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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

In re VERITY HEALTH SYSTEM OF CALIFORNIA, INC., *et al.*, Debtors	District Court Case Number: 2:18-cv-10675-RGK Bankruptcy Court Case Number: 2:18-bk-20151-ER
Official Committee of Unsecured Creditors of Verity Health System of California, Inc. Appellant v. Verity Health System of California, Inc. Appellee	Adversary Case Number: N/A **MOTION OF UMB BANK, N.A. AND WELLS FARGO BANK, NATIONAL ASSOCIATION, AS INDENTURE TRUSTEES, TO INTERVENE IN APPEAL**

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UMB Bank, N.A. and Wells Fargo Bank, National Association, solely in their capacities as indenture trustees (the "Trustees"), hereby move to intervene (this "Motion to Intervene") in the instant appeal pursuant to Fed R. Bankr. P. 8013(g). The parties to this appeal, the Official Committee of Unsecured Creditors, as appellant (the "Committee"), and Verity Health Systems of California Inc., *et. al.*, as appellee (the "Debtors"), do not oppose the request by the Trustees to intervene. In support hereof, the Trustees state as follows:

SUMMARY OF ARGUMENT

The Committee has appealed an order of the Bankruptcy Court by which the Debtors were authorized to prime the prepetition liens of the Trustees and to use the cash collateral pledged to the Trustees. As the Debtors' largest secured parties holding secured claims in excess of $461 million, the Trustees were a full participant in the objections, negotiations and hearings in the Bankruptcy Court with respect to such order. Ultimately, the Trustees decided to agree to the entry of the order for a number of reasons, including the condition that it contain certain terms and provisions acceptable to the Trustees. Among the terms and provisions requested by the Trustees were various customary waivers of potential rights of the Debtors to challenge the Trustees' secured claim during the course of the bankruptcy case.

The Committee's appeal is limited to asking the District Court to rule that the Bankruptcy Court erred in approving the Debtors' decision to agree to two such waivers: (i) a waiver of certain theoretical rights under Section 506(c) of the Bankruptcy Code (11 U.S.C. §101 *et. seq.*) by which the Debtors might be able to surcharge the Trustees' collateral for the amount of any preservation costs, and (ii) a waiver of the Debtors' potential rights under Section 552(b) of the Bankruptcy Code to challenge the enforceability of the Trustees' liens on certain equitable grounds.[1]

[1] The Trustees strongly deny that, as a substantive matter, the Debtors have any grounds whatsoever to assert any such rights under either Section 506(c) or Section

The waivers were requested by the Trustees, not the Debtors; the waivers benefit the Trustees, not the Debtors; and the parties which will be affected by the inclusion (or exclusion) of the waivers are the Trustees, not the Debtors. In fact, it is conceivable that the Debtors might actually derive a benefit if the waivers were stricken. In short, the real party with the economic interest and the greatest incentive to argue that the waivers should not be stricken from the Bankruptcy Court order is the Trustees. However, the Notice of Appeal [Docket No. 932 of the Bankruptcy Court proceeding] does not list the Trustees as an appellee and only lists the Debtors as appellees. Accordingly, the Trustees seek to intervene in this appeal as appellees pursuant to Fed R. Bankr. Proc. 8013(g). The Trustees' request for intervention is timely and the Trustees do not seek any extensions, adjournments, or to add to the record on appeal which was recently certified as being complete.

Counsel for the Trustees has conferred with counsel for the Committee and counsel for the Debtors, and both the appellant and the appellee do not oppose the intervention of the Trustees in this appellate proceeding.

