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

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

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,

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.

Case No. 2:20-cv-00613-DSF

Hon. Dale S. Fischer

PLAINTIFFS' OPPOSITION TO DEFENDANTS' MOTION TO DISMISS FIRST AMENDED COMPLAINT

Date: August 10, 2020
Time: 1:30 p.m.
Place: Courtroom 7D
350 West 1st Street
Los Angeles, CA 90012

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I. INTRODUCTION

This case arises from Defendants' deliberate efforts to wrongfully and fraudulently lock Plaintiffs into an asset purchase agreement (the "APA") for the sale of four hospitals under the auspices of a Bankruptcy Court order. As aptly observed by the Bankruptcy Court, Defendant Strategic Global Management, Inc. ("SGM") "felt that the asset purchase agreement wasn't actually an asset purchase agreement. It was a contract to contemplate the purchase of an asset after the Attorney General removed his conditions […]." SGM RJN, Ex. S at 20:7-14 (Emphasis added).

For nearly a year, Plaintiffs expended tremendous resources with respect to the sale, including obtaining judicial and regulatory approval and diligently preparing to close, including efforts to transition more than 4,000 employees. Once all conditions precedent were satisfied, waived or passed, Defendants repeatedly defaulted under the APA, sought to coerce a re-trade at a substantially lower price, levied meritless accusations against Plaintiffs and ultimately refused to close the sale, all to the detriment of Plaintiffs, the bankruptcy estates, creditors, employees and patients.

Defendants never intended to pay the full purchase price and instead planned to walk away from the transaction if they could not force a lower purchase price. Meanwhile, Plaintiffs were required to continue operations at estimated daily losses of $450,000 and were precluded from selling the hospitals to anyone else. As Defendants' actions continue to demonstrate to this day, their goal has been to coerce a sale of the hospitals at a dramatically reduced price from what they promised to pay in order to secure selection by Plaintiffs and approval by the Bankruptcy Court.

Defendants' Motion to Dismiss the First Amended Complaint ("FAC") should be denied in its entirety. In their haste to secure a premature, evidenced-based ruling on the merits, Defendants failed to comply with this Court's meet and confer Orders and Civil Local Rule 7-3. That alone requires denial of the motion.

In addition, there is no merit to Defendants' assertion that the entire FAC should be dismissed merely because they contend certain conditions precedent under

the APA were not satisfied as a matter of disputed fact. This is a *pleadings motion* (not summary judgment), and Federal Rule of Civil Procedure 9(c) expressly permits Plaintiffs to allege satisfaction of conditions precedent in a conclusory manner. In addition, the FAC's factual allegations confirm all conditions were satisfied. In any event, the FAC sets forth many bases for liability that are independent of Defendants' "conditions precedent" theory, including other contract theories and valid claims for promissory fraud, breach of the implied covenant and tortious breach of contract.

For the reasons fully described below, the Debtors respectfully request that the Court deny the Motion in its entirety and allow the case to proceed on the merits.

II. FACTUAL ALLEGATIONS

A. The Bankruptcy And The Hospital Sale

On August 31, 2018, Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center ("St. Vincent"), St. Vincent Dialysis Center, Inc., St. Francis Medical Center ("St. Francis"), and Seton Medical Center (together with St Francis and St. Vincent, the "Hospitals"), and Verity Holdings, LLC, and the above-captioned debtors (collectively, the "Debtors" or "Plaintiffs") each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code, which are currently jointly administered before the Bankruptcy Court. The Debtors' bankruptcy cases are the second largest hospital bankruptcy case in U.S. history.

On August 13, 2018, the Debtors received an offer letter from SGM on letterhead that included the logo of its affiliates, offering to purchase the Hospitals for $610 million (the "Purchase Price"). On December 3, 2018, Defendants provided a letter regarding the asserted availability of certain liquidity from Defendant Kali P. Chaudhuri, M.D., the founder and Chief Executive Officer of SGM and its alter egos. Plaintiffs selected SGM to be the stalking-horse bidder based on its representations and inducements its offer to acquire the Hospitals in exchange for (among other things) a cash payment of $610 million. *See* FAC, ¶¶ 40-42.

On January 8, 2019, SGM executed the APA to acquire the Hospitals and

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related assets for the Purchase Price. *See* FAC, ¶ 45. As discussed further below, the APA contains provisions requiring approval by the Bankruptcy Court, approval by the Attorney General, and the transfer of Medicare and Medi-Cal provider agreements to SGM. *Id.,* ¶ 47, Ex. A. On January 17, 2019, the Debtors filed a motion to approve, among other things, the form APA and related "stalking horse" protections and bidding procedures for the sale of the Hospitals, which the Court approved. *Id.*, ¶¶ 48, 51. On May 2, 2019, the Court entered an order approving the sale to SGM (the "Sale Order"). *Id.,* ¶ 54.

B. Attorney General Review And The Enforcement Motion Supported By SGM

One of the conditions to closing under the APA was (i) the approval by the California Attorney General, pursuant to California Corporations Code § 5914 and title 11 of the California Code of Regulations, § 999.5, and (ii) that the Attorney General did not impose any conditions that were "materially different" that those set forth in Schedule 8.6 to the APA. FAC, ¶ 65. Under Section 8.6, the APA also provided that SGM "shall reasonably cooperate in any efforts to render the Supplemental Sale Order a final, non-appealable order." *Id.*

On September 25, 2019, the Attorney General consented to the sale subject to certain conditions (the "Additional Conditions") that were materially different from those SGM contractually agreed to in Schedule 8.6. SGM would not close the sale if the Additional Conditions remained extant. *See* FAC, ¶ 72.

On September 30, 2019, the Debtors filed a motion (the "Enforcement Motion"), which sought (i) entry of an order enforcing the Sale Order, (ii) a finding that the sale was free and clear of certain additional conditions imposed by the Attorney General, and (iii) a finding limiting the sale to only those conditions to which SGM contractually agreed to assume in Schedule 8.6 of the APA. *See* FAC, ¶ 72. On October 10, 2019, SGM filed a statement in support of the AG Conditions Motion requesting that the Court enter an order granting the AG Conditions Motion.

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See Plaintiffs' Request for Judicial Notice In Support of Opposition to Motion to Dismiss ("Plaintiffs' RJN"), Ex. A. On October 23, 2019, the Court entered a memorandum of decision (the "AG Conditions Memorandum Decision") setting forth the Court's ruling to grant the AG Conditions Motion and requesting that the Debtors lodge an order consistent with the ruling. *See* FAC, ¶ 73.

