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Debtors and 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*.

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' MOTION TO DISMISS DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S COUNTERCLAIMS, OR IN THE ALTERNATIVE, TO STRIKE PORTIONS OF DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S COUNTERCLAIMS

Date: August 31, 2020
Time: 1:30 p.m.
Place: Courtroom 7D
350 West 1st Street
Los Angeles, CA 90012

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NOTICE OF MOTION AND MOTION

TO DEFENDANTS AND THEIR COUNSEL AND TO THE CLERK OF THE COURT:

PLEASE TAKE NOTICE that on August 31, 2020 at 1:30 p.m. or as soon thereafter as counsel may be heard in the United States District Court for the Central District of California, located at First Street Courthouse, 350 W. 1st Street, Courtroom 7D, Los Angeles, California, Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, Verity Holdings, LLC, and the above-captioned debtors will and hereby do move to dismiss (in whole or in part) each count of Defendant Strategic Global Management, Inc.'s Counterclaims (the "Counterclaim"), as well as its claim for punitive damages, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to state a cognizable claim for relief.

In addition, and in the alternative, Plaintiffs move pursuant to Rule 12(f) of the Federal Rules of Civil Procedure to strike the portions of SGM's Counterclaim that seeks refund of the Deposit, including: page 2, lns. 9-10, 23-26; page 3, lns. 1-2; page 11, lns. 2-9; page 12, lns. 1-3; page 21, lns. 6-8; page 22, lns. 6-7, 13-14; page 23, lns. 17-19, 23-24; and page 25, ln. 14. In addition, Plaintiffs move to strike SGM's punitive damages allegations associated with SGM's conversion claim for the same reasons the conversion claim fails, and because the punitive damages request is improperly pleaded as a matter of law.

This motion is based upon this Notice, the following Memorandum of Points and Authorities, the concurrently-filed Request for Judicial Notice, all pleadings, records and documents on file herein, and such additional evidence and argument as may be properly introduced in support of the motion.

This motion is made following the conference of counsel pursuant to L.R.7-3, which took place on July 23, 2020, with subsequent emails among counsel.

Respectfully submitted,

Dated: July 31, 2020

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By */s/ Sonia Martin*
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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

This case arises from an asset purchase agreement (the "APA") for the sale of four hospitals to Defendant Strategic Global Management, Inc. ("SGM") under the auspices of a Bankruptcy Court order. Ultimately, SGM did not close the sale, and Plaintiffs terminated the APA. The Counterclaim alleges the APA requires Plaintiffs to refund SGM's $30 million deposit (the "Deposit"), and asserts claims for breach of contract, breach of the implied covenant of good faith and fair dealing, conversion and violation of the California Unfair Practices Act, §§ 17000 *et seq.* (the "UCL"). The theory fails as a matter of law.

First, all of SGM's claims must be dismissed because, pursuant to the express terms of Section 1.2 of the APA, the Deposit was "non-refundable." The APA provides that SGM is entitled to a refund of the Deposit under only four triggering circumstances, *none* of which SGM alleges. SGM fails to allege that any of those circumstances occurred, and it fails to allege any basis for recovering the Deposit under the APA or any legal theory.

Second, all of SGM's claims must be dismissed because Plaintiffs *are under court order* not to release the Deposit. Specifically, the Bankruptcy Court's May 2, 2019 order approving the SGM Sale ordered that sale proceeds shall not be used for any purpose "except as provided in this Order, the DIP Credit Agreements or the Final DIP Order without further order of this Court." *See* Plaintiffs' RJN, Ex. B. Declining to violate a court order does not breach the APA or its implied covenant of good faith and fair dealing. Nor does it supply a basis for conversion and unfair competition claims.

Third, SGM's conversion and unfair competition claims fail on additional grounds. The conversion claim is based on Debtors' supposed breach of the APA. But the economic loss rule bars a claimant from premising a conversion claim on a

breach of contract. As for the unfair competition claim, the Counterclaim fails to allege "unfair" conduct under the standards set forth in applicable authority.

Finally, SGM fails to allege any basis on which it could recover punitive damages against Plaintiffs: the Counterclaim does not come close to alleging the type of fraudulent, malicious or oppressive conduct required for this unique remedy. Debtors have retained the Deposit based on clear language in the APA and pursuant to a court order preventing Debtors from releasing the Deposit. This is light years away from the types of facts that allow a claimant to plausibly seek punitive damages.

For the reasons fully described below, Plaintiffs respectfully request that the Court dismiss Counterclaims I [First Cause of Action - Breach of Contract] ("**Count I**") and II [Second Cause of Action - Breach of The Implied Covenant of Good Faith and Fair Dealing] ("**Count II**"), to the extent they are premised on purported breach of the APA for failure to refund SGM's $30 million deposit, and strike any allegations seeking the refund of the Deposit. In addition, Plaintiffs respectfully request that the Court dismiss SGM's Counterclaims III [Third Cause of Action - Conversion] ("**Count III**") and IV [Fourth Cause of Action - Violation of Cal. Bus. & Prof. Code § 17200] (("**Count IV**") in their entirety, including SGM's prayer for punitive damages.