ARGUMENT

I. Background of the Appeal.

In connection with this Chapter 11 bankruptcy proceeding, which was filed by the Debtors on August 31, 2018, UMB Bank, N.A. serves as master trustee for the holders of nine series of debt securities comprising the largest secured claim against the Debtors, totaling in excess of $461 million. Wells Fargo Bank, National Association serves as indenture trustee for three of those series of debt instruments issued in 2005 in an outstanding amount exceeding $259 million. The aggregate debt owed to the Trustees is secured by liens and security interests on the Debtors' primary assets, including, without limitation, all five of the Debtors' acute care

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552(b). However, this appeal only deals with the question of whether the Bankruptcy Court erred in approving the Debtors' decision to waive such rights, and does not include the actual assertion by the Debtors of any of such rights.

hospitals with approximately 1,680 inpatient beds and a host of related facilities and assets such as receivables, equipment, inventory, intangibles and other collateral.

As is customary in virtually every bankruptcy case with significant pre-petition debt secured by the debtor's receivables, the Debtors filed a motion at the very beginning of these proceedings (i) to obtain additional, third-party financing in the amount of $185 million secured by a lien that would prime the prepetition lien of the Trustees, and (ii) to use the "cash collateral" (as defined in Section 363 of the Bankruptcy Code) of the Trustees during the case, *i.e.*, the Debtors sought to use the post-petition proceeds of the Debtors' prepetition receivables. Sections 363 and 364 of the Bankruptcy Code provide that, absent the consent of the secured party, a debtor is not entitled to grant a priming lien and is not entitled to use cash collateral unless the debtor provides "adequate protection" of the value of the secured party's secured claim. The bankruptcy term "adequate protection" is defined in Section 361 of the Bankruptcy Code, and can take any number of different forms, which are almost always set forth in the terms and provisions of a so-called DIP financing and cash collateral order (a "cash collateral order"). Adequate protection provisions in cash collateral orders frequently include waivers of certain theoretical rights of the Debtors under the Bankruptcy Code to challenge the secured claims of the lenders during the bankruptcy case.

When the Debtors initially proposed their cash collateral order in this case, it did not contain all of the customary waivers that the Trustees desired and, in the opinion of the Trustees, that secured creditors typically see in such orders. The Trustees formally and informally objected and, after numerous meetings, consultations and negotiations with the Debtors and other interested parties, the filing of written objections, and the attendance and argument by the Trustees and its professionals at the Bankruptcy Court hearings thereon, the Debtors agreed to insert into the proposed cash collateral order a number of the waivers requested by the Trustees. Such waivers not only formed a part of the adequate protection of the

secured claim of the Trustees, but also induced the Trustees to withdraw their objections. Ultimately, the Bankruptcy Court ruled, among other things, that the terms and provisions of the proposed cash collateral order were an appropriate exercise of the business judgment of the Debtors and were proper under the Bankruptcy Code. Accordingly, on October 4, 2018, the Bankruptcy Court entered that certain *"Final Order (A) Authorizing the Debtors to Obtain Post Petition Financing (B) Authorizing the Debtors to Use Cash Collateral and (C) Granting Adequate Protection to Prepetition Secured Creditors Pursuant to 11 U.S.C. §§ 105, 363, 364, 1107 and 1108,"* [Docket No. 409 in the Bankruptcy Court proceedings] (the "Financing Order").

Two of the adequate protection provisions requested by the Trustees, agreed to by the Debtors, and approved by the Bankruptcy Court in the Financing Order as adequate protection are (i) the agreement of the Debtors to waive any theoretical right to surcharge the collateral of the Trustees under Section 506(c) of the Bankruptcy Code for costs and expenses of preserving or disposing of such collateral during the case (the "506(c) Waiver"), and (ii) any theoretical right of the Debtors to claim, under Section 552(b) of the Bankruptcy Code, that the otherwise valid and enforceable pre-petition lien of the Trustees which extends to post-petition proceeds of pre-petition collateral should be disallowed because of the "equities of the case" (the "552(b) Waiver" and, together with the 506(c) Waiver, the "Waivers").