C. SGM Seeks To Undermine The Order It Previously Supported

After entry of the AG Conditions Memorandum Decision, the Attorney General, the Debtors, and SGM engaged in discussions amongst each other concerning a proposed form of order. SGM sought to obstruct those efforts by insisting on language that was not required by the APA, despite its express agreement in the APA to cooperate in making any Supplemental Sale Order *non-appealable*:

> During any Evaluation Period or Extended Evaluation Periods, Purchaser shall reasonably cooperate in any efforts to render the Supplemental Sale Order a final, non-appealable order, including timely taking reasonable steps in preparation for closing of the transactions described in this Agreement[.]

FAC, Ex. A., p. 33.

After careful consideration, the Debtors and their constituents determined that entry of the Proposed Order was in the best interests of the estates given that it ensured that the Attorney General would not appeal the Proposed Order and it contained the exact findings required under Section 8.6 of the APA. *See* FAC, ¶ 74. On November 8, 2019, the Debtors and the Attorney General filed a stipulation (the "Stipulation") and lodged a proposed order granting the AG Conditions Motion (the "Proposed Order"). *See* Plaintiffs' RJN, Ex. B; FAC, ¶ 74. Pursuant to the Stipulation, (i) the Attorney General agreed to authorize the sale free and clear of "Additional Conditions," (ii) the Debtors agreed to obtain a withdrawal of the AG Conditions Memorandum Decision, and (iii) the Attorney General agreed not to appeal the Proposed Order. The Proposed Order adopted the language required by Section 8.6 nearly verbatim. *See* Plaintiffs' RJN, Ex. B; FAC, Ex. A (APA § 8.6 at 33).

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On November 11, 2019, SGM—despite having supported the AG Conditions Motion—filed an objection to the Proposed Order and lodged a competing order. *See* SGM RJN, Ex. B; Plaintiffs' RJN, Ex. C, *see also* FAC, ¶ 74. SGM's objection sought revisions to the Proposed Order that went beyond the relief required by Section 8.6 of the APA. *See* SGM RJN, Ex. B; Plaintiffs' RJN, Ex. C. On November 13, 2019, the Court held a hearing on the Stipulation, at which the Court overruled SGM's objection to the Proposed Order. On November 14, 2019, the Court entered the Proposed Order, as modified on the record at the November 13 hearing, granting the AG Conditions Motion (the "Enforcement Order"). *See* FAC, ¶ 76.

On November 29, 2019, despite the modifications to the Proposed Order, SGM filed a notice of appeal related to the Enforcement Order. *See* FAC, ¶ 96.[1]

D. Transfer Of The Medicare And Medi-Cal Provider Agreements

As noted above, the APA also required that Plaintiffs secure the transfer of Medicare and Medi-Cal Provider Agreements to SGM. On November 19, 2019, Plaintiffs obtained a settlement with the Centers for Medicare and Medicaid Services ("CMS"), providing for the transfer of their Medicare Provider Agreements to SGM without successor liability, thereby satisfying their remaining obligations under Article 8.7 of the APA. *See* FAC, ¶ 79.

With respect to California Department of Health Care Services ("DHCS"), Plaintiffs obtained an Order from the Court authorizing the transfer free and clear of any interests asserted by DHCS, in addition to the Sale Order which terminated all creditors' recoupment rights, including DHCS. *See* FAC, ¶ 79; SGM RJN, Ex. O. Those Orders afforded equal or greater protection to SGM than any settlement could have, thereby satisfying Section 8.7. SGM disagreed that the DHCS Order and the Sale Order satisfied Section 8.7. *See id.* Consequently, although not necessary but given SGM's position, on November 22, 2019, Plaintiffs reached a settlement

[1] On May 14, 2020, this Court dismissed the appeal as moot and on June 10, 2020, vacated the appealed Enforcement Order. [2:19-cv-10352-DSF, Docket No. 65]. That order is now on appeal. [2:19-cv-10352-DSF, Docket Nos. 19, 66, 67].

agreement with DHCS, which provided for the transfer of the Medi-Cal Provider Agreement without successor liability, which the Court approved. *Id.* ¶¶ 79, 92.

E. SGM Fails To Close

As of December 5, 2019, the Debtors had satisfied or were deemed to have satisfied all conditions to close under the APA. *See* FAC, ¶ 87.

The supplemental sale order provisions of Section 8.6 of the APA were not triggered because the Enforcement Order mirrored the findings required under the APA. *See* FAC, ¶ 77. In any event, the Debtors had obtained a final, non-appealable Supplemental Sale Order. *See* FAC, ¶ 85. Further, the Debtors materially complied with Article 8.7 by obtaining an order authorizing the transfer of the Medi-Cal Provider Agreements free and clear of any interest asserted by the DHCS and obtained a settlement with the CMS providing for the transfer of their Medicare Provider Agreements to SGM, thereby satisfying their remaining obligations under Article 8.7 of the APA. *See* FAC, ¶¶ 79, 92.

SGM did not close the sale on December 5, 2019. *See* FAC, ¶ 108. Instead, it sent the Debtors a letter demanding the return of its $30 million deposit which, pursuant to the APA, was "non-refundable in all events, except as provided in Section 6.1(b) [Bankruptcy Court approval for Sales Procedures Motion] or Section 6.2, or in the event Purchaser has terminated this Agreement pursuant to Section 9.1 (other than Section 9.1(b)) or as set forth in Section 9.2, in which case Seller shall immediately return the Deposit to Purchaser with all interest earned thereon." *See* SGM's Counterclaim, Docket No. 41 at ¶¶ 67, 79.

On December 6, 2019, the Debtors filed an emergency motion for issuance of an order to show cause why SGM failed to close the sale by December 5, 2019. *See* SGM RJN, Ex. R. On December 9, 2019, the Bankruptcy Court denied the motion and ruled that "[a]ny efforts undertaken by the Debtors with respect to the alternative disposition of the Hospitals" would not violate the APA. Plaintiffs' RJN, Ex. D at 2. The Bankruptcy Court recognized that:

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> 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. . . . In 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.

Plaintiffs' RJN, Ex. E at 2.

By letter dated December 10, 2019, Plaintiffs confirmed they remained prepared to close and had secured a settlement agreement with the DHCS:

> Given SGM's continued objection to the sufficiency of the Court's prior Orders, the Debtors reached a settlement agreement in principle with DHCS to the same effect on November 22, 2019. […] The APA did not require a written agreement or a Court approved agreement, so that an oral agreement as to terms expressly satisfied the terms and requirements of Section 8.7, even though they had been previously materially satisfied. Further, the Court entered an Order approving that settlement yesterday […]
>
> In any event, even if the Court's prior Orders regarding the Medi-Cal Provider Agreements were somehow insufficient to satisfy Section 8.7 (which we, and the Court, dispute), it would not trigger a basis under the APA for the return of the Deposit. Rather, it would simply mean that the mandatory Closing Date for the transaction would have been yesterday (December 9, 2019)—ten days from the date a settlement was reached with DHCS. The Debtors were prepared to close on December 5, and remain able and willing to do so today. SGM, however, has intentionally frustrated the Debtors' efforts, and has never proposed any alternative closing date[.]

