with the facts at issue in this adversary proceeding and are certainly not "separate from, or collateral to, the matter involved in the

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[1] This Motion is being filed solely for the purpose of raising the defenses herein, which generally must be raised in the initial response to the Complaint. By filing this Motion and in accordance with Fed. R. Bankr. P. 7012(b), Defendants are not consenting to the jurisdiction of Bankruptcy Court over this adversary proceeding, and dispute the Bankruptcy Court's authority to enter final judgment in connection with this Adversary Proceeding. All Defendants are hereby reserving all rights, claims, and defenses.

appeal." Second, the Complaint must also be dismissed as to the Non-SGM Defendants because they have not consented to the Court's jurisdiction. The Non-SGM entities have nothing to do with this transaction – they 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, and have not waived their Seventh Amendment right to a jury trial. To the contrary, Plaintiffs knew of the existence of these entities at the time they entered into the APA with SGM and affirmatively opted to contract *solely* with SGM – a fact which, as explained below, also necessarily defeats Plaintiffs' specious alter-ego allegations.

But the Court's lack of subject matter jurisdiction is not the only fatal flaw with Plaintiffs' Complaint. Plaintiffs' Complaint must also be dismissed under Federal Rule of Civil Procedure 12(b)(6) because none of Plaintiffs' three causes of action state a claim as a matter of law.

At the outset, all of Plaintiffs' claims fail as a matter of law because the very facts pled in Plaintiffs' own Complaint indisputably establish that Plaintiffs did not comply with APA Section 8.7. Because they did not satisfy all conditions to close, Plaintiffs cannot establish that they were at all wronged by Defendants or suffered any damages as a result of any the alleged breaches or alleged misrepresentation. All of Plaintiffs' claims should be dismissed for this reason alone.

Plaintiffs' second cause of action for promissory fraud also fails for two additional reasons. First, Defendants' alleged misrepresentations were made during the course of the bankruptcy proceeding, are covered by the litigation privilege (Cal. Civ. Code. §47(b)), and cannot give rise to liability as a matter of law. Second, even if the alleged false promise was not privileged (it is), Plaintiffs' false promise claim also fails because Plaintiffs' allegations explicitly negate their fraud theory. Plaintiffs' fraud theory is that Defendants intended to breach the contract from the time they entered it. Compl. ¶ 102. Yet, Plaintiffs' specific allegations reveal that is not true. Plaintiffs definitively allege that Defendants "never anticipated" that Plaintiffs would satisfy the conditions in the contract and "believed they would never be obligated to pay the full purchase price." Compl. ¶ 58. This allegation conclusively shows that Defendants merely had the *opinion* they would never be *obligated* to pay, as opposed to a belief that they would be

obligated and *intention* to breach that obligation. Because they never anticipated the obligation arising, Defendants could not have the fraudulent intent necessary for fraud.

Plaintiffs' third cause of action for tortious breach of contract also fails because the law does not recognize a claim for "tortious breach of the implied covenant of good faith and fair dealing" in arms-length transactions such at the one at issue here. *See Pension Tr. Fund for Operating Engineers v. Fed. Ins. Co.*, 307 F.3d 944, 955 (9th Cir. 2002). Even if this was a valid claim, the allegations are also covered by the litigation privilege.

Plaintiffs' claims against the Non-SGM Defendants also fail for an independent reason – Plaintiffs' alter-ego allegations are legally defective. It is well-settled that a plaintiff may not invoke the alter-ego doctrine as a substitute for obtaining contractual guarantees from alleged alter-egos that the plaintiffs knew existed at the time of contracting. *See Lynch v. McDonald*, 155 Cal. 704, 706–07 (1909). Here, Plaintiffs admit in their Complaint that they had extensive knowledge of the relationship between SGM and the Non-SGM Defendants before they entered into the APA. *See* Compl. ¶¶ 41-44. With that knowledge, Plaintiffs agreed to contract solely with SGM, likely believing SGM's $30 million deposit gave them adequate security. Plaintiffs cannot circumvent this negotiated relationship with manufactured and false allegations of alter-ego. As explained below, Plaintiffs' boilerplate and conclusory conspiracy and agency allegations do not save their faulty alter-ego claims.

For these reasons, Defendants request that the Court dismiss all of Plaintiffs' claims and enter judgment in favor of Defendants.

II. PLAINTIFFS' ALLEGATIONS AND PROCEDURAL HISTORY

A. SGM's Offer to Purchase Hospitals

After 25 years of substantial operating losses and any number of attempts to rescue their hospitals, Plaintiffs filed their bankruptcy petition on August 31, 2018 and instituted a process to sell substantially all of their assets. Compl. ¶ 37.

SGM made an offer to purchase four of Plaintiffs' hospitals. Plaintiffs quoted large portions of SGM's offer in their Complaint. Compl. ¶ 41. Notably, the offer letter discussed in

detail the relationship between SGM and various other affiliated companies. *Id.* Regarding SGM, it stated:

> Strategic Global Management Inc. ("SGM or "Strategic") is a venture company used to acquire assets and businesses, through companies which are affiliated or associated (through common ownership and otherwise) with SGM, but which are not subsidiaries of SGM.

Id. The letter also explains that defendant KPC HealthCare, Inc. is owned by employees, and not Dr. Chaudhuri or another related entity: "KPC Health has been sold to an Employee Stock Ownership Plan ("ESOP") and now operates for the benefits of its employees but remains managed by SGM affiliates under a long-term agreement." *Id.*

To support its offer, SGM also provided a letter that showed that Dr. Chaudhuri had a certain amount of liquid assets personally. Compl. ¶ 42.

After various meetings with SGM representatives, Plaintiffs ultimately selected SGM to serve as the stalking-horse bidder. Compl. ¶ 43.

B. The Asset Purchase Agreement

With knowledge of these various related entities, Plaintiffs agreed to enter into an APA with just SGM. Compl., Exh. A ("APA"). The APA was subject to numerous conditions that would need to occur first before SGM would have an obligation to close. Some examples include:

- Because SGM was the stalking-horse bidder, Plaintiffs had the ability to find a buyer (or buyers) who would outbid SGM and then could, of course, choose to sell the assets to the other buyer and cancel the agreement with SGM (APA § 6.1);
- The APA was subject to Bankruptcy Court Approval (APA §§ 7.6 & 8.2);
- The APA needed approval by the California Attorney General (APA § 8.6); and
- Plaintiffs had to reach agreements with CMS and DHCS that would allow the transfer of the Medicare and Medi-Cal provider agreements free and clear of all known and unknown potential future claims. APA § 8.7.

When it entered into the contract, SGM made a "good faith deposit" of $30 million that could be lost if SGM did not comply with an obligation to close. APA § 1.2. Of course, Plaintiffs were obligated to return the deposit if they did not comply with their obligations. APA §§ 1.2 &

11.2.

C. Defendants' Alleged Mindset When Agreeing to the APA

Plaintiffs contend that Defendants believed that Plaintiffs would never be able to satisfy the conditions in the APA and thus Defendants would never be obligated to close at the price set forth in the agreement. Compl. ¶ 58. Plaintiffs alleged:

> In particular, it now appears that **Defendants never anticipated** that Debtors would obtain agreement from the Attorney General of California not to impose conditions on the sale transaction that materially differed from the conditions SGM developed and agreed to in Section 8.6 and Schedule 8.6 of the APA. Rather, **Defendants believed they would never be obligated to pay the full purchase price** (comprised of a cash payment $610 million, plus cure costs and assumption of liabilities) and instead concluded they would eventually be positioned to either walk away from the transaction or coerce the Debtors into a re-trade at a significantly lower purchase price.

Compl. at Preliminary Statement; ¶ 58 (emphasis added).

D. The Court Rejects the California Attorney General's Additional Conditions

On September 25, 2019, the Attorney General consented to the sale, but included conditions that were "materially different" than those SGM agreed to in the APA. Compl. ¶ 70. On October 23, 2019, the Bankruptcy Court issued a memorandum of decision finding that the materially different conditions the AG had imposed were not enforceable under the Bankruptcy Code. *Id.* ¶ 71. After this ruling, Plaintiffs and the AG reached a stipulation wherein the AG released its rights to appeal the ruling in return for the Bankruptcy Court setting aside this decision that could potentially be used as precedent that would weaken the AG in the future. Compl. ¶ 72; RJN Ex. F. SGM objected to the proposed order submitted by the AG and Plaintiffs. Compl. ¶ 72, RJN Ex. I. On November 14, 2019, the Bankruptcy Court entered the order that the property could be sold free and clear without any additional conditions. Compl. ¶¶ 73-74.