This appeal is brought by the Committee seeking to overrule the Bankruptcy Court's approval of the Waivers contained in the Financing Order as part of the adequate protection of the Trustees' prepetition liens. Only the Debtors are named as the appellees in this appeal. The Trustees bring this Motion to Intervene in order to protect the Waivers, which were part of the bargain by which the Trustees agreed to withdraw their objections to the Financing Order.

II. Since the Outcome of this Appeal Will Primarily Affect the Trustees, the Trustees are Entitled to Intervene.

In order to have standing to submit briefs, present oral argument, participate or object to any potential settlement, file further notices of appeal (if necessary), and otherwise participate in this appeal as the true party in interest in support of retaining the Waivers, the Trustees seek to intervene in this appeal pursuant to Fed R. Bankr. P. 8013(g), which states:

> (g) *Intervening in an Appeal*. Unless a statute provides otherwise, an entity that seeks to intervene in an appeal pending in the District Court or BAP must move for leave to intervene and serve a copy of the motion on the parties to the appeal. The motion or other notice of intervention authorized by statute must be filed within 30 days after the appeal is docketed. It must concisely state the movant's interest, the grounds for intervention, whether intervention was sought in the bankruptcy court, why intervention is being sought at this stage of the proceeding, and why participating as an amicus curiae would not be adequate.

The Trustees have timely filed this Motion to Intervene,[2] and have otherwise demonstrated and complied with each and every requirement under Fed R. Bankr. P. 8013(g).

By their express terms, the Waivers directly affect the pecuniary interests of the Trustees. Absent the 506(c) Waiver, the Debtors would have a potential right to attempt to surcharge the collateral of the Trustees for alleged costs of preservation or disposition. Depending upon the value of the Trustees' collateral, such potential

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[2] This Motion to Intervene has been filed within 30 days of the effective docketing of the appeal as required by Fed R. Bankr. P. 8013(g). The appeal was effectively docketed on February 4, 2019, when the final motion pending in the Bankruptcy Court seeking to amend the findings in the Financing Order was resolved by an order of the Bankruptcy Court [Docket No. 1457 in the Bankruptcy Court proceeding]. *See*, Fed R. Bankr. P. 8002(b)(2) (providing that the filing of a notice of appeal is not effective until the lower court resolves all motions seeking to amend the underlying order which is the subject of the appeal). This Motion to Intervene was filed within 30 days after the Bankruptcy Court's February 4, 2019 order resolving the final motion to amend the Financing Order.

surcharge could be a direct, dollar-for-dollar reduction of the recovery available to the Trustees and its note holders on account of their secured claim. Therefore, the Trustees have a direct interest in seeking to have this Court affirm the entry of the Financing Order with the 506(c) Waiver intact.

Similarly, without the 552(b) Waiver, if the Trustees were somehow prevented from recovering the post-petition proceeds of their pre-petition collateral under the "equities of the case" exception contained in Section 552(b) of the Bankruptcy Code, the Trustees could also suffer direct, pecuniary damage in the form of a reduced recovery on account of their otherwise valid security interest. In fact, the vast majority of the recovery on the Trustees' secured claims in this case will come from the post-petition sales proceeds of the Debtors' acute care hospitals, which are encumbered by the pre-petition liens and security interests of the Trustees. If the 552(b) Waiver were expunged from the Financing Order, there would be at least a theoretical risk that the Trustees might not be entitled to the primary source of collateral proceeds which would otherwise satisfy their secured claims.[3] *LaBarre v. Ulrich*, 2015 U.S. Dist. LEXIS 164258 (U.S. District Court AZ) (creditor was allowed to intervene in appeal of order confirming plan of reorganization because it had a sufficient interest in the issues on appeal, to wit, it actively participated in the plan process, made significant concessions with respect to its secured claim, and would benefit from an affirmance of the confirmation order).