FAC, ¶¶ 103-104. Plaintiffs remained prepared to close the sale through December 27, 2019. *Id,* ¶ 106. At no time did SGM offer or request a different closing date at the Purchase Price, and the Closing did not occur. *Id.,* ¶ 108.

F. <u>The Adversary Proceeding Against SGM and Its Alter Egos</u>

Plaintiffs filed their original Complaint in this adversary proceeding on January 1, 2020. On February 19, 2020, Defendants filed a Motion to Dismiss the Complaint. In response, the Debtors filed the FAC, which includes thirty-two (32) paragraphs of additional factual allegations and asserts claims for breach of contract, promissory fraud, breach of the covenant of good faith and fair dealing, tortious breach of contract, and tortious breach of the covenant of good faith and fair dealing.

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As noted above, SGM's appeal of three underlying orders from the Bankruptcy Court, including the Enforcement Order, were consolidated before this Court in Case No. 2:19-cv-10352-DSF (the "Appeals"). By Stipulation and Order dated April 13 and April 14, 2020, the parties agreed to stay this action pending the Court's decision on the Appeals, and agreed to further meet and confer regarding any contemplated motion to dismiss by the Defendants and amendment of the complaint by Plaintiffs. [2:20-cv-00613-DSF, Docket Nos. 35, 36]. On May 14, 2020, this Court dismissed the Appeals on mootness grounds and, on June 10, 2020, vacated the underlying orders (the "Vacatur Order"). [2:19-cv-10352-DSF, Docket Nos. 59, 65, 66, 67].

Despite the court's Order, the parties' Stipulation and Local Rule 7-3, Defendants failed to further meet and confer before filing the instant Motion to Dismiss on July 10, 2020. [2:20-cv-00613-DSF, Docket No. 39 ("Motion")].

III. LEGAL STANDARD

A motion to dismiss is disfavored, and dismissal is proper only in "extraordinary cases." *See Broam v. Bogan*, 320 F.3d 1023, 1028 (9th Cir. 2003); *United States v. White*, 893 F. Supp. 1423, 1428 (C.D. Cal. 1995) (quoting *United States v. Redwood City*, 640 F.2d 963 (9th Cir.1981)). In resolving a Rule 12(b)(6) motion, the Court "must accept as true all factual allegations in the complaint and draw all reasonable inferences in favor of the nonmoving party." *Retail Prop. Tr. v. United Bhd. of Carpenters & Joiners of Am.,* 768 F.3d 938, 945 (9th Cir. 2014). Not only should the complaint be construed generously, but the plaintiff's brief may be used to clarify allegations in the complaint whose meaning is unclear. *See Orion Tire Corp. v. Goodyear Tire & Rubber Co.*, 268 F.3d 1133, 1138 (9th Cir. 2001).

Dismissal "is appropriate only where the complaint lacks a cognizable legal theory or sufficient facts to support a cognizable legal theory." *Mendiondo v. Centinela Hosp. Ctr.,* 521 F.3d 1097, 1104 (9th Cir. 2008). The motion should be denied if the complaint contains "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570 (2007). A

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complaint may be dismissed based on an affirmative defense "only if the defendant shows some obvious bar to securing relief on the face of the complaint." *ASARCO, LLC v. Union Pacific R. Co.*, 765 F.3d 999, 1004 (9th Cir. 2014). "If, from the allegations of the complaint as well as any judicially noticeable materials, an asserted defense raises disputed issues of fact, dismissal under Rule 12(b)(6) is improper." *Id.* (citing *Scott v. Kuhlmann*, 746 F.2d 1377, 1378 (9th Cir.1984)). If dismissal is granted, leave to amend should be allowed unless the pleading may not possibly be cured. *See Lopez v. Smith*, 203 F.3d 1122, 1130 (9th Cir. 2000).

IV. ARGUMENT

A. Defendants Failed to Meet and Confer, In Violation Of This Court's Order And Civil Local Rule 7-3.

To begin, Defendants' Motion should be denied because they admittedly failed to meet and confer as ordered by the Court.

The parties' April 13, 2020 Stipulation and the Court's April 14, 2020 Order provided that "[o]nce the Court issues a ruling regarding the appeals, the parties will further meet and confer regarding any motion to dismiss contemplated by Defendants, and any amendment to the First Amended Complaint contemplated by Plaintiffs." [Docket Nos. 35, 36]. The Central District's Local Civil Rule 7-3 also states that counsel "shall first contact opposing counsel to discuss thoroughly, preferably in person, the substance of the contemplated motion and any potential resolution." Finally, this Court's Standing Order states:

> Motions to dismiss are strongly discouraged. Many motions to dismiss or to strike can be avoided if the parties confer in good faith (as required by Local Rule 7-3), especially for perceived defects in a complaint, answer, or counterclaim that could be corrected by amendment […]

Despite these explicit requirements, Defendants failed to further meet and confer before filing this Motion. *See* Decl. of Sonia Martin, ¶¶ 2-4. Although the parties had discussed some of Defendants' arguments months ago before the stay, Defendants did not raise all of them at that time and others were not fully discussed.

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Id. That was part of the reason the parties agreed—and the Court ordered—that Defendants must "further meet and confer regarding any motion to dismiss contemplated by Defendants" after the Court ruled on the Appeals. Defendants admittedly failed to do so.

Accordingly, the Court should deny the Motion on this basis. *See Vape Soc'y Supply Corp. v. Zeiadeh*, 2017 WL 2919080, *2 (C.D. Cal. Feb. 6, 2017) ("Local Rule 7-3 isn't just a piece of petty pedantry put down to trip up lawyers. Nor is Local Rule 7-3 a mere formalism simply there to be checked off by lawyers."); *U.S.A. v. Kan-Di-Ki LLC*, 2013 WL 12147597, *1 (C.D. Cal. Mar. 21, 2013) (accord).

B. Plaintiffs Have Alleged They Satisfied All Conditions Precedent.

Defendants' Motion to Dismiss also fails on substantive grounds. The Motion is premised on the sweeping assertion that "[a]ll of Plaintiffs' claims should be dismissed because Plaintiffs failed to satisfy at least two contractual conditions to SGM's obligation to close the transaction at issue." Notice of Motion at 1:13-14. Citing inapplicable state court standards for nonsuits, Defendants assert that "Plaintiffs have the burden to establish that all conditions precedent have been satisfied," [Motion at 21:21-23], and then debate the *factual merits* of whether Plaintiffs satisfied Sections 8.6 and 8.7 of the APA.