Plaintiffs again alleged that "**SGM did not anticipate** such a favorable order would be entered, but instead anticipated that a supplemental sale order would trigger the Evaluation Period under Section 8.6 of the APA, which would give SGM the option to withdraw from the transaction and/or coerce the Plaintiffs to agree to a substantially reduced purchase price." Compl. ¶ 76 (emphasis added). Defendants appealed the Court's November 14, 2019 Order to the District Court.

See RJN Ex. Q; Compl. ¶ 93.

On November 18, 2019, the Court issued an order [RJN Ex. K] and related memorandum [RJN Ex. J] which Plaintiffs state held: "The Debtors have complied with their obligation to obtain a final, nonappealable Supplemental Sale Order. Consequently, SGM is now obligated to promptly close the SGM Sale, provided that all other conditions to closing have been satisfied." Compl. ¶ 83. Defendants appealed the Court's November 18, 2019 Order to the District Court. *See* RJN Ex. R; Compl. ¶ 93.

E. Plaintiffs' Alleged Attempt to Satisfy APA Section 8.7

Section 8.7 of the APA obligated Plaintiffs to transfer their Medicare and Medi-Cal provider agreements to SGM pursuant to "settlement agreements" with CMS (Medicare) and DHCS (Medi-Cal). Such transfers are critical because the purchasing entity cannot obtain payment for services to patients covered by Medicare and Medi-Cal without a provider agreement. Section 8.7 provides:

> Sellers shall transfer their Medicare provider agreements pursuant to a settlement agreement . . . with the California Department of Health Care Services ("DHCS"), 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 . . . DHCS . . . has against the Seller or Purchaser for monetary liability arising under the . . . Medi-Cal provider agreements before the Effective Time; provided, however, that Purchaser acknowledges that it will succeed to the quality history associated with the relevant . . . Medi-Cal provider agreements assigned and shall be treated, for purposed of survey and certification issues as if it is the relevant Seller and no change of ownership occurred.

APA § 8.7.

For background, Plaintiffs had accumulated substantial liabilities to DHCS, which administers Medi-Cal in California, for unpaid Hospital Quality Assurance Fees ("HQA Fees"), and for Medi-Cal fee-for-service overpayments. On March 22, 2019, DHCS filed an objection to the proposed sale to SGM, arguing that the Medi-Cal provider agreements between it and the Plaintiffs were executory contracts that could not be transferred free and clear of claims, interests,

and encumbrances unless all defaults were cured, as required by Bankruptcy Code § 365(b). Thus, according to DHCS, the provider agreements associated with each of the hospitals could not be transferred to SGM unless and until the Plaintiffs cured the unpaid HQAF and fee-for-service overpayments. In response to DHCS's objection to the sale on April 10, 2019, the Plaintiffs argued that they did not need do so because the Medi-Cal provider agreements are non-executory contracts.

On May 2, 2019, the Court entered its Sale Order authorizing the sale of the Plaintiffs' assets to SGM free and clear of claims, liens, and encumbrances. RJN Ex. B. However, the Sale Order expressly carved out Medi-Cal Provider Agreements from the released claims, liens, and encumbrances. Specifically, the Sale Order states: "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 DHCS or a court order resolving the DHCS's objection." *Id.*

On September 11, 2019, DHCS filed a Supplemental Brief regarding its unresolved objection to the sale of the hospitals free and clear of Debtors' Medi-Cal Provider Agreements. RJN Ex. C. Plaintiffs contested DHCS's characterization of the Medi-Cal Provider Agreements as executory contracts. In its Supplemental Brief, DHCS claimed that it was owed in excess of $70 Million for unpaid HQA Fees and for reimbursement of fee for service overpayments which would have to be "cured" in order for the Provider Agreements to be transferred to SGM. RJN Ex C at 7-11. Plaintiffs filed a reply brief in which they once again argued that the Provider Agreements could be transferred free and clear of any liens and claims without compliance with Bankruptcy Code § 365, while recognizing the need to provide SGM with such a transfer to satisfy its contractual obligations. RJN Ex. D at 13.

On September 26, 2019, the Bankruptcy Court entered its Memorandum of Decision in which it agreed with Plaintiffs' contention that the Medi-Cal Provider Agreements could be transferred without compliance with Bankruptcy Code § 365(b). At the same time, the Court expressly acknowledged that APA Section 8.7 obligated Plaintiffs to transfer the Provider Agreements free and clear of any DHCS claims of liability. RJN Ex. E at 3 ("Each of the Hospitals has executed a Provider Agreement with DHCS. The Asset Purchase Agreement (the

"APA") [Dkt. No. 2305-1] 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.").

Despite the Court's statement in its Memorandum of Decision that it was not deciding the recoupment issue, on October 8, 2019, Plaintiffs lodged a proposed order seeking to prevent Medi-Cal from recouping payments from future SGM receivables in connection with the transfer of the Medi-Cal Provider Agreements. RJN, Ex. O. The next day, DHCS objected to Plaintiffs' proposed order, noting that "the proposed order is not 'consistent' with the Memorandum [of Decision]" and that "it overreaches by inserting gratuitous terms, to, for example, prohibit the Department's recoupment after the sale." RJN Ex. G.

On October 11, 2019, the Court agreed with DHCS that the Plaintiffs' proposed order was overreaching, stating that: "the Memorandum Decision did not determine whether DHCS' recoupment rights against SGM (if any) are extinguished by the transfer of the Provider Agreements free and clear of claims, interests, and encumbrances." RJN Ex. H at fn. 2. When entering the Order on October 11, 2019, the Court deleted the word "recoup" from the section providing for a transfer of the Medi-Cal Provider Agreements free and clear of claims, and expressly stated that it was reserving the issue of DHCS's recoupment rights against the Debtors and SGM for future adjudication. *Id*. The Court thus left open the question of whether the Medi-Cal Provider Agreements can be transferred free of recoupment rights.

Nevertheless, in their Complaint, Plaintiffs argued (notwithstanding: (1) Section 8.7's requirement of a "settlement agreement" and (2) the reservation of "recoupment in the October 11 order) that the Court's orders satisfied section 8.7 because they "afforded equal or better protection to SGM than any settlement could have…." Compl. ¶ 77.

F. Plaintiffs Send Notice of Closing.

On November 20, 2019, Plaintiffs sent SGM a letter representing that they had satisfied the conditions to close on November 19, 2019 and noticed a closing of the transaction for December 5, 2019. Compl. ¶ 85.

On November 27, 2019, the Court entered an Order and accompanying memorandum of decision that Plaintiffs contend held: (1) Plaintiffs' November 20 notice of closing was valid; and (2) all conditions to closing had been satisfied by Plaintiffs as of November 19, 2019, such that SGM was "obligated" to close the sale on December 5, 2019. RJN Ex. T, U. Defendants appealed the Court's November 27, 2019 Order to the District Court. *See* RJN Ex. S.

G. Plaintiffs' Claims

Plaintiffs filed this Adversary Proceeding on January 3, 2020. Plaintiffs assert three causes of action: (1) breach of contract; (2) promissory fraud; and (3) a claim described as "tortious breach of contract (breach of the implied covenant of good faith)."

Plaintiffs allege that SGM breached the APA by:

> (a) failing to consummate and close the Sale transaction in accordance with the APA; (b) failing to have funds available to close the Sale at the price set forth in the APA; (c) representing in Section 3.9 of the APA and elsewhere that they had the ability to obtain "funds in cash in amounts equal to the purchase price;" (d) attempting to coerce Plaintiffs to agree to a substantially reduced purchase price, (e) failing to cooperate with Plaintiffs and move with alacrity towards closing the SGM Sale; (f) making unfounded and untimely assertions of alleged Material Adverse Effects; (g) asserting entitlement to an "Evaluation Period" when no such period existed after the entry of the Enforcement Order, the Section 8.6 Order and the Closing Order; (h) appealing the Enforcement Order to avoid its' obligation to close and despite the APA's requirement that Defendants cooperate to render it a final, nonappealable order; and (i) filing meritless and frivolous Notices of Appeal.