II. FACTUAL BACKGROUND

A. The Bankruptcy And The Hospital Sale

On August 31, 2018, Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center (together with St Francis and St. Vincent, the "Plaintiff 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 administered before the Bankruptcy Court. *See* SGM Counterclaims ("Counterclaim"), Docket No. 41,

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at ¶ 16. The Debtors' bankruptcy cases are the second largest hospital bankruptcy in U.S. history.

In January 2019, SGM executed an agreement to buy the Hospitals and their assets in exchange for (among other things) a cash payment of $610 million. *See* Counterclaim, ¶ 2. On January 8, 2019, SGM executed the APA, which is attached as an exhibit to the Plaintiffs' First Amended Complaint ("FAC"). *See* FAC, Ex. A; Counterclaim, ¶¶ 2, 17.

B. The Deposit And The Limited Circumstances For Its Refund

Pursuant to APA Section 1.2, SGM wired the $30 million Deposit into VHS's bank account. *See* Counterclaim, ¶ 18. APA section 1.2 states:

> The Deposit shall be *non-refundable in all events*, except as provided in Section 6.1(b) or Section 6.2, or in the event [SGM] *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 [Plaintiffs] shall immediately return the Deposit to [SGM] with all interest earned thereon.
>
> FAC, Ex. A (emphasis added).

Accordingly, the Deposit is non-refundable except as provided in four sections of the APA. Specifically, Section 6.1(b)(2) of the APA requires the refund of the Deposit in the event the Hospitals were sold to an "overbidder" other than SGM:

> [I]n the event that an overbidder (and not the Purchaser) is the successful bidder for the purchase of the Assets (the '**Alternate Transaction**') and the Alternative Transaction is approved by the Bankruptcy Court, (a) the Deposit, and any interest earned thereon, shall be returned to Purchaser immediately upon the entry of such sale order[.]
>
> FAC, Ex. A.

Section 6.2 requires refund of the Deposit in the event the Bankruptcy Court's "Sale Order" approving the APA was appealed and a stay was imposed:

> In the event a stay is issued by any appellate court, including the United States District Court, which prevents the sale from closing, as scheduled, Purchaser shall have the right to terminate this Agreement if such stay is not vacated on or before 45 days from the date of the stay is

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> issued, and Purchaser shall be entitled to the prompt return of the Deposit and any interest earned thereon.
>
> FAC, Ex. A.

Section 9.1 of the APA delineates the following grounds on which the APA could be terminated, permitting a refund of the Deposit:

> 9.1 Termination. This Agreement may be terminated at any time prior to Closing:
>
> (a) by the mutual written consent of the parties;
>
> (b) by Sellers if a material breach of this Agreement has been committed by Purchaser and such breach has not been (i) waived in writing by Sellers or (ii) cured by Purchaser to the reasonable satisfaction of Sellers within fifteen (15) business days after service by Sellers upon Purchaser of a written notice which describes the nature of such breach;
>
> (c) by Purchaser if, in its sole and absolute discretion, it is not satisfied with either (i) the results of its due diligence examination of the Hospitals, or (ii) the contents of any schedule or exhibit that was not completed and attached to this Agreement, but which has been provided to Purchaser after the Signing Date, and Purchaser has notified Seller of its election to terminate the Agreement under this Section 9.1(c) on or prior to January 8, 2019 […];
>
> (d) by Purchaser if a material breach of this Agreement has been committed by Sellers and such breach has not been (i) waived in writing by Purchaser or (ii) cured by Sellers to the reasonable satisfaction of Purchaser within fifteen (15) business days after service by Purchaser upon Sellers of a written notice which describes the nature of such breach;
>
> (e) by Purchaser if satisfaction of any of the conditions in ARTICLE 8 has not occurred by December 31, 2019 or becomes impossible […].
>
> (f) by Sellers if satisfaction of any of the conditions in ARTICLE 7 has not occurred by December 31, 2019 or becomes impossible […];
>
> (g) by either Purchaser or Sellers if the Bankruptcy Court enters an order dismissing the Bankruptcy Cases or fails to approve the Sales Procedures Motion by the date specified in Section 6.1(b);

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> (h) by Sellers if, in connection with the Bankruptcy Cases, any Seller accepts an Alternate Transaction and pays the Break-Up Fee;
>
> (i) by either Purchaser or Sellers if the Closing has not occurred (other than through the failure of any party seeking to terminate this Agreement to comply fully with its obligations under this Agreement) on or before December 31, 2019; or
>
> (j) by Purchaser if a force majeure event […].
>
> FAC, Ex. A.

Finally, Section 9.2 of the APA states that the Deposit must be refunded if the APA is terminated for any of the above reasons other than the Purchaser's default under Section 9.1(b):

> 9.2 Termination Consequences. If this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1: (a) all further obligations of the parties under this Agreement shall terminate (other than Purchaser's right to receive the Break-Up Fee if applicable), provided that the provisions of ARTICLE 12, shall survive; and (b) each party shall pay only its own costs and expenses incurred by it in connection with this Agreement; provided, in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof. In addition, *if this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 (other than Section 9.1(b)), Seller shall immediately return the Deposit to Purchaser with all interest earned thereon.* Each Party acknowledges that the agreements contained in this Section 9.2 are an integral part of the transactions contemplated by this Agreement, that without these agreements such Party would not have entered into this Agreement.
>
> FAC, Ex. A (emphasis added).