This is a *pleadings motion*, not summary judgment. "In pleading conditions precedent, it suffices to allege generally that all conditions precedent have occurred or been performed." Fed. R. Civ. P. 9(c). In a contract dispute, "[t]he standards for pleading a condition precedent are lax." *Sam Rubin Entm't, Inc. v. AARP, Inc.*, 2016 WL 7336554, *8 (C.D. Cal. Dec. 15, 2016); *see also Kiernan v. Zurich Cos.*, 150 F.3d 1120, 1124 (9th Cir. 1998) (general allegations satisfied "loose guidelines of Rule 9(c)"); *Ruiz Food Prod., Inc. v. Catlin Underwriting U.S., Inc.*, 2011 WL 3323046, *3 (E.D. Cal. Aug. 2, 2011) ("Neither Rule 9(c) nor Rule 8(a)(2) expressly requires that the performance or occurrence of conditions precedent be pled at all[.]" (quoting 2 James W. Moore, Moore's Federal Practice § 9.04[1] (3d ed. 1997)).

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Here, the FAC alleges that "[a]ll conditions for Defendants' performance had occurred, and Defendants' performance was neither excused nor waived." FAC ¶ 121; *see also* 2:19-20, ¶¶ 50, 59-60, 65, 72-77, 80, 84-120. As a matter of law, such allegations are sufficient and controlling. *See TreeFrog Dev., Inc. v. Seidio, Inc.*, 2013 WL 4028096,*3 (S.D. Cal. Aug. 6, 2013) (Rule 9(c)'s "relaxed pleading standard" applies "to the element of performance"); *accord U.S. Bank v. Miller*, 2013 WL 12183652, *4 (C.D. Cal. May 8, 2013); *Rector v. Mitec Telecom, Inc.*, 2011 WL 13356240, *3 (S.D. Cal. Aug. 2, 2011). Defendants' Motion based on a fact-intensive affirmative defense is flatly improper. *See J. Line Pump Co. v. Shimmick Constr. Co.*, 2012 WL 13012660, *2 (C.D. Cal. Mar. 8, 2012) (denying dismissal based on factual arguments regarding satisfaction of conditions precedent); *City & Cty. of San Francisco v. Tutor-Saliba Corp.*, 2005 WL 645389, *19-20 (N.D. Cal. Mar. 17, 2005) ("arguments that Plaintiffs cannot plead fulfillment of the conditions precedent are not well-taken because they require a factual analysis which is not possible on a motion to dismiss").

In addition, as explained below, Defendants' specific assertions regarding Sections 8.6 and 8.7 are meritless.

1. Plaintiffs Adequately Allege Satisfaction Of Section 8.6

In addition to generally alleging that Plaintiffs satisfied Section 8.6, as expressly permitted by Civil Rule 9(c), the FAC contains detailed allegations regarding those efforts. *See* FAC, ¶¶ 59-60. Defendants nonetheless assert Section 8.6 was not satisfied because SGM appealed the Enforcement Order. Not so.

To begin, the provisions of Section 8.6 were inapplicable at the time SGM appealed the Enforcement Order. Plaintiffs' obligations under Section 8.6 could only be triggered "[i]n the event the CA AG imposes conditions on the [Sale], or on [SGM] in connection therewith, which are materially different than the Purchaser Approved Conditions set forth on Schedule 8.6[.]" FAC, Ex. A. Because the Enforcement Order provided that "[t]he Assets . . . are being sold free and clear of the Additional

Conditions without the imposition of any other conditions which would adversely affect the Purchaser," the Additional Conditions were no longer "impose[d]" on the Sale, thereby rendering the remainder of Section 8.6 surplusage.

Further, as alleged in the FAC, "[a]ll conditions for Defendants' performance had occurred, and Defendants' performance was neither excused nor waived." FAC, ¶ 121. Specifically, Defendants contractually agreed in Section 12.3 as follows:

> For so long as Sellers are subject to the jurisdiction of the Bankruptcy Court, 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. [FAC, Ex. A.]

In addition, Defendants expressly agreed in Section 8.6 to cooperate in making any Supplemental Sale Order *non-appealable*:

> During any Evaluation Period or Extended Evaluation Periods, Purchaser shall reasonably cooperate in any efforts to render the Supplemental Sale Order a final, non-appealable order, including timely taking reasonable steps in preparation for closing of the transactions described in this Agreement[.]

FAC, Ex. A., p. 33. Appealing the Enforcement Order is the antithesis of cooperating to make it non-appealable. By agreeing to cooperate to render any Supplemental Sale Order non-appealable and to submit all related disputes to the exclusive jurisdiction of the Bankruptcy Court, Defendants waived any right to appeal the Enforcement Order.[2] *See Throne v. Citicorp Inv. Serv. Inc.,* 378 Fed. App'x. 629 (9th Cir. 2010) (upholding waiver of right to appeal); *U.S. Consol. Seeded Raisin Co. v. Chaddock & Co.,* 173 F. 577, 579 (9th Cir. 1909) (it is "universally held that, where such an agreement [to waive appeal rights] is made upon [. . .] it will be enforced […]") (citations omitted);

[2] Plaintiffs also contend Defendants waived, are estopped from, and lacked standing to appeal based on SGM's conduct before the Bankruptcy Court in connection with the Enforcement Motion. The Court previously addressed this issue in its Order Denying Emergency Motion to Dismiss Appeal [2:19-cv-10352, Docket No. 19, which has been appealed to the Ninth Circuit. *E.g.*, *Perfect 10, Inc. v. Google, Inc.*, 2008 WL 4217837, at *6 (C.D. Cal. July 16, 2008) ("The filing of a notice of appeal . . . 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." (quoting *Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982)). The Court's Order Denying Emergency Motion to Dismiss Appeal did not address Plaintiffs' contractual waiver arguments, which are raised herein.

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In re Odyssey Contracting Corp., 944 F.3d 483, 488 (3d Cir. 2019) (finding waiver sufficiently express where stipulation "indicate[s] an intent to waive" the appeal right by authorizing bankruptcy court to determine issue of breach "in all respects" and "with prejudice"); *see also Minesen Co. v. McHugh*, 671 F.3d 1332, 1343 (Fed. Cir. 2012); *Slattery v. Ancient Order of Hibernians in Am.*, 1998 WL 135601, *1 (D.C. Cir. Feb. 9, 1998); *In re Lybarger*, 793 F.2d 136, 139 (6th Cir. 1986).