Compl. ¶ 100.

For their promissory fraud claim, Plaintiffs contend that at the time SGM entered into the APA, "Defendants had no intention of performing in accordance with the APA, including (without limitation) by paying the $610 million purchase price." Compl. ¶ 102.

Plaintiffs also assert a claim for tortious breach of contract, which is largely duplicative of its breach of contract claim. Compl. ¶ 107.

Based on allegations of alter-ego, agency, and conspiracy, Plaintiffs also assert the same three claims against the Non-SGM Defendants. Compl. ¶¶ 18-26.

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III. THE COURT LACKS SUBJECT MATTER JURISDICTION OVER THE ADVERSARY PROCEEDINGS.

A. The Court Has Been Divested of Jurisdiction Due to SGM's Pending Appeals.

The Court should dismiss Plaintiffs' Complaint because it lacks subject matter jurisdiction over the proceedings in light of SGM's currently pending Appeals. The pending Appeals divest this Court of jurisdiction over the Adversary Proceeding, because it raises claims related to the rulings set forth in this Court's November 14, November 18, and November 27 Orders, all of which are pending appeal in the District Court. (*See, e.g.* Compl. ¶¶ 74-76; 83-95; 100; 107).

As Plaintiffs concede,[2] the Ninth Circuit has held that where, as here, the subject matter of an appeal covers the same ground as the Adversary Proceedings, the Court is "'automatically divested of its authority to proceed with trial pending appeal.'" *Rodriguez v. Cty. of Los Angeles*, 891 F.3d 776, 791 (9th Cir. 2018) (quoting *Chuman v. Wright*, 960 F.2d 104, 105 (9th Cir. 1992). This is a *mandatory* claims processing rule that *automatically* divests the Court of jurisdiction. *Id.*[3]

To be clear, the Orders on appeal need not be "dispositive" of the issues in the adversary proceeding to implicate the mandatory divestiture rule. The lower court is divested of jurisdiction to control *any* aspects of the proceedings "*involved* in the appeal." *Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982) (emphasis added). In short, the Court lacks subject matter jurisdiction to determine any issues involved in the appeal unless it is affirmatively shown that such issues are "separate from, or collateral to, the matter involved in the appeal…." *Ashker v. Cate*, 2019 WL 1558932, at *3 (N.D. Cal. Apr. 10, 2019).

Plaintiffs have not shown, because they cannot show that the issues involved in the appeal are "separate from or collateral to" the Adversary Proceedings. To the contrary, Plaintiffs'

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[2] Plaintiffs relied heavily on *Rodriguez v. Cty. of Los Angeles*, 891 F.3d 776, 791 (9th Cir. 2018) in their opposition to SGM's motion to stay the adversary proceedings.

[3] This mandatory divestiture rule is subject to only two exceptions – where the lower court has certified the appeal as frivolous or where the litigant has waived its right to a stay. *Rodriguez v. Cty. of Los Angeles*, 891 F.3d 776, 791 (9th Cir. 2018). Neither of these limited exceptions are applicable here.

Complaint states upfront that it seeks damages because "Defendants … violated the Bankruptcy Court's orders requiring them to close the sale…." Compl. at p. 3. Indeed, *Plaintiffs' breach of contract and tortious breach claims are both premised, inter alia, on Defendants' "filing meritless and frivolous Notice of Appeal."* Compl. ¶¶ 100; 107. The Complaint is replete with references to issues addressed in the Orders on appeal. Compl. ¶¶ 63-65; 70-76; 77; 84-85; 88-91; 100; 107. And while the Court has held that "Debtors cannot rely *solely* upon the Material Adverse Effect Order to support their allegation that SGM was obligated to close as of December 5, 2019" [Dkt. No. 29], the fact that that Order is even *potentially* applicable to Plaintiffs' claims at issue in this Adversary Proceeding evidences that it is neither "separate from" or "collateral to" the Adversary Proceedings. As such, the Court lacks subject matter jurisdiction to adjudicate this case while the Orders are on Appeal. Plaintiffs' Complaint should be dismissed pursuant to Federal Rule of Civil Procedure 12(b)(1).

B. The Adversary Proceedings Are a Non-Core Matter & the Non-SGM Defendants Have Not Consented to Jurisdiction.

The Adversary Proceedings are a non-core matter because Plaintiffs' claims "do not depend on bankruptcy laws for their existence and … could proceed in another court….'" *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1008 (9th Cir. 1997). Plaintiffs' Complaint exclusively contains state law claims for breach of contract, fraud, and "tortious breach of contract (implied covenant of good faith and fair dealing)" relating to SGM's alleged breach of the APA. Such claims are inherently "non-core." *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). It is also 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, and have not waived their Seventh Amendment right to a jury trial.

As such, the Non-SGM Defendants are not subject to the Bankruptcy Court's jurisdiction. *In re Miller*, 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 bankruptcy court may not exercise jurisdiction over the non-SGM defendants as a matter of law. *See Stern v. Marshall*, 564 U.S. 462, 503 (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); *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…."); *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.").

IV. PLAINTIFFS' COMPLAINT FAILS TO STATE A CLAIM AS A MATTER OF LAW

A. Plaintiffs' Claims All Fail As A Matter of Law Because Plaintiffs Did Not Satisfy APA Section 8.7.

Plaintiffs' claims for breach of contract, breach of the implied covenant of good faith, and fraud all depend on Plaintiffs first establishing that they satisfied all of the conditions to close the sale as of November 19, 2019, when they represented to SGM that they had satisfied all conditions to closing and demanded that SGM close on December 5, 2019. If Plaintiffs did not satisfy the conditions to close as of November 19, 2019, when they represented to SGM that they had satisfied all conditions to closing and demanded that SGM close on December 5, 2019 and Plaintiffs cannot possibly establish that any of the harm they have suffered was in anyway attributable to SGM.[4] Of course, Plaintiffs have the burden to establish that all conditions

[4] Resulting damages is an element of breach of contract and fraud claims. *See Richman v. Hartley*, 224 Cal.App.4th 1182, 1186 (breach of contract requires "resulting damages"); *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996) (stating same for fraud elements).

precedent have been satisfied. *Consolidated World Investments, Inc. v. Lido Preferred Ltd.*, 9 Cal. App. 4th 373, 380 (1992) ("[W]here defendant's duty to perform under the contract is conditioned on the happening of some event, the plaintiff must prove the event transpired.").

Here, Plaintiffs cannot establish that they satisfied the condition stated in APA Section 8.7. APA Section 8.7 obligated Plaintiffs to transfer their Medi-Care and Medi-Cal provider agreements to SGM pursuant to settlements with the CMS and DHCS. Section 8.7 provided:

> Sellers shall transfer their Medicare provider agreements pursuant to a settlement agreement with the Centers for Medicare and Medicaid Services ("CMS") and shall transfer their Medi-Cal provider agreements pursuant to a settlement agreement with the California Department of Health Care Services ("DHCS"), which such settlement agreements shall result 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 under the Medicare or Medi-Cal provider agreements, whether known or unknown, that CMS or DHCS, as applicable, has against the Seller or Purchaser for monetary liability arising under the Medicare or Medi-Cal; provider agreements before the Effective Time; provided, however, that Purchaser acknowledges that it will succeed to the quality history associated with the relevant Medicare or Medi-Cal provider agreements assigned and shall be treated, for purposed of survey and certification issues as if it is the relevant Seller and no change of ownership occurred.

On November 20, 2019, Plaintiffs sent Defendants a letter representing that all conditions to close as of November 19, 2019, contrary to their representation to SGM that they had done so, had been satisfied on November 19, 2019 and that the sale should close by December 5, 2019. Compl. at ¶ 85. For that notice of closing to be valid, Plaintiffs need to have satisfied Section 8.7 before November 20, 2019. However, Plaintiffs cannot meet this burden because Plaintiffs admit in their Complaint that they had not satisfied Section 8.7 because they had not obtained a settlement agreement with DHCS before November 20, 2019. *Id.* at ¶ 77. Plaintiffs admit that, at the earliest, this agreement was not reached until November 22, 2019 (which, as discussed more below, is also not true). Nevertheless, because Plaintiffs admit their notice of closing was invalid, Defendants never had an obligation to close the transaction.