Given that the two, narrow issues in this appeal relate almost exclusively to the amount of the recovery that the Trustees, as secured creditors, will receive in this case, the Trustees, and not the Debtors, are actually the most appropriate party to defend the inclusion of the Waivers in the Financing Order. In fact, if the Waivers

[3] As noted above, the Trustees steadfastly maintain that there are no substantive grounds whatsoever under which the Debtors or any other party could make a successful claim against the Trustees under Section 506(c) or the "equities of the case" exception of Section 552(b).

were expunged from the Financing Order, it could potentially benefit the Debtors by removing or reducing the aggregate secured debt that the Debtors must deal with in the bankruptcy proceeding. The Trustees do not doubt the good faith effort that the Debtors will make in defending the Financing Order that it fought hard to have entered by the Bankruptcy Court, but, at the same time, the true parties in interest with the most to lose should be entitled to participate directly in arguing that the Financing Order should be sustained as is. This point is highlighted by the fact that the Waivers were included in the Financing Order not at the request of the Debtors, but at the insistence of the Trustees as part of their adequate protection for allowing a priming lien with respect to the Debtors' additional $185 million financing and for consenting to the use of their cash collateral during the course of the case. *Patrick v. Macrose Indus. Corp.*, 186 B.R. 789 (U.S. Dist. Ct. EDNY 1995) (lender was permitted to intervene in an adversary proceeding under Fed. R. Bankr. P. 7024 to assert a secured claim to an escrow account because the debtor would gain very little regardless of the outcome of the litigation and, thus, was not the party with the real economic interest).

III. Allowing the Trustees to File an *Amicus Curiae* Brief Would not be an Adequate Substitute for Intervention.

Allowing the Trustees to file an *amicus curiae* brief would not be an adequate substitute for intervention. For example, it is possible that the current appellant and the appellee could decide to settle this matter before a decision is rendered by this Court. Such settlement might expunge the Waivers, condition the Waivers, or otherwise modify the Waivers in any number of ways that are unacceptable to the Trustees which, as the parties with the direct pecuniary interest, might thereafter result in a financial loss to the Trustees. An *amicus curiae* would have little or no say in such settlement.

It is also conceivable that this Court might rule against the Debtors on the merits of this appeal. As merely an *amicus curiae*, the Trustees would be unable to

decide, independently of the Debtors, whether to appeal this Court's adverse appellate decision.

In most circumstances, while an *amicus curiae* is certainly interested in the outcome of an appeal, it rarely has a risk of a direct pecuniary loss. In contrast, in this case, the Trustees are virtually the only parties that have a direct, pecuniary risk of loss if the Waivers are expunged from the Financing Order. Accordingly, merely allowing the Trustees to file an *amicus curiae* brief would not be an adequate substitute for intervention as an appellee.

CONCLUSION

The Trustees are the real parties in interest with respect to the issues raised by this appeal because they have the primary risk of pecuniary loss in the event that this Court reverses the decision of the Bankruptcy Court and expunges the Waivers contained in the Financing Order. The Trustees have satisfied all of the requirements of Fed R. Bankr. P. 8013(g), and should be permitted to intervene as appellees. As noted above, neither the Committee, as appellant, nor the Debtors, as appellee, oppose the request of the Trustees to intervene.

CORPORATE DISCLOSURE STATEMENT PURSUANT TO FED. R. BANKR. P. 8012

Pursuant to Fed R. Bankr. P. 8012, (i) UMB Bank, N.A. states that it is a federally chartered banking institution and is a wholly owned subsidiary of UMB Financial Corporation, a publicly held corporation, and (ii) Wells Fargo, National

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Association states that it is a federally chartered banking institution, that it has no parent corporation, and that there is no publicly held corporation which owns 10% or more of its stock.

Dated: March 4, 2019

MINTZ LEVIN COHN FERRIS GLOVSKY AND POPEO, P.C.

/s/ Abigail V. O'Brient
Abigail V. O'Brient

and

Daniel S. Bleck (*pro hac vice*)
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