Further, contrary to Defendants' cursory assertion, this Court's subsequent Vacatur Order on the Appeals does not preclude Plaintiffs from establishing the historical fact that the Enforcement Order existed in full force and effect as of the closing date, and satisfied any obligations of Plaintiffs under Section 8.6. *See DHX, Inc. v. Allianz AGF MAT, Ltd.*, 425 F.3d 1169, 1176 (9th Cir. 2005) ("at minimum, a vacated opinion still carries informational and perhaps even persuasive or precedential value." (citing *County of Los Angeles v. Davis*, 440 U.S. 625, 646 n. 10 (1979) (Powell, J., dissenting) (vacated opinion "will continue to have precedential weight and, until contrary authority is decided, [is] likely to be viewed as persuasive authority if not the governing law of the [ ] Circuit")); *Chartis Specialty Ins. Co. v. Queen Anne HS, LLC*, No. C11-335RAJ, 2012 WL 3780345, at *3 (W.D. Wash. Aug. 31, 2012) (holding that "[v]acatur does not make an order disappear" and "does not eliminate it from the public record"); *McKenzie v. Day*, 57 F.3d 1493, 1494 (9th Cir. 1995) (adopting analysis of vacated opinion, "[a]lthough the opinion was subsequently vacated, Richmond remains persuasive authority, and we adopt its analysis of this issue as our own.").[3]

Finally, Defendants incorrectly assert they were entitled to a 21-business day "Evaluation Period" under Section 8.6 beginning when the Enforcement Order was issued, on November 14, 2019. *See* Motion at 12:25-26. Not so. As noted above, the Enforcement Order did not trigger Section 8.6 because the Attorney General was not

[3] To the extent the Court disagrees with Plaintiffs' narrow interpretation of its prior Orders, Plaintiffs respectfully submit the Court should decline to address these issues while they are on appeal.

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imposing Additional Conditions on the Sale. Moreover, Section 8.6 provides: "If the Supplemental Sale Order becomes a final, non-appealable order prior to the expiration of the Evaluation Period . . . Purchaser shall consummate the Sale provided that all other conditions to closing have been satisfied." So even assuming Section 8.6 had been triggered, the Enforcement Order would constitute a final, non-appealable order that required SGM to consummate the Sale because the only parties that could appeal it had waived any right to do so. *See* FAC, ¶¶ 74-77. Finally, and in any event, 21 business days after November 14, 2019 was December 17, 2019—when Plaintiffs remained willing to close, but SGM failed to do so. *Id.*, ¶ 106.

For all of these reasons, Plaintiffs have alleged that Section 8.6 was satisfied, and the Motion must be denied.

2. Plaintiffs Adequately Allege Satisfaction Of Section 8.7

Defendants next assert that Plaintiffs cannot recover on any claim for relief because Section 8.7 of the APA allegedly was not satisfied. Defendants are wrong.

Section 8.7 was plainly satisfied here. It provides as follows:

> 8.7 Medicare and Medi-Cal Provider Agreements. 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. [FAC, Ex. A.]

Here, in accordance with Section 8.7, the Debtors alleged they obtained a settlement with CMS providing for the transfer of their Medicare Provider Agreements to SGM on November 19, 2019. *See* FAC, ¶ 79. With respect to the

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transfer of the DHCS Medi-Cal Provider Agreements, the Debtors alleged that they materially complied with their obligation to be positioned to transfer their Medi-Cal Provider Agreements to SGM with a "full satisfaction, discharge, and release of any claims under the … Medi-Cal provider agreements, whether known or unknown, that … DHCS … has against [SGM] for monetary liability arising under the … Medi-Cal provider agreements before the Effective Time," in other words, without successor liability. *Id.*

First, the allegations are supported by SGM's RJN. On September 26, 2019, the Bankruptcy Court entered its Memorandum Opinion (the "Memorandum Opinion"), expressly holding that the Medi-Cal "Provider Agreements may be sold free and clear of the liabilities which DHCS contends attach to the Provider Agreements." *See* SGM RJN, Ex. L. This includes the alleged liabilities for approximately $30 million in unpaid HQA Fees and $25 million in Medi-Cal overpayments. *Id.* Second, the Debtors secured an Order (the "Medi-Cal Provider Agreement Transfer Order") authorizing transfer of the Medi-Cal Provider Agreements free and clear of any interests asserted by DHCS:

> DHCS shall not adjust, offset or lien any payments owing to SGM and other SGM affiliates (collectively, "SGM Buyers") which are assigned any rights in connection with the transfer of the Medi-Cal Provider Agreements … and the SGM acquisition of the Hospitals and St. Vincent Dialysis Center (collectively, the "Assets") pursuant to the Sale Motion ("SGM Sale") after the transfer of the Assets (the "Transfer Effective Date"), or make any claims against any of the SGM Buyers or any of their assets, including, without limitation, any assets acquired by any of the SGM Buyers pursuant to the SGM Sale, for any obligations, liabilities, claims or other interests against the Debtors related to periods on or before the Transfer Effective Date ("Pre-Transfer Effective Date Liabilities") including without limitation for Pre-Transfer Effective Date Liabilities under or related to (a) the Medi-Cal Program, and (b) without prejudice to the rights of the Debtors or the SGM Buyers as provided for in the Asset Purchase Agreement [Docket No. 2305-1] by and among the Debtors and SGM, the Hospital Quality Assurance Fees Program, California Welfare & Institutions Code, § 14169.52(a) et. seq. or similar or successor statutes ("HQA Fee Program")."

SGM RJN, Ex. O; FAC, ¶ 79. Although the Medi-Cal Provider Agreement Transfer

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Order did not address or resolve Medi-Cal's recoupment rights, if any, against SGM, that was unnecessary because those rights had previously been resolved in the Sale Order. *See* FAC, ¶¶ 79, 86. In the Sale Order, which is long since final and was never appealed by DHCS, "recoupment" rights by all creditors, including DHCS, were expressly extinguished as to SGM.

As alleged in the FAC, those Orders afforded equal or greater protection to SGM than any settlement could have, thereby satisfying Section 8.7. Contrary to Defendants' assertion, a written settlement agreement was not the only means of satisfying Section 8.7. Rather, Section 8.4 of the APA provides:

> **8.4 Performance of Covenants.** Sellers shall have in all material respects performed or complied with each and all of the obligations, covenants, agreements and conditions required to be performed or complied with by Sellers on or prior to the Closing Date; provided, however, this condition will be deemed to be satisfied unless (a) Sellers were given written notice of such failure to perform or comply and did not or could not cure such failure to perform or comply within fifteen (15) business days after receipt of such notice and (b) the respects in which such obligations, covenants, agreements and conditions have not been performed have had or would have a Material Adverse Effect. [FAC, Ex. A.]

Here, at a minimum, the Memorandum Opinion and the Medi-Cal Provider Agreement Transfer Order materially complied with Section 8.7.

In any event, given SGM's continued objection to the sufficiency of the Bankruptcy Court's prior Orders, the Debtors reached a settlement agreement in principle with DHCS to the same effect on November 22, 2019. *See* FAC, ¶ 86. Because the APA did not require a written agreement or a court approved agreement, an oral agreement as to terms further satisfied the terms and requirements of Section 8.7. *See id.*, ¶ 92. At a minimum, these allegations must be accepted as true for purposes of the Motion. Accordingly, even if the Court's prior Orders regarding the Medi-Cal Provider Agreements were somehow insufficient to satisfy Section 8.7 (which Plaintiffs dispute), it would simply mean that the mandatory Closing Date for the transaction would have been a few days later, *i.e.,* ten days from the date a

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settlement was reached with DHCS. The DHCS settlement agreement was filed with the Court on December 9, 2019. Even assuming that agreement was a prerequisite to closing, the APA then required that the close occur "no later than ten (10) business days" later, which would have been December 23, 2019. *See* FAC, ¶ 85, Ex. A, § 1.3. Defendants, however, failed to close and the APA terminated four days later, on December 27, 2019.

