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

Friday, April 10, 2020 **Hearing Room 1568**

1:30 PM

2:18-20151 Verity Health System of California, Inc. **Chapter 11**

#100.00 Hearing re [4394] Sale of St. Vincent Medical Center

fr. 4-1-20

Docket 0

Tentative Ruling:

4/10/2020

Note: Telephonic Appearances Only. The Courtroom will be unavailable for in-court appearances. If you wish to make a telephonic appearance, contact Court Call at 888-882-6878, ext. 188 no later than one hour before the hearing. The cost for persons representing themselves has been waived.

For the reasons set forth below, the Sale Motion is **GRANTED**.

Pleadings Filed and Reviewed:

1) Papers filed in connection with the Bidding Procedures Motion:
   a) Debtors' Emergency Motion for the Entry of: (I) An Order (1) Approving Form of Asset Purchase Agreement; (2) Approving Auction Sale Format and Bidding Procedures; (3) Approving Stalking Horse Bidder and Bid Protections; (4) Approving Form of Notice to be Provided to Interested Parties; (5) Scheduling a Court Hearing to Consider Approval of the Sale to the Highest and Best Bidder; and (6) Approving Procedures Related to the Assumption of Certain Executory Contracts and Unexpired Leases; and (II) An Order Authorizing the Sale of Property Free and Clear of All Claims, Liens and Encumbrances [Doc. No. 4365] (the "Bidding Procedures Motion")
   b) Order Setting Hearing on Debtors' Emergency Motion to Approve Bidding Procedures for the Auction of St. Vincent Medical Center [Doc. No. 4367]
      i) Declaration of Service by Kurtzman Carson Consultants, LLC Regarding Docket Numbers 4365 and 4367 [Doc. No. 4369]
2) Papers filed in connection with the Sale Motion:
   a) Debtors' Memorandum in Support of Entry of an Order, Pursuant to 11 U.S.C. § 363(b), (f), and (m), (A) Authorizing the Sale of Certain Assets of St.

Vincent Medical Center, Verity Holdings, LLC, and Verity Health System of California, Inc., Free and Clear of all Claims, Liens, and Encumbrances; (B) Authorizing the Assumption and Assignment of Designated Executory Contracts and Unexpired Leases; and (C) Granted Related Relief [Doc. No. 4518]

i) Order (1) Approving Form of Asset Purchase Agreement; (2) Approving Auction Sale Format and Bidding Procedures; (3) Approving Stalking Horse Bidder and Bid Protections; (4) Approving Form of Notice to Be Provided to Interested Parties; (5) Scheduling a Court Hearing to Consider Approval of the Sale to the Highest and Best Bidder; and (6) Approving Procedures Related to the Assumption of Certain Executory Contracts and Unexpired Leases [Doc. No. 4398] (the "Bidding Procedures Order")

ii) Notice of Sale Procedures, Auction Date, and Sale Hearing Related to St. Vincent Medical Center [Doc. No. 4399]

b) Objection of California Attorney General to Sale of St. Vincent Medical Center "Free and Clear" of Attorney General's Review and Consent or With a "Good Faith" Finding as to Purchaser [Doc. No. 4474]

c) Response and Reservation of Rights of the State of California Governor's Office of Emergency Services to the Debtors' Motion for Entry of an Order Authorizing the Sale of St. Vincent Medical Center Free and Clear of All Claims, Liens and Encumbrances [Doc. No. 4442]

d) SEIU-UHW's Response and Reservation of Rights to Debtors' Motion for Entry of Order Authorizing the Sale of St. Vincent [Doc. No. 4465]

e) Limited Opposition of Belfor USA Group, Inc., to Debtors' Motion for an Order Authorizing the Sale of St. Vincent Medical Center Free and Clear of All Claims, Liens, and Encumbrances [Doc. No. 4462]

f) Declaration of Douglas Reed Maughan Regarding the Qualification of Purchaser as Good-Faith Purchaser Pursuant to 11 U.S.C. § 363(m) in Connection with the Sale of Certain Assets [Doc. No. 4521]

g) The Purchaser's Reply to Objection of Attorney General [Doc. No. 4523]

I. Facts and Summary of Pleadings

Debtors move for entry of an order approving the sale of St. Vincent Medical Center and related assets ("St. Vincent") to Patrick Soon-Shiong IC, LLC, Patrick Soon-Shiong IC 2, LLC, and Patrick Soon-Shiong IC 3, LLC (the "Purchaser"), free and clear of liens, claims, and encumbrances (the "Sale Motion"). The California

Attorney General (the "Attorney General") opposes the Sale Motion.