C. The Bankruptcy Court Orders Effectuating The Sale And Preventing Release Of The Deposit

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. *See* Plaintiffs' Request for Judicial Notice In Support of Motion to Dismiss SGM's Counterclaims ("Plaintiffs' RJN"), Ex. A. On May 2, 2019, the Court entered an order approving the sale to

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SGM (the "Sale Order"). *See* Plaintiffs' RJN, Ex. B. SGM filed a brief in support of entry of the Sale Order. *See* Plaintiffs' RJN, Ex. M. ("SGM respectfully requests that the Court grant the Sale/Bid Procedures Motion as submitted by the Debtor.")

The Sale Order required that all sale proceeds (including the SGM deposit) be held in Escrow Deposit Accounts pursuant to the terms and restrictions set forth in the order authorizing postpetition financing, use of cash collateral, liens, adequate protection, and other relief (the "Final DIP Order"), which were expressly incorporated into the Sale Order. *See* Plaintiffs' RJN, Ex. C. Pursuant to the Final DIP Order, the subsequent cash collateral orders entered in the bankruptcy proceedings, and the Sale Order, the Debtors cannot use sale proceeds held in Escrow Deposit Accounts without the consent of the Prepetition Secured Creditors or an order of the Court. *See* Plaintiffs' RJN Exs. D-H.

Specifically, the Final DIP Order required the Debtors to place "all proceeds of any sale or other this position of the Debtors' property" in "Escrow Deposit Accounts" subject to deposit account control agreements. Plaintiffs' RJN, Ex. C. Paragraph 4 of the Final DIP Order restricts the Debtors' authority to use or transfer funds held in the Escrow Deposit Accounts:

> [T]he Debtors shall not be permitted to use Cash Collateral of any of the Prepetition Secured Creditors held in any Escrow Deposit Account for any purpose without first obtaining the consent of the applicable Prepetition Secured Creditor or obtaining an order of the Court pursuant to Section 363 of the Bankruptcy Code after notice and a hearing. *Id.*

In addition, the DIP Agent was granted a first priority lien on the Escrow Deposit Account and all Sale Proceeds:

> As provided by the Interim Order, this Final Order and the DIP Credit Agreement, the DIP Liens *shall attach as first priority liens and security interests*, pursuant to section 364(d) of the Bankruptcy Code and the DIP Financing Agreements, to all proceeds of any sale or other disposition of the Debtors' property, including, without limitation, the Healthcare Facilities (as defined in the DIP Credit Agreement) and any other DIP Collateral (as defined below) (the "***Sale Proceeds***"). The Sale Proceeds

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> shall be held in escrow in one or more deposit accounts subject to a deposit account control agreement in favor of the DIP Agent (the "***Escrow Deposit Account***"). Any funds held in the Escrow Deposit Account shall not be commingled with any other funds of the selling Debtor, the Sale Proceeds of any other Debtor or otherwise.
>
> Plaintiffs' RJN, Ex. C. (emphasis in italics added)

The terms of the Final DIP Order were expressly incorporated into the Sale Order, which likewise provides that Sale Proceeds shall not be used for any purpose "except as provided in this Order, the DIP Credit Agreements or the Final DIP Order *without further order of this Court*":

> 13. The terms and conditions of the Final DIP Order shall apply with respect to the Sale Proceeds and Escrow Deposit Accounts (defined herein). Without limiting the foregoing, the Debtors shall comply with paragraph 4 of the Final DIP Order in the following manner:
>
> (a) the Debtors shall direct SGM, pursuant to the terms of the APA, to remit all Sale Proceeds to the separate accounts opened in the name of each Debtor for the Sale Proceeds (each such hereafter referred to as "Escrow Deposit Account");
>
> [. . .]
>
> (c) without limitation of the rights of the DIP Agent and DIP Lender under the DIP Financing Agreements and the Final DIP Order, *no funds held in any Escrow Deposit Account shall be* (i) commingled with any other funds of the applicable Debtor or any of the other Debtors or (ii) *used by the Debtors for any purpose, except as provided in this Order, the DIP Credit Agreements or the Final DIP Order without further order of this Court,* after reasonable notice under the circumstances to the DIP Agent, the Prepetition Secured Creditors and the Committee; and
>
> (d) each Escrow Deposit Account shall be subject to a deposit account control agreement in favor of the DIP Agent and DIP Lender, and subject to, without limitation of the rights of the DIP Agent and DIP Lender under the DIP Financing Agreements and the Final DIP Order with respect to the Sale Proceeds and Escrow Deposit Account, including, without limitation, following the occurrence of an Event of Default or the Revolving Loan Termination Date (as defined in the DIP Credit Agreement), the Debtors shall not be permitted to use the funds held in any Escrow Deposit Account for any purpose, except as provided in paragraph 14, 15, 16, and 17 of this Order [concerning payment of cure amounts for assigned

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> contracts], and to fund any Purchase Price adjustment in favor of the Purchaser, without first obtaining the consent of the DIP Agent, DIP Lender and the Prepetition Secured Creditors or obtaining an order of the Court pursuant to §§ 363 or 1129 after reasonable notice under the circumstances to the DIP Agent, the DIP Lender, the Prepetition Secured Creditors and the Committee and, if necessary, a hearing thereon[.]
>
> Sale Order, Plaintiffs' RJN, Ex. B at ¶ 13 (emphasis added).