In their Complaint, Plaintiffs argue that they satisfied Section 8.7 even though they did not obtain a settlement agreement with DHCS. Plaintiffs contend they secured an "Order [Docket No.

3372] from the Bankruptcy Court authorizing the transfer free and clear of any interests asserted by DHCS, in addition to the Sale Order which they contend terminated any creditor's recoupment rights [Docket No. 2306]." Plaintiffs' contend those "Orders afforded equal or greater protection to SGM than any settlement could have, thereby satisfying Section 8.7." This argument fails for multiple reasons.

1. Only A Settlement Agreement Satisfies Section 8.7.

Section 8.7 unambiguously requires Plaintiffs to reach a "Settlement Agreement" with DHCS. There is nothing in Section 8.7 that allows Plaintiffs to satisfy this condition through some alternative means that they unilaterally decide is as good as a Settlement Agreement. SGM bargained for a Settlement Agreement, signed by DHCS, that would guarantee that it would not have liability or a potential fight with DHCS. At best, the alleged orders that protected SGM would just give SGM an argument in a future dispute with DHCS. An argument is not an equal trade for a Settlement Agreement that would fully mitigate any risk and the need for making any argument at all.

2. The Court Orders Do Not Afford "Equal or Better Protection" Than A Settlement Agreement.

A review of the Orders also disputes Plaintiffs' characterization that these Orders "afforded equal or better protection" than a Settlement Agreement. Specifically, the Court's order on October 11 – the order at Docket No. 3372 [RJN Ex. H] referenced in the Complaint – expressly stated that the Court was reserving the issue of DHCS's recoupment rights against the Debtor and SGM for future adjudication. Accordingly, the risk of having the DHCS recoup from SGM the tens of millions of dollars of its claims against Plaintiffs, was the opposite of the full release and discharge required by Section 8.7.

On March 22, 2019, DHCS filed an objection with the Bankruptcy Court to Plaintiffs' proposed sale to SGM arguing that the Medi-Cal provider agreements between it and Plaintiffs were executory contracts under Bankruptcy Code §365, which could not be transferred to SGM free and clear of claims, interests, and encumbrances. Thus, according to DHCS, the Provider Agreements associated with each Hospital could not be transferred to SGM unless and until

Plaintiffs cured the unpaid Hospital HQA Fees and fee-for-service overpayments as required by Bankruptcy Code §365(b).

In response, on April 10, 2019, despite its obligations to SGM to reach a settlement with DHCS, Plaintiffs argued in its brief to the Bankruptcy Court that it not need do so, because the Medi-Cal agreements are non-executory contracts.

On May 2, 2019, the Bankruptcy Court entered its Sale Order authorizing the sale of Plaintiffs' assets to SGM free and clear of claims, liens, and encumbrances. Rather than resolve the executory contract dispute, the Sale Order expressly carved out Medical Provider Agreements from the released claims, liens, and encumbrances. Specifically, the Sale Order states: "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 DHCS or a court order resolving the DHCS's objection." RJN Ex. B.

On September 11, 2019, DHCS again objected to the sale of the hospitals free and clear of Plaintiffs' Medi-Cal Provider Agreements. RJN Ex. C. On September 26, 2019, the Bankruptcy Court issued its Memorandum of Decision Authorizing Debtors to Sell Medi-Cal Provider Agreements, Free and Clear of Interests Asserted by The California Department of Health Care Services, Pursuant to § 363(F)(5). RJN Ex. E. In the Order, the Court ruled that the Medi-Cal Provider Agreements are not executory contracts and could be sold free and clear of liens, claims, and interests. However, importantly, the Court specifically stated that it was declining to decide the issue of applicability of recoupment subsequent to the transfer of Medi-Cal Provider Agreements. RJN Ex. H

Plaintiffs' lodged a proposed order with respect to the Memorandum of Decision on October 8, 2019. Despite the Court's clear statement that it was not deciding the recoupment issue, Plaintiffs' proposed order sought to prohibit recouping payments owed to SGM in connection with the transfer of the Medi-Cal Provider Agreements.

Unsurprisingly, the next day, on October 9, 2019, DHCS objected to Plaintiffs' proposed order, noting that "the proposed order is not 'consistent' with the Memorandum [of Decision] and that "it overreaches by inserting gratuitous terms, to, for example, prohibit the Department's

recoupment after the sale." RJN Ex. G.

On October 11, 2019, the Court agreed with DHCS that Plaintiffs' proposed order was overreaching. The Bankruptcy Court stated "the Memorandum Decision did not determine whether DHCS' recoupment rights against SGM (if any) are extinguished by the transfer of the Provider Agreements free and clear of claims, interests, and encumbrances." RJN Ex. H at fn. 2. As such, when entering the Order, the Court deleted the word "recoup" from the section providing for a transfer of the Medi-Cal Provider Agreements and expressly stated that it was reserving the issue of DHCS's recoupment rights for future adjudication. The Court explained:

> Provided, however, that nothing in this paragraph shall be construed to limit whatever rights DHCS may or may not have to withhold, under principles of equitable recoupment, payments owed by DHCS 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 HQAF Program. RJN Ex. H (Emphasis added.)

DHCS appealed from the Court's October 11 Order. Thus, as of the entry of the Court's October 11 Order, Plaintiffs (1) had no "settlement agreement" with DHCS to satisfy the closing condition of Section 8.7, (2) the only court order permitting Plaintiffs to transfer their the Medi-Cal Provider Agreements to SGM expressly left open DHCS's right to recoup from future SGM receivables and (3) the order authorizing the transfer was not final.

Even if Plaintiffs could substitute their obligation to obtain a settlement agreement with DHCS with an alleged "better" court order, Plaintiffs cannot meet their burden of establishing that this order offered equal protection because the Court expressly reserved the issue regarding DHCS's recoupment rights. In other words, had SGM closed the sale on December 5 as the Debtors had demanded, SGM would have been at risk for DHCS's recoupment from SGM's accounts receivables acquired in the sale for what had become $80 million of claims.

3. Plaintiffs' Alleged November 22, 2019 Settlement Agreement With DHCS Does Not Save Plaintiffs.

Plaintiffs also allege that they reached a settlement agreement with DHCS on November 22, 2019. Compl. ¶ 77. As an initial matter, even if Plaintiffs did obtain a settlement agreement with DHCS on November 22, 2019, this would not justify Plaintiffs' improper notice of closing

that they sent two days earlier on November 20. That said, Plaintiffs have admitted in prior Court proceedings and in open court that they did not have any such agreement with DHCS.

Indeed, at a Court hearing on November 26, 2019 and were still "negotiating". Plaintiffs cannot seriously argue that "a settlement in principle" which was still being "negotiated" satisfied the asset purchase agreement's obligation with regard to Medi-Cal [referring to the prior court orders], we also have continued to negotiate for a settlement and believe we have a settlement in principle, which we are now negotiating the terms of a written settlement agreement." RJN Ex. L. Plaintiffs thus admitted that they did not have a final enforceable settlement agreement with DHCS as of November 26, 2019. Plaintiffs cannot seriously argue that "a settlement in principle" satisfied Section 8.7. Again, at best, this would just leave SGM with an argument – and a bad one – that DHCS had released its claims. [5]

Because Plaintiffs cannot establish they satisfied section 8.7, Plaintiffs' claims should all be dismissed.

B. Plaintiffs' Promissory Fraud Claim Fails As a Matter of Law.

As explained below, Plaintiffs' claim for promissory fraud fails for two separate and distinct reasons. First, Plaintiffs' claim fails because the alleged false promises are protected by the litigation privilege. Second, even if the claims were not privileged, Plaintiffs' claims also fail because Plaintiffs' specific allegations contradict their fraud theory.

1. The Alleged Fraudulent Representation is Protected by the Litigation Privilege.

One of the many purposes of the litigation privilege codified in section 47(b) of the California Civil Code is to "promote the effectiveness of judicial proceedings by encouraging

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[5] Defendants believe that Plaintiffs may now attempt to argue that Plaintiffs' December 9, 2019 settlement with DHCS somehow satisfies Section 8.7. Such an argument would fail for numerous reasons. First, a settlement agreement executed on December 9, 2019 proves that the Section 8.7 condition was unsatisfied on November 19, 2029, when Plaintiffs represented that all conditions to closing had been satisfied and, obviously, cannot have required SGM to close *four days earlier* on December 5, 2019. Second, Plaintiffs' settlement with DHCS did not satisfy the requirements of Section 8.7 because it did not release all known and *unknown* claims as required by Section 8.7.