A. The Closure of St. Vincent

On August 31, 2018 (the "Petition Date"), Verity Health System of California, Inc. ("VHS") and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The Debtors' cases are being jointly administered. As of the Petition Date, the Debtors operated six acute care hospitals (the "Hospitals").

On January 9, 2020, the Court authorized the Debtors to implement a plan to close St. Vincent on an emergency basis (the "Closure Plan"). *See* Doc. No. 3934 (the "Closure Order"). Pursuant to the Closure Order, emergency services were discontinued as of January 9, 2020, the dialysis center was closed as of January 13, 2020, all inpatients were discharged or transferred as of January 18, 2020, all outpatient visits ceased as of January 22, 2020, all transplant candidates were transferred as of January 23, 2020, all medical records were removed to off-site storage as of March 23, 2020, and all hazardous waste was removed as of March 26, 2020. *See* Doc. Nos. 3982, 4308, and 4410 (status reports describing implementation of the Closure Plan).

B. The Court-Approved Agreement Authorizing the Debtors to Lease St. Vincent to the State of California

On March 20, 2020, the Court authorized the Debtors to enter into a lease [Doc. No. 4302, Ex. C] (the "Lease") with the California Department of Public Health (the "State"), under which the Debtors leased St. Vincent to the State in exchange for monthly rent of $2.6 million. Doc. No. 4315. The term of the Lease is six months, subject to monthly extensions for up to an additional six months. *Id.* at § 2. The Lease provides that the State shall have exclusive control of St. Vincent:

> Tenant shall have exclusive control, possession, occupancy, use, and management of the Premises. Tenant shall have full and complete charge, authority and control of the administration, management and operation of the Medical Business at the Premises. Tenant shall have the right and authority to determine all business, technical and professional policies relating to the operation of the Medical Business, with no restrictions, qualifications or supervision by Landlord. Tenant shall determine the financial policy of the Medical Business and shall have complete power to fix, control and regulate

> the charges and collections made for services therein. Accordingly, Tenant shall be responsible for all operational and medical services provided at the Premises and the security of all persons and property at the Premises in compliance with applicable Laws, and Tenant acknowledges and agrees that Landlord is providing no services whatsoever and shall not responsible or otherwise liable for the same.

Id. at § 5.2.

C. The Dispute Between the Debtors and the Attorney General Regarding the Attorney General's Authority to Review the Sale of St. Vincent

1. Background

California law requires "[a]ny nonprofit corporation that … operates or controls a health facility, as defined in Section 1250 of the Health and Safety Code, or operates or controls a facility that provides similar health care, *regardless of whether it is currently operating or providing health care services or has a suspended license*, … to provide written notice to, and to obtain the written consent of, the Attorney General prior to entering into any agreement or transaction" to sell a material amount of its assets. Cal. Corp. Code § 5914 (governing the sale of assets to a for-profit corporation or entity) and § 5920 (parallel provision governing the sale of assets to a nonprofit corporation or entity) (emphasis added). The Attorney General has discretion "to consent to, give conditional consent to, or not consent to" the transaction. Cal. Corp. Code §§ 5917 and 5923.

Prior to 2018, the California Corporations Code did not include the qualifying phrase "regardless of whether it [the health facility] is currently operating or providing health care services or has a suspended license." In *In re Gardens Reg'l Hosp. & Med. Ctr., Inc.*, decided under the pre-2018 version of the Corporations Code, the Court found that a non-profit entity was not required to obtain the Attorney General's consent to sell a hospital that was no longer operating. 567 B.R. 828, 826 (Bankr. C.D. Cal. 2017). The Court reasoned that a closed hospital was not a "health facility" within the meaning of Cal. Health & Safety Code § 1250:

> The statute specifies the characteristics of a "health facility" in the present tense—a facility qualifies only if it "*is* ... operated for the diagnosis, care, prevention, and treatment of human illness" (emphasis added). Cal. Health & Safety Code § 1250.

> "In construing statutes, the use of verb tense by the Legislature is considered significant." *Hughes*, *supra*, 17 Cal.4th at 776, 72 Cal.Rptr.2d 624, 952 P.2d 641. The statute does not say that it applies to a facility that "is *or previously was* operated for the ... treatment of human illness." In addition, a facility that is closed cannot meet the other requirements of the statute's definition—a closed facility cannot diagnose or care for patients, or admit patients for a 24-hour stay or longer. In sum, the statute clearly and unambiguously applies only to health facilities that are operating.