After the bankruptcy court entered the Sale Order, the Debtors obtained authority for the consensual use of cash collateral pursuant to a Supplemental Cash Collateral Order and subsequent amendments to the Supplemental Cash Collateral Order. *See* Plaintiffs' RJN Exs. D-H. Each order explicitly incorporates the limitations of the Final DIP Order.

D. SGM Fails To Close And Never Terminates The APA

The background regarding Plaintiffs' efforts to close the Sale with SGM are detailed in the First Amended Complaint, and incorporated by reference. *See* 2:20-cv-00613-DSF, Docket No. 29. SGM did not close the sale on December 5, 2019 or at any time thereafter despite ample opportunity. *See* Counterclaim, ¶¶ 63-65. Instead, it sent the Debtors a letter on December 5, 2019, demanding the refund of its $30 million deposit. *See* Counterclaim, ¶ 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* Plaintiffs' RJN, Ex. I. 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. J, at 2. The Bankruptcy Court recognized that:

> 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.

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Plaintiffs' RJN, Ex. K at 2.

By letter dated December 10, 2019, Plaintiffs confirmed they remained prepared to close, stating "[t]he 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, Answer to First Amended Complaint ("SGM Answer"), Docket No. 41, ¶¶ 103-104. On December 17, 2019, Debtors sent SGM a letter advising that the APA would terminate effective December 27, 2019. *See* Plaintiffs' RJN, Ex. L; Counterclaim, ¶ 66. SGM never terminated the APA—only Debtors did.

E. The Adversary Proceeding Against SGM and Its Alter Egos

Plaintiffs filed their original Complaint in this proceeding on January 3, 2020. On March 11, 2020, Plaintiffs filed the FAC. *See* Docket No. 29.

On July 10, 2020, SGM answered the FAC and filed its Counterclaim, asserting four counts. Count I and Count II allege Plaintiffs breached the APA and the implied covenant of good faith and fair dealing. Count III accuses Plaintiffs of conversion based their retention of the Deposit. Finally, Count IV alleges Plaintiffs violated the UCL based on the same alleged conduct. Each of SGM's claims is premised on the allegation that Plaintiffs are required under the APA to refund the Deposit. As explained below, that is incorrect.

III. LEGAL STANDARD

A motion to dismiss a counterclaim is subject to the same standard as a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6). *E.g.*, *Eagle Eyes Traffic Indus. USA Holding v. AJP Distributors Inc.*, No. 218CV01583SJOAS, 2018 WL 4859260, at *2 (C.D. Cal. June 22, 2018) (citing *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003)). "Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Id.* (quoting *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1988)). "Rule 12(b)(6) must be read in conjunction with Rule 8(a), which requires 'a short

and plain statement of the claim showing that the pleader is entitled to relief.'" *Id.* (quoting Fed. R. Civ. P. 8(a)(2)). Thus, the Court may not accept as true mere legal conclusions in the counterclaim, and the legal "framework" of the counterclaim "must be supported by factual allegations." *Id.* (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009).

IV. ARGUMENT

A. SGM Cannot Recover The Deposit Because It Was Non-Refundable Under The Express Terms Of The APA

Each of SGM's claims fail, in whole or in part, because the express terms of the APA do not entitle SGM to recover the Deposit. *See Gosha v. Bank of New York Mellon Corp.*, 707 F. App'x 484 (9th Cir. 2017) (affirming dismissal of claims based on parties' written agreements, because "absent ambiguity, the court construes the words of a contract as a matter of law" (quotation omitted)).

1. The Deposit Is Non-Refundable Because None Of The Exceptions Under Section 1.2 Are Applicable.

SGM admits it paid the Deposit to VHS "[p]ursuant to APA Section 1.2." Counterclaim, ¶ 18. APA Section 1.2 states:

> The Deposit *shall be non-refundable in all events*, except as provided in Section 6.1(b) or Section 6.2, or in the event [SGM] *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 [Plaintiffs] shall immediately return the Deposit to [SGM] with all interest earned thereon.
>
> FAC, Ex. A (emphasis added).

The Counterclaim, however, does not allege that any of the referenced four APA sections referenced in the APA (6.1(b), 6.2, 9.1, or 9.2) entitle SGM to a refund of the Deposit. Nor do these four APA sections entitle SGM to a refund of the Deposit as discussed in term.

First, APA Section 6.1(b) would have been triggered only in the event that an "Overbidder" successfully bid to purchase the Hospitals in an "Alternate

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Transaction." *See* FAC, Ex. A, § 6.1(b). There is no dispute this did not occur, as is clear from the First Amended Complaint and the Counterclaim.

Second, APA Section 6.2 is likewise inapplicable on its face, because there was no appellate court stay of the Sale Order preventing a closing and SGM did not terminate the APA. *See* FAC, Ex. A, § 6.2.