Defendants suggest Plaintiffs had an obligation to issue a "notice of closing" when the DHCS settlement agreement was filed on December 9, 2019. *See* Motion at 27:19-20. The APA contains no such express or implied requirement, and instead states the "Closing Date" shall occur "no later than 10 days following the satisfaction or waiver of the closing conditions" to close. *See* FAC, ¶¶ 85, 105, Ex. A, § 1.3.

Nor is there any merit to Defendants assertion that "Plaintiffs then terminated the APA on December 17, 2019." Motion at 27:28-28:8. The FAC expressly alleges that the APA terminated on *December 27, 2019* due to Defendants' breaches. *See* FAC, ¶ 107 ("On December 17, 2019, the Debtors sent a notice to SGM citing various notices of breaches, and stating that the APA *would terminate effective December 27, 2019*.") (emphasis added). Defendants' factual arguments to the contrary are not properly considered on a motion to dismiss.

Finally, and in any event, Defendants incorrectly assume they were entitled to 10 days after the satisfaction of conditions before being required to close. In fact, the APA states that the close must occur "promptly but *no later than* ten (10) business days following the satisfaction or waiver of the conditions set forth." FAC, ¶ 106; Ex. A (emphasis added). Here, even under Defendants' theory of Section 8.7, the there was no reason they could not close promptly upon notice of the DHCS settlement. They simply did not wish to pay the negotiated price. As alleged in the FAC, all other conditions had been fully satisfied since at least December 5, 2019. *See* FAC, ¶ 87. Defendants failure to do so constitutes yet another breach of the APA.

In sum, the FAC more than adequately alleges satisfaction, waiver and/or

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excuse concerning all conditions precedent, including Sections 8.6 and 8.7.

C. Regardless, Defendants' Assertions Regarding Sections 8.6 and 8.7 Do Not Bar All Relief Sought By The Amended Complaint.

Further, Defendants' assertions regarding Section 8.6 and 8.7 supply no basis on which any claim for relief should be dismissed.

Defendants do not challenge (or even reference) Plaintiffs' other breach of contract claims set forth in Count I, based on *inter alia* (1) Defendants' failure to cooperate in rendering the Enforcement Order final and non-appealable, and (2) failure to have the closing funds available as required by APA Section 3.9. *See* FAC, ¶¶ 113-114. These are independent breach claims that survive regardless of Plaintiffs' assertions regarding Sections 8.6 and 8.7.

Nor could Defendants' assertions concerning Sections 8.6 or 8.7 possibly preclude Count II, for promissory fraud, which alleges that Defendants entered the APA with no intention of performing under it. *See* FAC, ¶¶ 115, 118. Defendants offer no explanation whatsoever on this point, and are precluded from doing so for the first time in their reply. *See Zamani v. Carnes*, 491 F.3d 990, 997 (9th Cir. 2007) ("district court need not consider arguments raised for the first time in a reply brief").

Finally, Defendants fail to explain how their Sections 8.6 and 8.7 theories could possibly bar Counts III, IV and V, for breach of the implied covenant of good faith and fair dealing and tortious breach of contract. As alleged in those claims, Defendants *inter alia* "unfairly interfered with Plaintiffs' rights to receive the benefits of the APA, which directly and proximately harmed Plaintiffs" and "enter[ed into] the APA with no intention to perform their obligations thereunder." FAC, ¶¶ 122,124. These theories are supported by factual allegations concerning Defendants' misrepresentations, delay and obstruction of Plaintiffs' efforts to receive the benefits of the APA. *Id.,* ¶¶ 48-112. In addition, the FAC alleges Plaintiffs would not have entered the APA and would not have continued to perform under it absent Defendants wrongful and fraudulent conduct, resulting in substantial damages. *Id.* at Preliminary

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Statement, 41, 61, 115-118; *see MH Pillars Ltd. v. Realini*, 277 F. Supp. 3d 1077, 1103 (N.D. Cal. 2017) (fraudulent inducement claim raised factual issues not appropriate for Rule 12(b)(6) motion). Accordingly, Defendants' Section 8.6 and 8.7 theories supply no basis for dismissing *any* claim for relief.

D. Plaintiffs' Promissory Fraud Claim Is Valid And Well Pled.

Defendants next assert that Plaintiffs' promissory fraud claim is barred by the litigation privilege and insufficiently pled. Again, they are incorrect.

1. The Litigation Privilege Is Inapplicable

Defendants argue that the litigation privilege under California Civil Code § 47(b) immunizes them from promissory fraud. Not so.

As Defendants' cited precedent confirm, the "purpose of the litigation privilege is to afford litigants and witnesses freedom of access to the courts [. . . and] to protect citizens from the threat of litigation for communications to government agencies whose function it is to investigate and remedy wrongdoing." *See McNair v. City & County of San Francisco,* 5 Cal. App. 5th 1154, 1162-1163 (2016) (internal quotations omitted). The privilege applies to statements: "(1) made in judicial or quasi-judicial proceedings; (2) by litigants or other participants authorized by law; (3) to achieve the objects of the litigation; and (4) that have some connection or logical relation to the action." *McNair v. City & County of San Francisco,* 5 Cal. App. 5th, 1154 at 1162 (*citing Silberg v. Anderson,* 50 Cal. 3d 205, 212 (1990)).

Here, unlike the cases they cite,[4] Defendants' false promises were made outside the bankruptcy proceeding, in private commercial interactions with Plaintiffs. Specifically, Defendants submitted a bid and signed the APA with no intention of

[4] Defendants' cases are distinguishable. *Sacramento Brewing Co. v. Desmond, Miller & Desmond*, 75 Cal. App. 4th 1082 (1999), and *Shoemaker v. Siegel,* 2017 WL 3671154 (C.D. Cal. 2017), involved claims based on statements made directly *to the bankruptcy court*. *Navarro v. IHOP Properties, Inc.*, 134 Cal. App. 4th 834 (2005), involved statements made to settle a lawsuit, not as part of a commercial transaction. In *Olsen v. Harbison*, 191 Cal. App. 4th 325, 334 (2010), unlike here, "the conversation between plaintiff and defendant occurred in order to *make* defendant a participant by having him associate in as **counsel**" for a *party* to the lawsuit. (emphasis in italics in original, emphasis in bold added)

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performing in accordance with it, and then dragged Plaintiffs through months of diminishing cash reserves without disclosing that they had no intention of ever closing the sale for the price dictated by the APA. Defendants contend the litigation privilege immunizes them from liability for fraud in the context of a potential bankruptcy sale. Reduced to its essence, Defendants contend there can be no liability for defrauding debtors involved in a bankruptcy proceeding. No legal authority supports their extreme position. Indeed, Defendants fail to cite a single case applying the litigation privilege to a claim of promissory fraud in any context.