Gardens, 567 B.R. at 827.

Gardens was decided on May 15, 2017. In June 2017, Assembly Member Al Muratsuchi introduced AB 651, which amended the Corporations Code by, among other things, inserting the language "regardless of whether it [the health facility] is currently operating or providing health care services or has a suspended license." No changes were made to the definition of "health facility" set forth in § 1250 of the Health and Safety Code. AB 651 was enacted on October 14, 2017. 2017 Cal. Legis. Serv. Ch. 782 (A.B. 651) (West). The legislation took effect on January 1, 2018. *Id.*

The legislative history indicates that the amendments were enacted in response to *Gardens*. An analysis prepared by the Senate Committee on Health provides in relevant part:

> Recent amendments to this bill, among other things, apply the AG review and consent process to a nonprofit facility "regardless of whether it is currently operating or providing health care services or has a suspended or cancelled license." This issue came up in a recent transaction involving Gardens Regional Hospital and Medical Center (Gardens Hospital), which filed for Chapter 11 bankruptcy in June of 2016. As part of the bankruptcy process, and while still operating as a hospital, Gardens Hospital sought to sell the facility to a for-profit entity, Strategic Global Management, Inc. Under its review and consent process, the AG approved the sale, but imposed certain conditions, including minimum levels of charity care. After several rounds of negotiations where the buyer attempted to reduce the charity care obligations, the transaction was terminated, and Gardens Hospital, running out of money to operate the hospital, closed the facility on February 2, 2017 and placed its general acute care license in suspense.
>
> Following closure, Gardens Hospital again sought to sell the assets of the

hospital, including the suspended hospital license, and licenses and permits relating the pharmacy and laboratory. The proposed purchaser, American Specialty Management Group, intends to seek reinstatement of the suspended license, and open a new hospital on the premises. Gardens Hospital argued in the bankruptcy court that it was not required to obtain the consent of the AG to sell the assets, because the hospital is closed and no longer qualifies as a "health facility." The AG disagreed, arguing that if this were the case, it would enable other nonprofit facilities to temporarily cease operations for purposes of selling their assets free of the AG's review and consent, which would permit assets intended for charitable purposes to be acquired by for-profit entities without proper oversight. On May 15, 2017, the federal bankruptcy judge hearing the case ruled that assets of a closed hospital are not a "health facility" within the meaning of the provisions of law governing AG review and consent, and that Gardens Hospital was therefore not required to obtain the consent of the AG prior to selling those assets.

This decision prompted a recent article in the Healthcare Law Blog, entitled *To Report or Not Report – Is It Really a Question?* According to this article, the Gardens Hospital decision is currently being considered, discussed, and appealed for its conclusions regarding the AG's ability to oversee nonprofit health facility transaction. According to this article, the lack of AG oversight is not reason enough to pursue the Gardens Hospital course of action in closing the facility, but it does tip the scales in favor of the termination or suspension of a hospital's license to avoid the potential pitfalls associated with AG review.

California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 5, 2017, at pp. 5–6.

As enacted, AB 651 amended the Corporations Code to provide that the Attorney General's review authority applied to a health facility "regardless of whether it is currently operating or providing health care services or has a suspended license." An earlier version of AB 651 was broader, and would have extended the Attorney General's review authority to both health facilities with a *suspended* license and to health facilities with a *cancelled* license. The legislative history indicates that the scope of the bill was deliberately narrowed. A report prepared for the Senate Committee on Health describing the earlier version of the bill containing the broader language states (emphasis added):

> Recent amendments to this bill apply the review and consent requirements related to nonprofit health facility transactions to nonprofit corporations even when the license of the health facility is suspended *or cancelled*. As described above, a recent case involving a hospital that had gone bankrupt and suspended its license led to a judge in the bankruptcy proceeding deciding that the AG did not have the authority to review and consent to the transaction in question because the license was suspended and it was no longer operating as a health facility. The AG's office views this decision as creating a loophole where one did not exist before. However, these amendments go beyond facilities where the license has been suspended, and also give the AG the ability to consent to transactions where a license has been terminated. Health facilities that close often suspend a license, because it is easier to resurrect a license from suspension and begin operating as a health facility again. However, if a license has been cancelled, *it is no longer a health facility at all*, and any entity wishing to reopen a health facility would have to start a new license application. Theoretically, these amendments could mean that a hospital could decide to close, for whatever reason, and terminate their license, but the AG would be able to continue to have final say over the disposition of those assets, and could control who was able to purchase the property, even when it is no longer licensed as a health facility. The author may wish to consider narrowing this provision, *either by applying it only to suspended licenses,* and/or limiting it to a certain length of time after the facility stops providing health care services.