Third, APA Section 9.1 (other than Section 9.1(b)) would only require a refund of the Deposit in the event "[SGM] has terminated this Agreement." FAC, Ex. A, § 1.2. As the Counterclaim confirms, however, this did not occur. Despite its baseless allegations that Plaintiffs had breached the APA, SGM never purported to terminate the APA for any of the reasons unilaterally available to Purchaser as enumerated in Section 9.1, *e.g.* § 9.1(c) [due diligence dissatisfaction before January 8, 2019], §9.1(d) [Sellers' material covenant breach], § 9.1(e) [Article 8 conditions unsatisfied by December 31, 2019], 9.1(g) [dismissal of the chapter 11 cases], or §9.1(i) [failure to close without fault of Purchaser]. Instead, it simply refused to close the transaction and demanded the return of its Deposit in one letter, while seeking to keep Plaintiffs locked in the APA, incurring estimated daily losses of $450,000 and being prevented from selling the Hospitals to another buyer.

Fourth, APA Section 9.2 also does not entitle SGM to a refund of the Deposit. That section provides:

> 9.2 Termination Consequences. If this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1: (a) all further obligations of the parties under this Agreement shall terminate (other than Purchaser's right to receive the Break-Up Fee if applicable), provided that the provisions of ARTICLE 12, shall survive; and (b) each party shall pay only its own costs and expenses incurred by it in connection with this Agreement; provided, in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof. In addition, *if this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 (other than Section 9.1(b)), Seller shall immediately return the Deposit to Purchaser with all interest earned thereon.* Each Party acknowledges that the agreements contained in this Section 9.2 are an integral part of the transactions contemplated by this Agreement, that without

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> these agreements such Party would not have entered into this Agreement.
>
> FAC, Ex. A (emphasis added).

Here, the APA was not terminated pursuant to Sections 6.1(b), 6.2 or 9.1. Rather, *Plaintiffs* terminated the APA, pursuant to Section 9.1(b). *See* FAC ¶¶ 88, 91, 93, 100, 107; SGM Answer ¶¶ 93, 107. Section 9.2 expressly provides that the Deposit will not be refunded in the event of a termination pursuant to Section 9.1(b). *See* FAC, Ex. A, APA, § 9.2 ("In addition, if this Agreement is terminated pursuant to Sections 6.1(b), 6.2 or 9.1 *(other than Section 9.1(b)),* Seller shall immediately return the Deposit to Purchaser with all interest earned thereon." (emphasis added)). Because none of the circumstances delineated in Section 1.2 occurred, the Deposit remains "*non-refundable*" according to the APA's express terms.

Consequently, SGM is not entitled to a refund of the Deposit.

2. Section 11.2 Does Not Entitle SGM To A Refund of the Deposit.

To avoid the express terms of Section 1.2, SGM stretches Section 11.2 of the APA to a breaking point. Contrary to SGM's assertions, APA Section 11.2 did not expand the limited set of circumstances in which the Deposit was refundable.

As its placement in the contract suggests, Section 11.2 merely outlines the remedies available in the event of a termination under Section 9.1(b) or (d). *See* FAC, Ex. A, § 9.2 ("in the case of any termination based on Sections 9.1(b) or (d) the consequences of such termination shall be determined in accordance with ARTICLE 11 hereof"). In contrast, Section 1.2 appears in the first section of the contract, sets forth the definition of "Deposit," and expressly states the Deposit is "non-refundable in all events," except for the four instances set forth in Sections 6.1(b), 6.2, 9.1 and 9.2. FAC, Ex. A; *see In re Keller's Estate,* 134 Cal. App. 2d 232, 236, 286 P.2d 889, 891 (1955) ("We are convinced that consideration should first be given to the order in which the provisions appear, for, unless some contrary design is apparent, what could be more logical in applying rules of interpretation than to say

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that each subsequent provision in a will must be considered in the light of that which has gone before.").

To supplement those four limited instances with a new section that was not referenced would eviscerate the "non-refundable in all events" language of Section 1.2. The "fundamental rule of contract interpretation" is that "a contract should be interpreted so as to give meaning to each of its provisions" without rendering any of them "meaningless." *Brinderson–Newberg Joint Venture v. Pac. Erectors, Inc.*, 971 F.2d 272, 278–79 (9th Cir.1992) (citing Restatement of Contracts (2d) § 203(a) cmt. b (1979)). SGM's proposed interpretation of Section 11.2 is also inconsistent with Section 9.1, which lists the specific circumstances entitling SGM to a refund in the event Plaintiffs did not fulfill their obligations under the APA.

For these reasons, SGM cannot recover the Deposit under the plain terms of the APA. Accordingly, the Court should dismiss each of Plaintiffs' Counts to the extent they are based on such a theory, or alternatively strike any allegations to this effect.