'open channels of communication and the presentation of evidence….'" *Silberg v. Anderson*, 50 Cal. 3d 205, 213 (1990) (quoting *McClatchy Newspapers, Inc. v. Superior Court*, 189 Cal. App. 3d 961, 970 (Ct. App. 1987). Courts have explained that "such open communication is 'a fundamental adjunct to the right of access to judicial and quasi-judicial proceedings.'" *Id.* (quoting *Pettitt v. Levy*, 28 Cal. App. 3d 484, 490-491, 104 (1972)). To be protected, the communications just need to "have some connection or logical relation to the action." *Id.; see also Sacramento Brewing Co.*, 75 Cal. App. 4th 1082, 1089 (1999) ("The privilege should be denied only where it is so palpably irrelevant to the subject matter of the action that no reasonable person can doubt its irrelevancy.").

"To effectuate its vital purposes, the litigation privilege is held to be absolute in nature." *Silberg*, 50 Cal. 3d at 215. And, like the anti-SLAPP statute, "the litigation privilege is broadly applied and doubts are resolved in favor of the privilege." *Ramalingam v. Thompson*, 151 Cal. App. 4th 491, 500 (2007) (citations omitted).

It is also well-settled that a "bankruptcy proceeding is a judicial proceeding within the scope of California's litigation privilege." *In re Cedar Funding, Inc.*, 419 B.R. 807, 825 (B.A.P. 9th Cir. 2009); *see also Sacramento Brewing Co.*, 75 Cal. App. 4th 1082, 1086 (1999) (finding privilege applied to statement made in a motion filed in a bankruptcy proceeding); *Shoemaker v. Siegel*, No. 1:17-BK-015182-GM, 2017 WL 3671154, at *3 (C.D. Cal. Aug. 25, 2017), *aff'd sub nom. In re Shoemaker*, 749 F. App'x 565 (9th Cir. 2019) (finding that litigation privilege applied to claims of fraud and negligent misrepresentation arising from statements made in connection with a bankruptcy proceeding).

Of course, given its absolute nature, section 47(b) provides a complete defense to claims arising from protected speech, including claims of fraud. *Id.* (citing numerous supporting cases). This includes promissory fraud claims. *See, e.g., Navarro*, at 841-42 (2005) (finding Plaintiffs' claims that IHOP did not intend to comply with the release was also barred by the litigation privilege).

Here, like *Navarro*, Plaintiffs' claims for promissory fraud arise from representations made during the course of a judicial proceeding. They are thus immune from tort liability based

on the litigation privilege. The Court should thus strike Plaintiffs' fraud claim for this reason alone.

2. Plaintiffs' Allegations Do Not Support Fraud.

The elements of fraud are: "(a) misrepresentation (false representation, concealment, or nondisclosure); (b) knowledge of falsity (or 'scienter'); (c) intent to defraud, i.e., to induce reliance; (d) justifiable reliance; and (e) resulting damage." *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996) (quoting Witkin, Summary of Cal. Law (9th ed. 1988) Torts § 676)). In general, statements about the future are considered to be opinions or predictions, not statements or fact, and are thus not actionable. *See Mueller v. San Diego Entm't Partners, LLC*, 260 F. Supp. 3d 1283, 1296 (S.D. Cal. 2017). That said, "an action for promissory fraud may lie where a defendant fraudulently induces the plaintiff to enter into a contract." *Lazar v. Superior Court*, 12 Cal. 4th 631, 638 (1996). However, importantly, to be actionable fraud, the plaintiff must establish that the defendant did not intend to comply with the contract at the time the defendant entered the contract. *Magpali v. Farmers Group, Inc.*, 48 Cal. App. 4th 471, 481 (1996) ("A promise of future conduct is actionable as fraud only if made without a present intent to perform.")

Here, Plaintiffs' own factual allegations contradict their claim that Defendants intended to breach the APA when SGM executed it. According to Plaintiffs, Defendants "never anticipated that Plaintiffs would obtain agreement from the Attorney General of California not to impose conditions on the sale transactions" and thus "Defendants believed they would never be obligated to pay the full purchase price…." Compl. at Preliminary Statement; ¶58 (emphasis added). According to Plaintiffs' own allegations, Defendants did not intended to breach a contractual obligation; rather, Defendants just erroneously failed to anticipate the possibility that Plaintiffs would be able to satisfy the conditions in the contract. This is not fraud. Plaintiffs' allegations, at best, show that Defendants misjudged Plaintiffs' ability to satisfy the contract's conditions. However, because Defendants "never anticipated that they would be obligated to pay the full purchase price," Plaintiffs cannot establish that Defendants did *intended* to breach an alleged obligation to pay that price. As Plaintiffs allege, Defendants never even imagined the possibility

that they would be obligated to pay the price and thus could not have planned to breach that obligation. Defendants thus did not have the requisite fraudulent intent as a matter of law.

Plaintiffs' fraud theory is also nonsensical as a practical matter. SGM made a good faith deposit of $30 million when it entered into the APA. If SGM did not comply with an obligation to close the sale, that $30 million deposit would be lost. It defies credulity to believe that any party would deposit $30 million if it intended not to comply with an obligation to close.

Because Plaintiffs' allegations conclusively establish that Defendants did not have a present intent to not perform under the contract, Plaintiffs' claim for promissory fraud fails as a matter of law and should be dismissed.

C. Plaintiffs' Claim for "Tortious Breach of Contract (Breach of the Implied Covenant of Good Faith and Fair Dealing)" Fails as A Matter of Law.

Plaintiffs' third cause of action for "Tortious Breach of Contract (Breach of the Implied Covenant of Good Faith and Fair Dealing)" is not a cognizable claim under California law and must be dismissed.

It is well known that in California, a "person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations." *Stop Loss Ins. Brokers, Inc. v. Brown & Toland Medical Group*, 143 Cal. App. 4th 1036, 1041 (2006); *Aas v. Superior Court*, 24 Cal.4th 627, 643 (2000) ("A person may not ordinarily recover in tort for the breach of duties that merely restate contractual obligations."). [6] For decades, the California Supreme Court has

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[6] For this reason, Plaintiffs' promissory fraud claim also violates California's economic loss rule. *JMP Sec. LLP v. Altair Nanotechnologies Inc., 880 F. Supp. 2d 1029, 1043 (N.D. Cal. 2012)* (dismissing the plaintiffs' promissory fraud claim under the economic loss rule because it "consist[ed] of nothing more than [defendants'] alleged failure to make good on its contractual promises."); *De Nora Water Tech., Inc. v. Nesicolaci*, 2017 WL 8110006, at *3 (C.D. Cal. Aug. 2, 2017) ("Counterclaimants attempt to take 'allegations underpinning a straightforward claim for breach of [an employment] contract and recast them as torts,' which 'consist of nothing more than [DNWT's] alleged failure to make good on its contractual promises.' []The economic loss rule bars such a claim under tort, unless Counterclaimants can point to conduct independent of DNWT's alleged breach of contract.") (internal citation omitted); *Darbeevision, Inc. v. C&A Mktg., Inc.*, 2018 WL 5880618, at *2 (C.D. Cal. Aug. 30, 2018) ("But the two inducing 'false promises' that Darbeevision cites are Defendants' statements that C&A would 'market and promote the product and ... purchase specified quantities of the product.' These promises are identical to C&A's duties under the contract, and the only allegation Darbeevision uses to show

recognized that there is no such claim as "tortious breach of contract." *See Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503, 514 (1994) ("One contracting party owes no general tort duty to another not to interfere with performance of the contract; its duty is simply to perform the contract according to its terms."). For that reason, the law *does not recognize* a claim for "tortious breach of the implied covenant of good faith and fair dealing" in arms-length transactions such at the one at issue here. *See Pension Tr. Fund for Operating Engineers v. Fed. Ins. Co.*, 307 F.3d 944, 955 (9th Cir. 2002); *Denholm v. Houghton Mifflin Co.*, 912 F.2d 357, 361 (9th Cir. 1990). Under California law, "no cause of action for the tortious breach of the implied covenant of good faith and fair dealing can arise unless the parties are in a special relationship with fiduciary characteristics. Thus, the implied covenant tort is not available to parties of an ordinary commercial transaction where the parties deal at arms' length." *Pension Tr. Fund for Operating Engineers*, 307 F.3d at 955 (internal citations omitted); *see also Velazquez v. GMAC Mortg. Corp.*, 605 F. Supp. 2d 1049, 1072 (C.D. Cal. 2008) (dismissing claim for "tortious breach of the implied covenant of good faith and fair dealing" and recognizing that "*tort* recovery for breach of the covenant … 'is available only in limited circumstances, generally involving a special relationship between contracting parties.'") (internal citation omitted, emphasis in original); *California Joint Powers Ins. Auth. v. Munich Reinsurance Am., Inc.*, 2008 WL 1885754, at *2 (C.D. Cal. Apr. 21, 2008) ("Because the covenant of good faith and fair dealing essentially is a contract term that aims to effectuate the contractual intentions of the parties, compensation for its breach has almost always been limited to contract rather than tort remedies.") (the Hon. Dale S. Fischer, presiding).