Defendants were not "participants authorized by law" to the bankruptcy proceeding when the false promises were made. Indeed, when they submitted their bid and signed the APA, they had never appeared in the bankruptcy court and were strangers to the proceedings. *See LiMandri v. Judkins,* 52 Cal. App. 4th 326, 345 (1997) (privilege did not extend to nonparty's notice of lien); *Wise v. Thrifty Payless, Inc.,* 83 Cal. App. 4th 1296, 1306-1307 (2000) (privilege did not extend to nonparty's communications with party about issues related to litigation); *Gonzalez v. Compass Vision, Inc.*, 2010 WL 3783164, *5 (S.D. Cal. 2010) (privilege "does not extend infinitely back in time to protect every tortious act that might someday result in a communication in an official proceeding"); *see also In re HST Gathering Co.,* 125 B.R. 466, 468 (W.D. Tex. 1991) (entity that desired to purchase assets of estate is not within the "zone of interests intended to be protected" under the bankruptcy statutes and regulations); *In re Nepsco, Inc.,* 36 B.R. 25 (Bankr. D. Me. 1983) (*accord*).

Moreover, no precedent supports Defendants' sweeping proposition that all interactions with parties to a bankruptcy proceeding are cloaked in the litigation privilege. Indeed, the court in *In re Morpheus Lights, Inc.,* 228 B.R. 449 (Bankr. N.D. Cal. 1998), rejected precisely such a proposition. The debtor sued its lender for "engag[ing] in a pattern of improper post-petition conduct" and taking "control of the debtor and the bankruptcy case" for its own benefit. *Id.* at 452. In declining to apply the privilege, the court held "the crux of the allegations against [defendant] is that it

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has exceeded its role as a mere lender to the debtor and has exercised control through a pattern of wrongful acts and unfair practices which has injured the debtor, creditors and estate. This type of conduct is separate and distinct from conduct typically found within even the most litigious court proceedings. The litigation privilege does not bar suits addressing such injurious conduct." *Id.* at 455–56.

In addition, the privilege only applies to communications made "to achieve the objects of the litigation." *See Silberg*, 50 Cal. 3d at 212. "That is to say, the communicative act—be it a document filed with the court, a letter between counsel or an oral statement—must function as a necessary or useful step in the litigation process and must serve its purposes." *Rothman v. Jackson,* 49 Cal. App. 4th 1134, 1146 (1996). Defendants' fraudulent course of conduct that began prior to any appearance in the bankruptcy cases and expanded through communications made away from matters appearing on the docket of the Bankruptcy Court, was designed to entrap Plaintiffs into an APA that Defendants had no intention of performing and certainly did not "achieve the objects of the litigation." It did just the opposite.

Finally, the litigation privilege does not apply to a "tortious course of conduct," which is precisely what is alleged in this case. *See LiMandri v. Judkins,* 52 Cal. App. 4th 326, 345 (1997) (privilege did not bar claim based on tortious course of conduct that included filing lien in litigation); *Mancini & Assoc. v. Schwetz,* 39 Cal. App. 5th 656, 661 (Ct. App. 2019), *as modified on denial of reh'g* (Sept. 30, 2019) ("although Schwetz's act of executing the Memorandum was communicative, it was but one act in a course of tortious conduct to deprive Mancini of its attorney fees"); *Olszewski v. Scripps Health*, 30 Cal. 4th 798, 830 (2003) (privilege does not apply to tortious courses of conduct).

Accordingly, the litigation privilege does not bar the promissory fraud claim.

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2. Plaintiffs Have Alleged Promissory Fraud

Defendants next assert that Plaintiffs cannot establish the elements of promissory fraud because they have alleged that Defendants "made a mistake in judgment." Motion at 10:27. Defendants' position is a semantic ploy.

The FAC contains detailed allegations about the parties' negotiations, Defendants' misrepresentations and omissions, and Defendants' fraudulent intent to cause Plaintiffs to reasonably but detrimentally rely on Defendants' misrepresentations. The FAC repeatedly alleges that Defendants had no intention of performing their obligation under the APA to pay the $610 million purchase. *See, e.g.*, FAC Preliminary Statement, ¶¶ 60, 115, 124, 129.

Defendants ask the Court to simply ignore the allegations in Paragraph 60, that: "In all events, at the time the APA was executed and at the time of the Sale Order SGM had no intention of ever paying the Purchase Price Required under the APA, regardless of whether the condition to close were satisfied." Motion at 21:11-18. Contrary to Defendants' assertions, this allegation did not change the theory alleged in the complaint—it merely clarified allegations that Defendants misconstrued in their prior motion to dismiss. The Court must accept as true Plaintiffs' factual allegations and all inferences to be derived from those allegations. Defendants' assertion that the fraud claim "defies credulity" is irrelevant, and merely confirms the claim involves disputed factual issues. *See Polderman v. Gannett Co., Inc.*, 2009 WL 10673007, *4 (S.D. Cal. Nov. 3, 2009) (holding dismissal under Rule 12(b)(6) not appropriate where "Defendants' argument rests on disputed questions of fact").

In any event, the *particular reason* Defendants had no such intention is not relevant. The bottom line is that they induced Plaintiffs to enter the agreement through the false promise that they would pay $610 million if and when the conditions were satisfied. The Court should reject Defendants' "attempt to override the clear statement[s] in Plaintiffs' complaint." *Santino v. Apple Inc.*, 2018 WL 2091491, *2 (N.D. Cal. May 7, 2018) (quoting *Caterpillar Inc. v. Williams*, 482 U.S. 386, 398-99

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(1987)); *see also Cruz v. Freedom Mortg. Corp.*, 2018 WL 6118532, *4 (C.D. Cal. May 3, 2018), *reconsideration denied*, 2018 WL 5905389 (C.D. Cal. July 6, 2018) (rejecting argument that certain allegations "concede" that defendant's misrepresentations were not fraudulent).

For the foregoing reasons, Plaintiffs have alleged promissory fraud.