B. Plaintiffs Are Prohibited By Court Order From Releasing The Deposit.

In addition, each claim asserted by SGM fails because orders issued by the Bankruptcy Court preclude Plaintiffs from disbursing the Deposit. Specifically, as explained above, the Sale Order incorporates the provisions of the Final DIP Order, which requires that all sale proceeds, including deposits, be held in a segregated Escrow Deposit Account, and precludes the Debtors from disbursing those funds absent the consent of the Debtors' Prepetition Secured Creditors or an order of the Court. *See* Sale Order, Plaintiffs' RJN, Ex. B at ¶ 13; Final DIP Order, Plaintiffs' RJN, Ex. C at ¶ 4. The Counterclaim does not allege that such consent has been given or that such an order has been issued.

In the face of these arguments, SGM has incorrectly asserted that the Bankruptcy Court's orders are contrary to the express terms of the APA. However,

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the Sale Order provides that, "[u]nless otherwise provided in this Sale Order, to the extent any inconsistency exists between the provisions of the APA and this Sale Order, the provisions contained in this Sale Order shall govern." Sale Order, Plaintiffs' RJN, Ex. B at ¶ 26. Accordingly, the more restrictive terms of the Sale Order limiting disbursements of sale proceeds govern over any contrary language in the APA.

Plaintiffs cannot be liable under any legal or equitable theory for refusing to engage in conduct that would violate a court order, particularly one that takes precedent over any inconsistent provisions contained in the APA. *See Singh v. Baidwan*, 651 F. App'x 616, 617-19 (9th Cir. 2016) ("the public importance of discouraging [illegal] transactions outweighs equitable considerations of possible injustice between the parties") (internal quotes omitted).

In short, Plaintiffs are obligated to hold the Deposit pursuant to the Bankruptcy Court's orders, and they have not breached the APA, converted funds or violated the UCL by acting in conformance with those orders designed to protect the interests of parties other than Plaintiffs. Accordingly, Counts III and IV, which are based entirely on Plaintiffs alleged failure to refund the Deposit, should be dismissed. Counts I and II should be dismissed to the extent they are premised on the same theory. In the alternative, the Court should strike all allegations that seek to impose liability for allegedly failing to remit the Deposit to SGM, as specified in the above Notice of Motion.

C. <u>The Conversion Claim Fails On Additional Grounds.</u>

In addition to the above, SGM has also failed to plead (and cannot plead) a cognizable claim for conversion. "The basic elements of conversion are (1) the plaintiff's ownership or right to possession of personal property; (2) the defendant's disposition of the property in a manner that is inconsistent with the plaintiff's property rights; and (3) resulting damages." *Cakebread v. Berkeley Millwork & Furniture*

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Co., No. 16-CV-00083-RS, 2017 WL 579913, at *8 (N.D. Cal. Feb. 13, 2017) (applying California law).

SGM alleges the it has a right to possess the Deposit under the APA. As explained above, however, the APA expressly rendered the Deposit "non-refundable in all events," with the exception of four specific events that did not occur here. In any event, a "mere contractual right of payment, without more, will not suffice" to support a right to possession for purposes of a conversion claim. *See Rutherford Holdings, LLC v. Plaza Del Rey*, 223 Cal. App. 4th 221, 233 (2014); *accord Cakebread*, 2017 WL 579913, at *8; *In re Bailey*, 197 F.3d 997, 1000 (9th Cir. 1999); *Lever Your Bus., Inc. v. Sacred Hoops & Hardwood, Inc.*, No. 519CV1530CASKKX, 2019 WL 7050226, at *6 (C.D. Cal. Dec. 23, 2019).

For much the same reasoning, the economic loss rule bars SGM from premising a conversion claim on an alleged breach of contract. "Courts grant motions to dismiss based on the economic loss rule when no harm has been alleged other than a broken contractual promise." *Lever Your Bus.,* 2019 WL 7050226, at *7 (citing *Correia v. Johnson & Johnson Co.*, No. 2:18-CV-09918-PSG-AS, 2019 WL 2120967, at *5 (C.D. Cal. May 9, 2019) (finding a conversion claim "barred by California's economic loss rule"); *Zhejiang Crafab Elec. Co. v. Advantage Mfg., Inc.*, No. 8:17-CV-02268-JVS-JPR, 2018 WL 6177952, *5-6 (C.D. Cal. Apr. 23, 2018) (dismissing a conversion claim arising "from the same alleged conduct that [gave] rise to its cause of action for breach of contract"); *Pollock v. Vanguard Grp. Inc.*, No. 2:16-CV-06482-JLS-JCG, 2017 WL 4786007, at *4-5 (C.D. Cal. Aug. 21, 2017) (dismissing a conversion claim where "there [was] no evidence that [plaintiff] suffered any harm 'above and beyond a broken contractual promise'"); *Baggett v. Hewlett-Packard Co.*, 8:07-CV-00667-AG-RNB, 2009 WL 3178066, at *2–3 (C.D. Cal. Sep. 29, 2009) (dismissing a conversion claim "aris[ing] solely out of their contract"). Here, SGM's conversion claim is premised entirely on the allegation that it is owed $30 million under the APA, and that Plaintiffs broke their contractual

promise. Because SGM's alleged damages arise solely out of a contractual agreement, the economic loss rule applies. *See also Culp Constr. Co. v. Sposito*, No. SACV19727JVSADSX, 2019 WL 6357971, at *4 (C.D. Cal. July 31, 2019) (dismissing conversion claim as barred by economic loss rule).