Plaintiffs have not (because they cannot) alleged that the parties had any "special

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that the promises were 'fraudulent' is that C&A didn't perform them. As a result, Darbeevision hasn't sufficiently alleged that Defendants' committed a tort independent of the alleged breach of contract."); *Grand Fabrics Int'l Ltd. v. Melrose Textile*, Inc., 2018 WL 5880175, at *3 (C.D. Cal. Aug. 6, 2018) ("The assurances allegedly made by Plaintiff related to its duty under the contract, *i.e.*, that Plaintiff would perform its end of the bargain by sending compliant fabrics. To allow a fraud claim under these facts would allow a fraud claim to be filed every time a contract was allegedly breached.")

relationship," such as that of an insurer and insured or fiduciary and beneficiary, that would permit them to assert a claim for tortious breach of the duty of good faith and fair dealing. As this Court has already held:

> ***Arm's Length Transaction***. The APA and other documents and instruments (the "Transaction Documents") related to and connected with this transaction (the "Transaction") and the consummation thereof were ***negotiated and entered into by the Debtors and Strategic Global Management, Inc. ("SGM"), as Purchaser under the APA without collusion, in good faith and through an arm's length bargaining process***.

RJN Ex. B (emphasis added); *see also id.* ("the negotiation and execution of the APA and related Transaction Documents were conducted in good faith and constituted an arms' length transaction.").

The claim must be dismissed as a matter of law.[7]

D. Plaintiffs' Alter Ego Claims Must Be Dismissed.

To establish alter-ego liability under California law, a plaintiff must plead and prove: (1) that there is "such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist" and (2) that there will be an "inequitable result if the acts in question are treated as those of the corporation alone." *Gerritsen v. Warner Bros. Entm't Inc.*, 116 F. Supp. 3d 1104, 1136 (C.D. Cal. 2015). Plaintiffs cannot satisfy either element against any of the Non-SGM Defendants. We begin with the second element.

1. Plaintiffs Cannot Use Alter-Ego As a Substitute for Negotiating Contractual Guarantees with Known Related Entities.

To satisfy the second element, "a plaintiff must plead facts sufficient to demonstrate that 'conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the

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[7] Moreover, the claim should also be dismissed because it is duplicative of Plaintiffs' breach of contract and fraud claims. Where, as here, a claim for breach of the implied covenant of good faith and fair dealing merely reiterates the cause of action for breach of contract; it is legally superfluous and should be dismissed. *See Careau & Co. v. Security Pacific Business Credit, Inc*. 222 Cal. App. 3d 1371, 1394–95 (1990); *Wilson v. Gateway, Inc.*, 2010 WL 11520532, at *3 (C.D. Cal. Jan. 25, 2010).

corporate form.'" *Tatung Co., Ltd. v. Shu Tze Hsu*, 217 F. Supp. 3d 1138, 1176 (C.D. Cal. 2016) (quoting *Stewart v. Screen Gems-EMI Music, Inc.*, 81 F. Supp. 3d 938, 963 (N.D. Cal. 2015)).

A plaintiff cannot invoke the alter-ego doctrine when the plaintiff had knowledge of the existence of the entity defendant's principal, but nevertheless decided to contract solely with the defendant instead of or in addition to the principal. *See Lynch v. McDonald*, 155 Cal. 704 (1909); *see also Finley v. Union Joint Stock Land Bank of Detroit*, 281 Mich. 214, 221–22 (1937) ("A claimant of the subsidiary corporation cannot be said to have been affected by the parent's use of the subsidiary as a mere instrumentality, if with knowledge of all the facts at the time he entered into the transaction with the subsidiary, he accepted or approved the relationship between the two corporations."); *Brunswick Corp. v. Waxman*, 459 F. Supp. 1222, 1231–32 (E.D.N.Y. 1978), aff'd, 599 F.2d 34 (2d Cir. 1979) (holding that the plaintiff was barred from piercing the corporate veil of a no-asset special purpose entity established solely to acquire trade equipment, as the plaintiff was aware of that fact).

The California Supreme Court's ruling in *Lynch v. McDonald* is instructive. In *Lynch*, the plaintiff entered into a services agreement to serve as the defendant mining company's attorney and expert. *Id*. at 705. The company's president executed the services agreement on behalf of the corporation. *Id*. When a dispute arose between the parties, the plaintiff sued the company and brought an alter-ego claim against the president, claiming that the president owned nearly all of the capital stock in the company and controlled the company's policies. *Id*. The California Supreme Court rejected the plaintiff's alter-ego theory because the plaintiff was thoroughly familiar with all the facts concerning the president's relation to the company. *Id*. at 706. The court reasoned that "[i]f this was an action by a stranger to the facts, who had been injured by ignorance of [the president's] holding of nearly all of the stock of the company, there might by some force in [the plaintiff's] position, and some necessity for the application of the [alter ego doctrine]." *Id.* The court continued that "if [the plaintiff] was content to act under a contract which [the president] refused to sign except as an officer of the company, he cannot complain that [the president], who was not a party signatory to the instrument, is not bound." *Id.*

The court's ruling in *Brunswick Corp. v. Waxman* further illustrates this principle. In that

case, the Waxmans were general partners interested in expanding their bowling operations and contacted Brunswick Corporation to discuss the purchase of bowling equipment. *Brunswick Corp. v. Waxman*, 459 F. Supp. at 1224. The Waxmans indicated that they were interested in making the bowling equipment purchases through a no-asset special purpose entity that would act as the purchaser and obligor on any conditional sale agreements. *Id*. Brunswick agreed, and the Waxmans formed the Waxman Construction Corp. ("Construction Corp."), a no-asset corporation to act as signatory on the sale contracts. *Id*. Recognizing that Construction Corp. did not have assets, Brunswick performed due diligence on its principals and considered the location, population, and presence of competitors to the proposed bowling alleys to determine the success of the bowling alleys. *Id.* Based on their due diligence, Brunswick was aware that the Waxmans were successful businessmen who had successfully operated other bowling lanes, and knowingly accepted the no-asset Construction Corp. as the obligor on a series of conditional sale contracts. *Id.*

While Construction Corp. was the signatory and obligor on the conditional sale contracts, it did not operate the bowling alleys. *Id.* at 1225. Rather, the bowling alleys were operated by the Waxmans in their capacity as partners. *Id*. No rent was paid to Construction Corp. for the use of the equipment. *Id*. Instead, prior to each of Construction Corp.'s payments to Brunswick, the Waxmans would transfer the exact amount of the payment from their bank accounts to Construction Corp. to meet the installment. *Id*. Brunswick was able to establish that Construction Corp. did not follow corporate formalities. *Id*. When Construction Corp. defaulted on its obligations, Brunswick sued the Waxmans for alter ego liability claiming that the Waxmans operated Brunswick's equipment in their individual capacities in complete disregard of corporate formalities and have rendered themselves personally liable for the entities' obligations. *Id*. at 1228. The Waxmans argued, *inter alia*, that Brunswick was fully aware that Construction Corp. lacked capitalization, and with that knowledge consented to contracting solely with that entity. *Id*. at 1231-32. The court agreed and dismissed Brunswick's complaint. *Id*. at 1231-32, 1234. The court relied on the long standing rule that "[t]he plaintiff was not wronged by the fact that the corporation was organized with a trifling capital and could not live except upon borrowed money;

nor by the fact that the lenders insisted upon security. [The plaintiff] knew the essential facts and accepted the situation." *Id*. at 1232 (quoting *Hanson v. Bradley*, 298 Mass. 371, 10 N.E.2d 259, 264 (S.J.C.1937)). The court reasoned that undercapitalization might, under some circumstances indicate that the corporate form was being used to mislead creditors and should be pierced, Brunswick had full knowledge of the lack of capitalization, and consented to it. *Id*. Further, the court reasoned that Brunswick was aware or otherwise on constructive notice that the bowling alleys were being operated by the Waxmans. *Id.* It held that "[w]hen one extends credit to a corporation in the large amounts involved in this case and relies upon that corporation, it is reasonable to assume that he will investigate the corporation's capitalization, its assets and its operations, and that his contract is made on this basis and not on the individual credit of the dominant stockholders." *Id.*