E. Plaintiffs Have Alleged Claims For Tortious Breach of Contract And Tortious Breach Of The Implied Covenant

Finally, Defendants incorrectly assert the fourth and fifth claims for relief are not cognizable under California law. California "has a legitimate and compelling interest in preserving a business climate free of fraud and deceptive practices" and "a plaintiff advances the public interest in punishing intentional misrepresentations and in deterring such misrepresentations in the future." *Robinson Helicopter Co. v. Dana Corp.*, 34 Cal. 4th 979, 990-93 (2004) (internal quotations omitted). "Simply put, a contract is not a license allowing one party to cheat or defraud the other." *Id.*[5]

Accordingly, a tortious breach of contract "may be found when (1) the breach is accompanied by a traditional common law tort, such as fraud or conversion; (2) the

[5] Defendants' mischaracterization of *Robinson Helicopter* as an "economic loss rule" case is simply untenable. *See* Motion at 23. Numerous courts have recognized the existence of such claims as in Counts IV and V outside the insurance context. *See Vestis, LLC v. Caramel Sales, Ltd.*, 2019 WL 3312212, *9 (C.D. Cal. Apr. 30, 2019); *Najor v. Wells Fargo Bank, N.A.*, 2019 WL 1858502, *4 (S.D. Cal. Apr. 25, 2019); *Dairy v. Harry Shelton Livestock, LLC*, 2019 WL 631493, at *10 (N.D. Cal. Feb. 14, 2019); *Century of Progress Prods. v. Vivendi S.A.*, 2018 WL 4191340, at *9 (C.D. Cal. Aug. 28, 2018); *Kanter v. Playbill, Inc.*, 2017 WL 10591601, at *7 (C.D. Cal. Aug. 31, 2017); *Expedited Packages, LLC v. Beavex Inc.*, 2015 WL 13357436, at *3 (C.D. Cal. Sept. 10, 2015); *Bullard v. Wastequip, Inc.*, 2014 WL 10987394, at *8 (C.D. Cal. Sept. 11, 2014); *Foley v. Aintabi*, 2013 WL 12130015, at *6 (C.D. Cal. Nov. 6, 2013); *Fortune Mfg. Co. v. Zurn Indus., LLC*, 2011 WL 13218043, *3 (C.D. Cal. Aug. 31, 2011); *Unique Functional Prod., Inc. v. JCA Corp.*, 2011 WL 13355975, *6 (S.D. Cal. May 4, 2011); *Gentec Enterprises Inc. v. Transistor Devices Inc*, 2011 WL 13217566, *3 (C.D. Cal. Jan. 31, 2011); *Velocity Staffing Corp., Inc. v. Resolve Staffing, Inc.*, 2008 WL 11342746, *3 (C.D. Cal. June 16, 2008); *Rejects Skate Magazine, Inc. v. Acutrack, Inc.*, 2006 WL 2458759, *5 (N.D. Cal. Aug. 22, 2006); *StreamCast Networks, Inc. v. IBIS LLC*, 2006 WL 5720345, *10 (C.D. Cal. May 2, 2006); *El Dorado Irrigation Dist. v. Traylor Bros.*, 2006 WL 306914, *5 (E.D. Cal. Feb. 7, 2006); *Putnam v. Putnam Lovell Grp. NBF Sec., Inc., a Delaware corporation*, 2005 WL 2463951, *9 (N.D. Cal. Oct. 5, 2005); *Bea v. Sw. Airlines Co.*, No. 2005 WL 646074, at *4 (N.D. Cal. Mar. 17, 2005); *Robinson Helicopter Co. v. Dana Corp.*, 34 Cal. 4th 979, 990 (2004); *Erlich v. Menezes*, 21 Cal. 4th 543, 981 P.2d 978 (1999).

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means used to breach the contract are tortious, involving deceit or undue coercion; or (3) one party intentionally breaches the contract intending or knowing that such a breach will cause . . . substantial consequential damages." *Id.* (quotation omitted). Here, the FAC alleges all three circumstances, which is more than sufficient to state a claim for relief under Rule 12(b)(6).

Moreover, as this Court previously observed, "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and in its enforcement." *Las Vegas Land & Dev. Co., Inc. v. Bank of Am., N.A.*, 2018 WL 6991161, *6 (C.D. Cal. Oct. 15, 2018) (quoting *Carma Developers, Inc. v. Marathon Development California, Inc.*, 2 Cal.4th 342, 371 (1992)). "This duty, or covenant, finds particular application in situations where one party is invested with a discretionary power affecting the rights of another" and exists "to prevent one contracting party from unfairly frustrating the other party's right to receive the benefits of the agreement actually made," even if no express breach is ultimately established. *Las Vegas Land, at *6* (quoting California cases). Defendants' fraudulent scheme to take advantage of community hospitals in dire financial distress is quintessential bad faith. *See id.*; *Sunfarms, LLC v. Eurus Energy Am. Inc.*, 2019 WL 4736223, *6 (S.D. Cal. Sept. 27, 2019) (denying dismissal where defendants frustrated plaintiff's expectations of benefit by causing unreasonable delay, asserted unreasonable terms, and failed to respond); *Century of Progress Prods. v. Vivendi S.A.*, 2018 WL 4191340, *10–13 (C.D. Cal. Aug. 28, 2018) (denying dismissal where defendants "engaged in separate nefarious accounting practices to conceal and underreport[,]" which imposed additional costs on Plaintiffs).

None of Defendants' cited cases address the rule set forth in *Robinson Helicopter*. Rather, Defendants' cited cases are either out of date, inapposite, or actually establish the viability of Plaintiffs' claim. For instance, *Pension Tr. Fund for Operating Engineers v. Fed. Ins. Co.*, 307 F.3d 944, 954-55 (9th Cir. 2002), held a party had adequately alleged tortious breach of the implied covenant where the

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opposing party owed a fiduciary duty by controlling the financially-dependent party. Similarly, the court in *Stop Loss Ins. Brokers, Inc. v. Brown & Toland Med. Grp.*, 143 Cal. App. 4th 1036, 1041 (2006), noted that "when the actions that constitute the breach violate a social policy that merits the imposition of tort remedies[,]" the cause of action exists. *Applied Equip. Corp. v. Litton Saudi Arabia Ltd.*, 7 Cal. 4th 503, 514 (1994), is inapposite because it involved a claim of tortious interference with contract and a conspiracy to breach claim, neither of which is at issue here. Further, *Aas v. Superior Court*, 24 Cal. 4th 627 (2000), has been superseded by statute. *See S. California Gas Leak Cases*, 7 Cal. 5th 391, 402 (2019). Defendants' remaining cases merely allowed tort recovery for a breach of the implied covenant where there was a special relationship between the parties. *See California Joint Powers Ins. Auth. v. Munich Reins. Am., Inc.*, 2008 WL 1885754, *2 (C.D. Cal. Apr. 21, 2008). None of these cases immunizes Defendants from the fourth or fifth claims for relief.

Accordingly, Plaintiffs' claims for tortious breach of the APA and tortious breach of its implied covenant of good faith and fair dealing, as set forth in Counts IV and V, are viable and properly pleaded.

V. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court deny Defendants' Motion. In the event the Court is inclined to grant any portion of the Motion, Plaintiffs respectfully request leave to amend.

Respectfully submitted,

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