In sum, SGM fails to allege a basis on which it had any right to ownership or possession over the Deposit. Nor could it, given that the APA rendered the Deposit non-refundable absent circumstances not alleged here, and court orders confirmed that the Deposit was properly in escrow accounts and cannot be disturbed absent subsequent court order. Accordingly, for these reasons SGM's Count III should be dismissed for failure to state a claim.

D. The UCL Claim Fails

SGM's Count IV, for restitution under the UCL, is defective for the same reasons discussed above.

The UCL defines unfair competition as "any unlawful, unfair or fraudulent business act or practice" and is "written in the disjunctive, establishing three varieties of unfair competition." *Shroyer v. New Cingular Wireless Servs., Inc.*, 622 F.3d 1035, 1043–44 (9th Cir. 2010) (internal quotation omitted). Under the UCL, "an act is independently wrongful [only] if it is unlawful, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard." *Korea Supply Co. v. Lockheed Martin Corp.,* 29 Cal. 4th 1134, 1159 (2003). There are two lines of authority for determining what constitutes "unfair" conduct under Section 17200. "One line defines 'unfair' as prohibiting conduct that is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers and requires the court to weigh the utility of the defendant's conduct against the gravity of the harm to the alleged victim […] The other line of cases holds that the public policy which is a predicate to a consumer unfair competition action under the 'unfair' prong of the UCL must be tethered to specific constitutional, statutory, or regulatory provisions." *Bardin v. DaimlerChrysler Corp.*, 136 Cal. App.

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4th 1255, 1260-1261 (2006) (citations omitted). Finally, fraudulent conduct requires a showing that "the public would likely be deceived," including "pleading [. . .] facts showing the basis for that conclusion." *Id.* at 1275.

Here, the Counterclaim fails to allege such conduct. First, the transaction does not affect retail consumers or the public and is not alleged to be tethered to any "specific constitutional, statutory, or regulatory provisions." *Bardin*, 136 Cal. App. 4th at 1261. Second, as explained above, APA and court orders rendered the Deposit non-refundable absent circumstances that are not present here, and the Debtors are entitled to retain it. Such conduct is clearly not of an "unethical, oppressive, unscrupulous" nature. *Id.* at 1260. Accordingly, SGM cannot demonstrate a basis for restitution under the UCL, because it cannot establish that Plaintiffs are obligated to refund the Deposit. *See Korea Supply,* 29 Cal. 4th at 1148 (monetary recovery under the UCL is limited to restitution, which is the return of money to those persons from whom it was taken or who had an ownership interest in it). Finally, and in any event, an alleged breach of contract is insufficient to support a UCL claim. *See Melody Kizler v. Budget Fin. Co.*, No. CV 5:20-0296-DOC-KK, 2020 WL 4037175, at *3 (C.D. Cal. May 5, 2020) (dismissing UCL based on breach of contract claim); *Bank Leumi USA v. R&R Food Servs. LLC*, No. CV 17-7183-MWF (SSX), 2018 WL 6003580, at *9 (C.D. Cal. July 13, 2018) (accord); *Macedonia Distrib., Inc. v. S-L Distribution Co., LLC*, No. SACV171692JVSKESX, 2018 WL 6190592, at *9 (C.D. Cal. Aug. 7, 2018) (accord). Accordingly, Count IV should be dismissed for failure to state a claim.

E. SGM's Request for Punitive Damages Should Be Dismissed Or Stricken.

SGM bases its punitive damages claim on its conversion claim. Because that claim fails as a matter of law, so too does SGM's request for punitive damages.

In addition, the Counterclaim fails to allege that Plaintiffs engaged in fraudulent, malicious or oppressive conduct, as required for punitive damages

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liability. *See* Cal. Civ. Code § 3294(a)). "Malice is defined as 'conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others.'" *California Spine and Neorosurgery Inst. v. Aetna Life Ins. Co.,* CV 18-6829-DMG, 2019 WL 960205 (C.D. Cal. Jan. 8, 2019) (quoting Cal. Civ. Code § 3294(c)(1)). "Oppression means 'despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights.'" *Id.* (quoting Cal. Civ. Code § 3294(c)(2)). "And fraud is 'an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.'" *Id.* (quoting Cal. Civ. Code § 3294(c)(3)).

Here, SMG "makes no non-conclusory allegations regarding [Plaintiffs'] intention to cause injury, conduct carried out with a conscious disregard of [SGM's] rights, or imposition of cruel or unjust hardship on [SGM]." *California Spine & Neurosurgery Inst.*, at *2–3 (C.D. Cal. Jan. 8, 2019) (dismissing punitive damages claim where plaintiff merely alleged that defendant improperly underpaid plaintiff, as "those allegations do not rise to the level of the intentional, despicable, and deceitful conduct California law requires for punitive damages awards."); *see also Bouncing Angels, Inc. v. Burlington Ins. Co.*, No. EDCV170015JGBSPX, 2017 WL 1294004, at *4 (C.D. Cal. Mar. 20, 2017) ("Since the allegations on which Plaintiff relies to sustain its claim for punitive damages go no further than what is alleged in support of Plaintiff's breach of contract and breach of the covenant of good faith and fair dealing claims, the Court cannot infer that Burlington's conduct is of a 'different dimension' than that which would be enough to make out a case for bad faith."). Nor could SGM possibly allege such conduct, given that Plaintiffs were entitled to retain the Deposit according to the express terms of the APA and court orders. Accordingly, SGM's punitive damages claim should be dismissed or stricken.

V. CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court grant Plaintiffs' Motion, and dismiss Counts III and IV with prejudice in their entirety, as well as Counts I and II with prejudice to the extent they assert breach premised on Plaintiffs' unwillingness to refund SGM's $30 million deposit.

Respectfully submitted,

Dated: July 31, 2020

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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

[PROPOSED] ORDER GRANTING PLAINTIFFS' MOTION TO DISMISS DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S COUNTERCLAIMS, OR IN THE ALTERNATIVE, TO STRIKE PORTIONS OF DEFENDANT STRATEGIC GLOBAL MANAGEMENT'S COUNTERCLAIMS

Date: August 31, 2020
Time: 1:30 p.m.
Place: Courtroom 7D
350 West 1st Street
Los Angeles, CA 90012

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The Court, having considered Plaintiffs Verity Health System of California, Inc., St. Vincent Medical Center, St. Vincent Dialysis Center, Inc., St. Francis Medical Center, Seton Medical Center, Verity Holdings, LLC, and the above-captioned debtors ("Plaintiffs") Motion to Dismiss Defendant Strategic Global Management's Counterclaims pursuant to Fed. R. Civ. P. 12(b)(6) and to strike portions of Strategic Global Management's Counterclaims pursuant to Fed. R. Civ. P. 12(f) ("Motion"), and finding good cause therefore, **GRANTS** the Motion.

ANALYSIS

All of Strategic Global Management's ("SGM") claims are dismissed because, pursuant to the express terms of Section 1.2 of the asset purchase agreement (the "APA"), the Deposit was "non-refundable." The APA provides that SGM is entitled to a refund of the Deposit under only four triggering circumstances, none of which SGM alleges. SGM fails to allege that any of those circumstances occurred, and it fails to allege any basis for recovering the Deposit under the APA or any legal theory.

In addition, all of SGM's claims are dismissed because Plaintiffs are under court order not to release the Deposit. Specifically, the Bankruptcy Court's May 2, 2019 order approving the SGM Sale ordered that sale proceeds shall not be used for any purpose "except as provided in this Order, the [Debtor-in-Possession] Credit Agreements or the [October 4, 2018 Final Debtor-in-Possession Order, Bankruptcy Docket No. 409] without further order of this Court." Plaintiffs' Request for Judicial Notice, Ex. B.[1] Declining to violate a court order does not breach the APA or its implied covenant of good faith and fair dealing. Nor does it supply a basis for conversion and unfair competition claims.

Further, SGM's conversion and unfair competition claims fail on additional grounds. The conversion claim is based on Debtors' supposed breach of the APA.

[1] Plaintiffs' Request for Judicial Notice in support of its Motion is granted. Judicial notice of the matters requested is proper under Federal Rules of Evidence Rule 201.

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A conversion claim cannot be premised on a breach of contract. *See In re Bailey*, 197 F.3d 997, 1000 (9th Cir. 1999) ("a mere contractual right of payment, without more, does not entitle the obligee to the immediate possession necessary to establish a cause of action for the tort of conversion."); *Rutherford Holdings, LLC v. Plaza Del Rey*, 223 Cal. App. 4th 221, 233 (2014). As for the unfair competition claim, the Counterclaim fails to allege "unfair," "unlawful," or "fraudulent" conduct under the standards set forth in applicable authority. California Business and Professions Code § 17200; *Shroyer v. New Cingular Wireless Servs., Inc.*, 622 F.3d 1035, 1043–44 (9th Cir. 2010).

Finally, SGM fails to allege any basis on which it could recover punitive damages against Plaintiffs : the Counterclaim does not come close to alleging the type of fraudulent, malicious or oppressive conduct required for this unique remedy. *See* Cal. Civ. Code § 3294. Debtors have retained the Deposit based on language of the APA and pursuant to court orders preventing Debtors from releasing the Deposit.

ACCORDINGLY, IT IS HEREBY ORDERED that:

1. Plaintiffs' Motion is **GRANTED** and Defendant Strategic Global Management's Counterclaims are dismissed for failure to state a cognizable claim for relief;
2. Plaintiffs' Request for Judicial Notice filed in support of its Motion is **GRANTED**;
3. Additionally, and in the alternative, the Court strikes the following portions of Strategic Global Management's Counterclaims:
    a. Page 2, lns. 9-10, 23-26; page 3, lns. 1-2; page 11, lns. 2-9; page 12, lns. 1-3; page 21, lns. 6-8; page 22, lns. 6-7, 13-14; page 23, lns. 17-19, 23-24; and page 25, ln. 14;
    b. The punitive damages allegations associated with Strategic Global Management's conversion claim.

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Dated: August __, 2020

_____
Hon. Dale S. Fischer
UNITED STATES DISTRICT JUDGE

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