The district court's dismissal was affirmed by the United States Court of Appeals, Second Circuit, which held: "[u]nder these circumstances Brunswick obtained precisely what it bargained for, and it did not bargain for or contemplate the individual liability of the Waxmans which it now seeks to enforce. To pierce the corporate veil here would not in our view accomplish justice or equity but would in fact thwart that end. We therefore refuse to disregard the corporate entity in this case. The creation of the dummy corporation under these circumstances to eliminate personal responsibility should be respected." *Brunswick Corp. v. Waxman*, 599 F.2d 34, 36 (2d Cir. 1979).

The facts presented in this case are strikingly similar to those in *Lynch* and *Brunswick*. Plaintiffs, in conjunction with their multiple attorneys and advisors, including Cain Brothers ("Cain"), reviewed, investigated, and ultimately approved SGM's offer to be the stalking-horse bidder of the Plaintiffs' assets. *See* Compl. ¶ 40. The deal was valued at $610,000,000. *Id*. SGM's offer letter, dated August 13, 2018, was one of the documents that Plaintiffs purportedly relied on in entering into the APA. *Id*. at ¶¶ 40-41. Crucially, that document specified that SGM is a "venture company used to acquire assets and businesses, through companies which are affiliated or associated (through common ownership and otherwise) with SGM, but which are not subsidiaries of SGM." *Id*. at ¶ 41. It was clear to Plaintiffs from SGM's initial offer letter that SGM would serve as a special purpose acquisition entity used to purchase the assets.

As part of the lengthy due diligence process with Plaintiffs and their advisors were, among other things, provided a letter from Dr. Chaudhuri's bank supporting Dr. Chaudhuri's liquidity. *Id*. at ¶ 42. Later that month, Plaintiffs, and Plaintiffs' advisors, met with representatives of SGM and the Non-SGM Defendants, including Dr. Chaudhuri, to discuss the sale of the Plaintiffs' assets. *Id.* at ¶ 43. At that juncture, Plaintiffs were thoroughly aware of facts concerning SGM's relationship to Dr. Chaudhuri and the other Non-SGM Defendants. Relying on their multiple advisors, and having full awareness of the facts concerning SGM's relationship to the Non-SGM Defendants, including knowledge of Dr. Chaudhuri's net worth, Plaintiffs chose to contract solely with SGM. *Id.* at ¶¶ 43, 44.

Just like the plaintiffs in *Lynch* and *Brunswick*, the Plaintiffs were thoroughly aware of SGM's relationship to the Non-SGM Defendants, particularly the fact that SGM was a special purpose entity established for the acquisition of assets. Plaintiffs were not strangers to the facts, but rather well informed of all of the facts regarding SGM's relationship to the Non-SGM Defendants.

Plaintiffs were also not left without recourse. Although they did not negotiate for contractual guarantees, SGM made a deposit of $30 million that Plaintiffs could keep if SGM defaulted on an obligation to close the transaction. Because the parties also agreed to limit the total amount of potential damages to $60 million, Plaintiffs likely they believed the deposit gave them sufficient security on what would be a total max recovery of $60 million. In short, they decided it was unnecessary to exhaust bargaining leverage to obtain guarantees from other parties.

Plaintiffs' decision to contract solely with SGM, despite their thorough understanding of the nature of the relationship with the Non-SGM Defendants, bars them from complaining that the Non-SGM Defendants, non-signatories to the APA, are not bound. Just like the plaintiff in *Brunswick*, Plaintiffs here obtained precisely what they bargained for, and did not bargain for or contemplate the liability of the Non-SGM Defendants. Piercing the corporate veil in these circumstances would thwart the alter ego doctrine's goal of promoting justice and equity. Thus, Plaintiffs' claims against the Non-SGM Defendants should be stricken on this additional basis.

2. Plaintiffs Have Not Alleged Sufficient Facts to Support Their Alter-Ego Claims Against the Non-SGM Defendants.

"[T]he corporate form will be disregarded only in narrowly defined circumstances and only when the ends of justice so require." *Eleanor Licensing LLC v. Classic Recreations LLC*, 21 Cal. App. 5th 599, 615 (2018). "Conclusory allegations of "alter ego" status are insufficient to state a claim. Rather, a plaintiff must allege specifically . . . the elements of alter ego liability, as well as facts supporting [those elements]." *Neilson v. Union Bank of Cal*., N.A., 290 F. Supp. 2d 1101, 1116 (C.D. Cal. 2003); *see also In re Currency Conversion Fee Antitrust Litigation*, 265 F.Supp.2d 385, 426 (S.D.N.Y. 2003) ("These purely conclusory allegations cannot suffice to state a claim based on veil-piercing or alter-ego liability, even under the liberal notice pleading standard"); *Kingdom 5-KR-41, Ltd. v. Star Cruises PLC*, No. 01 Civ. 2946(AGS), 2002 WL 432390, * 12 (S.D.N.Y. March 20, 2002) ("[I]n order to overcome the 'presumption of separateness' afforded to related corporations, [plaintiff] is required to plead more specific facts supporting its claims, not mere conclusory allegations") (quoting *De Jesus v. Sears, Roebuck & Co.*, 87 F.3d 65, 69–70 (2d Cir. 1996).

In paragraphs 18-22 of the Complaint, Plaintiffs ask the Court to disregard SGM's corporate existence because it is alleged that SGM is the alter ego of the "other defendants". Such a claim requires allegations demonstrating that SGM has no legitimate separate existence – that it is are merely an instrumentality for the Non-SGM Defendants – and that inequity will result if its corporate form is recognized. *Id*. at 1117.

Plaintiffs, however, have not identified any facts to support their claim. Plaintiffs offer only a "formulaic recitation" of each factor that courts typically consider in analyzing a request to pierce the corporate veil. They do not provide any meaningful factual allegations that would "allow[] the court to draw the reasonable inference" that the Non-SGM Defendants actually are the mere instrumentality of SGM and that inequity will result if SGM's corporate existence is recognized. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

For example, Plaintiffs allege, on information and belief, as to Dr. Chaudhuri and "KPC", the following conclusions:

> "[Dr. Chaudhuri and KPC] (1) controlled the business and affairs of SGM, including any and all of their affiliates; (2) disregarded legal formalities and failed to maintain arm's length relationships among the corporate entities; (3) inadequately capitalized SGM; (4) used the same office or business location and employed the same employees for the corporate entities; (5) held Chaudhuri himself out as personally liable for the debts of the corporate entities; (6) used the corporate entities as a mere shells, instrumentalities or conduits for Chaudhuri and/or his individual businesses; (7) manipulated the assets and liabilities between the corporate entities so as to concentrate the assets in one and the liabilities in another; (8) used corporate entities to conceal their ownership, management and financial interests and/or personal business activities; and/or (9) used the corporate entities to shield against personal obligations, and in particular the obligations as alleged in this Complaint."

Compl. ¶ 20.

None of the above conclusions are sufficient to create an inference that SGM is the instrumentality of the other defendants.

First, Plaintiffs' ubiquitous use of "defendants" makes it impossible to understand the nature of Plaintiffs' allegations. Do Plaintiffs contend the corporate entities are alter egos of Dr. Chaudhuri, SGM, or perhaps the other defendants? Relatedly, the Plaintiffs use of "and/or" makes it impossible to understand which of the conclusory acts were committed and by which defendants. Plaintiffs' Complaint provides no answers to these issues and thus fails to put the Non-SGM Defendants on notice of the claims against them.[8] By failing to do so, Plaintiffs' alter ego allegations violate the most basic principle underpinning a notice pleading – to provide notice of the claims against each particular defendant.

Second, Plaintiffs' boilerplate "information and belief" alter ego allegations are insufficient as a matter of law. The Federal rules do not recognize usage of the phrase

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[8] This lumping of all entities as "defendants" is alone sufficient to grant Defendants' motion to dismiss. *See McDonald v. Kiloo Aps*, 385 F. Supp. 3d 1022, 1040 (N.D. Cal. 2019) (dismissing complaint for lumping the defendants in allegations); *see also In re Resistors Antitrust Litig.*, 2017 WL 3895706, at *4 (N.D. Cal. Sept. 5, 2017) ("indiscriminate and generalized lumping together of defendants does not make for a sound pleading approach"); *Gibson Guitar Corp. v. Viacom Int'l Inc.*, 2013 WL 877967, at *3 (C.D. Cal. Mar. 8, 2013) (the conclusory lumping together of defendants makes it difficult to discern what actions have been alleged against which defendants and is not sufficient to meet the pleading standard set forth in *Twombly* and *Iqbal*).

"information and belief" as a proper pleading device. *See Vespa v. Singler-Ernster, Inc*. 2016 WL 6637710, at *1 (N.D. Cal., Nov. 8, 2016) ("The phrase 'on information and belief' at best constitutes surplusage . . ." and suggests that the party is "engaging in speculation to an undue degree . . . .") *Id*. Factual allegations made on information and belief are only proper if they specifically allege that they will have evidentiary support after reasonable opportunity for further investigation or discovery. *See* Fed. R. Civ. Proc. 11(b)(3). However, Rule 11(b)(3) "does not permit [a] [p]laintiff to allege claims in the absence of any facts, simply because [the] [p]laintiff speculates that those facts will eventually be discovered." *Herrera v. Los Angeles Unified Sch. Dist.*, 2017 WL 7888037, at *3 (C.D. Cal. Nov. 6, 2017) (quoting *Chagby v. Target Corp.*, No. CV 08-4425-GKH(PJWX), 2008 WL 5686105, at *4 fn. 2 (C.D. Cal. Oct. 27, 2008), aff'd, 358 F. App'x 805 (9th Cir. 2009). Plaintiffs' Complaint is replete with this deficiency and *all* of Plaintiffs' alter ego claims are improperly pled on information and belief. *See* Complaint ¶¶ 12, 14, 15, 16, 17, 19, 20, 22, 58, 102, 105, 110. It is evident that Plaintiffs are improperly attempting to bootstrap the Non-SGM Defendants into this lawsuit on mere conjecture. Plaintiffs' Complaint must be dismissed on this basis alone.

Third, Plaintiffs' use of soundbites taken from various websites and meetings also do not buttress their alter ego claims against Non-SGM Defendants. The statements merely show that there is a relationship, albeit an arms-length relationship, between the defendants. A relationship is not enough to allege an alter ego claim. Rather, Plaintiffs must allege facts to establish that there is "such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist." *Mesler v. Bragg Mgmt. Co*., 39 Cal. 3d 290, 300 (1985). No facts have been alleged that compel a finding that the separate personalities between SGM and the Non-SGM Defendants somehow no longer exist.

3. Plaintiffs Concede Facts Defeating Their Alter-Ego Claims Against KPC Healthcare.

As noted above, all of Plaintiffs' alter ego claims must fail as a matter of law. But even more astonishingly, Plaintiffs' Complaint *itself* alleges facts that necessarily defeat their alter ego claims against Non-SGM Defendant, KPC Healthcare. Specifically, Plaintiffs admit, in paragraph

41 of their Complaint, that KPC Healthcare has been sold to an Employee Stock Ownership Plan that is not owned by Dr. Chaudhuri or SGM. *See* Compl. ¶ 41. By the inclusion of this allegation, Plaintiffs acknowledge that KPC Healthcare is not owned by SGM or any of the other defendants and cannot be SGM's alter ego. KPC HealthCare should be dismissed for this additional reason.

E. Plaintiffs' Boilerplate "Agency, Aiding and Abetting, and Conspiracy" Allegations Do Not Save Their Failed Alter Ego Claims.

Knowing that their alter ego claims are doomed to fail, Plaintiffs attempt to resuscitate their claims against the Non-SGM Defendants via boilerplate "agency, aiding and abetting and conspiracy" allegations. (Compl. ¶23-26). These boilerplate allegations are insufficient to create liability for the Non-SGM Defendants as a matter of law. It is undisputed that SGM, and only SGM, entered into the APA with Plaintiffs. The Non-SGM parties are not signatories to the contract and cannot be directly liable for its breach. *Conder v. Home Savings of Am.*, 680 F. Supp. 2d 1168, 1174 (C.D. Cal. 2010) (holding that plaintiff failed to state a claim for breach of contract against defendant because it was not a party to the contract). As a result, Plaintiffs seek to hold the Non-SGM Defendants liable for breach of contract on the basis of "agency; aiding and abetting; and conspiracy." *See* Compl. ¶¶ 22-26. The law does not recognize such liability – "there is no cause of action for civil conspiracy to breach a contract." *Hanni v. Am. Airlines, Inc.*, 2008 WL 5000237, at *5 (N.D. Cal. Nov. 21, 2008); *Hale Bros. Inv. Co., LLC v. StudentsFirst Inst.*, 2017 WL 590255, at *8 (E.D. Cal. Feb. 14, 2017) ("[c]onspiracy to breach a contract is not a legally cognizable claim…."); *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503 (1994) (explaining rationale for rule that conspiracy does not extend to contract claims); *See Automatic Poultry Feeder Co. v. Wedel*, 213 Cal. App. 2d 509, 518 (1963) (explaining that agents are not liable for contracts for a disclosed principal).[9]

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[9] Nor could Dr. Chaudhuri conspire with SGM. *Hanni v. Am. Airlines, Inc.*, 2008 WL 5000237, at *4 (N.D. Cal. Nov. 21, 2008) ("There can be no civil conspiracy among a corporation and its own employees.").

V. CONCLUSION

For the reasons discussed above, Defendants request that the Court grant their Motion to Dismiss.

Dated: February 19, 2020

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

By: */s/ Gary E. Klausner*
Gary E. Klausner
Counsel for Strategic Global Management, Inc.; Kali P., Chaudhuri, M.D.; KPC Healthcare Holdings, Inc.; KPC Healthcare, Inc., KPC Global Management, LLC

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is 10250 Constellation Boulevard, Suite 1700, Los Angeles, CA 90067.

A true and correct copy of the foregoing document entitled **DEFENDANTS' NOTICE OF MOTION ANDMOTION TO DISMISS PLAINTIFFS' COMPLAINT [Fed. R. Civ. Proc. 12(b)(1) & 12(b)(6)]** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner stated below:

1. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF): Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On **February 19, 2020**, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

- James Cornell Behrens jbehrens@milbank.com, gbray@milbank.com;mshinderman@milbank.com;dodonnell@milbank.com;jbrewster@milbank.com;JWeber@milbank.com
- Gary E Klausner gek@lnbyb.com
- Jeffrey S Kwong jsk@lnbyb.com, jsk@ecf.inforuptcy.com
- Samuel R Maizel samuel.maizel@dentons.com, alicia.aguilar@dentons.com;docket.general.lit.LOS@dentons.com;tania.moyron@dentons.com;kathryn.howard@dentons.com;joan.mack@dentons.com;derry.kalve@dentons.com
- Tania M Moyron tania.moyron@dentons.com, chris.omeara@dentons.com;nick.koffroth@dentons.com;Sonia.martin@dentons.com;Isabella.hsu@dentons.com;lee.whidden@dentons.com;Jacqueline.whipple@dentons.com
- Kyrsten Skogstad kskogstad@calnurses.org, rcraven@calnurses.org
- United States Trustee (LA) ustpregion16.la.ecf@usdoj.gov

2. SERVED BY UNITED STATES MAIL: On **February 19, 2020**, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

☐ Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on **February 19, 2020**, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

Served via Attorney Service
The Honorable Ernest M. Robles
United States Bankruptcy Court
Edward R. Roybal Federal Building
255 E. Temple Street, Suite 1560
Los Angeles, CA 90012

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

February 19, 2020	Lisa Masse	*/s/ Lisa Masse*
Date	*Type Name*	*Signature*