California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 5, 2017, at pp. 8–9.

In response to the foregoing analysis, the Assembly Member Muratsuchi agreed to narrow the scope of the bill. As explained in a subsequent report prepared for the Senate Judiciary Committee: "Per the request of the Senate Committee on Health, the author agreed to take the following amendment that would remove the AG's review of these agreements when they pertain to a non-profit health facility with a cancelled license." California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 11, 2017, at p. 7.

2. The Attorney General's Position

The Attorney General asserts that he has authority to review the sale for the following reasons:

1) The legislative history makes clear that the Corporations Code was amended to reverse *Gardens*. "An amendment materially changing a statute following a court decision interpreting the statute in its original form is to be regarded as an indication of legislative intent to change the meaning of the law." *O'Brien v. Dudenhoeffer*, 16 Cal. App. 4th 327, 335, 19 Cal. Rptr. 2d 826, 831 (1993). Courts "must reject an interpretation of the statute which would leave the prior judicial construction in effect." *Id.* Under the amended Corporations Code, the Attorney General has authority to review the sale of health facilities even if they have closed.
2) There is no merit to the Debtors' contention that the statute does not apply because the Debtors do not currently "operate or control" St. Vincent. The point of the amendment was to make clear that the statute applies regardless of whether the Debtors *currently* operate or control the facility.

3. The Debtors' Position

The Debtors contend that the Attorney General lacks authority to review the sale of St. Vincent, notwithstanding the amendments to the Corporations Code. Debtors assert that Cal. Corp. Code § 5920 does not apply to the sale transaction for the following reasons:

1) Cal. Corp. Code § 5920 applies only to an entity that "operates or controls" a health facility. The Lease provides that the State "shall have exclusive control, possession, occupancy, use, and management" of St. Vincent. Lease at § 5.2. As a result, the Debtors no longer "operate or control" St. Vincent, making Cal. Corp. Code § 5920 inapplicable.
2) St. Vincent is not a "health facility" within the meaning of Cal. Health & Safety Code § 1250. St. Vincent has none of the attributes of a health facility. It is not "organized, maintained, and operated for the diagnosis, care, prevention, and treatment of human illness." Cal. Health & Safety Code § 1250. It does not have "an organized medical staff that provides 24-hour inpatient care," Cal. Health & Safety Code § 1250(a). Under the Lease, the State has already acknowledged that St. Vincent is "providing no services whatsoever." Lease at § 5.2. Finally, the Debtors intend to cancel St. Vincent's

license.

D. The Dispute Regarding whether the Purchaser is Entitled to Protections Under § 363(m)

The APA provided that St. Vincent would be sold to the Chan Soon-Shiong Family Foundation (the "Foundation"), but authorized the Foundation to assign its rights under the APA to another entity. On the morning of the hearing, the Foundation assigned its rights under the APA to the Purchaser.

Prior to the Foundation's assignments of its rights under the APA, the Attorney General opposed the Debtors' request for a finding that the Foundation was a good-faith purchaser entitled to the protections of § 363(m).

The Foundation is an affiliate of NantWorks LLC ("NantWorks"), which is a secured creditor of the estates. Specifically, one of the Foundation's directors, Dr. Soon-Shiong, also holds an interest in NantWorks.

According to the Attorney General, the sale transaction involves self-dealing, because the purchase price will satisfy some or all of NantWorks' secured claim, thereby benefitting Dr. Soon-Shiong. The Attorney General argues that the Foundation's purchase of St. Vincent could subject the Foundation to litigation and other enforcement actions by the Attorney General. The Attorney General's theory is that Dr. Soon-Shiong is violating his fiduciary duties to the Foundation by orchestrating a transaction involving self-dealing. As a result, the Attorney General maintains, the Foundation does not qualify as a good-faith purchaser.

The Foundation disputes the Attorney General's contention that the transaction involved self-dealing, but assigned its rights to the Purchaser to eliminate any suggestion that the transaction was tainted by self-dealing.

E. The Dispute Regarding Satisfaction of Belfor's Mechanic's Lien

Belfor USA Group, Inc. ("Belfor") holds a mechanic's lien against St. Vincent in the amount of $250,733.03, plus interest and costs. Belfor objects to any sale free and clear of its lien, unless the sale proceeds are sufficient to satisfy its lien in full.

Debtors contend that that St. Vincent can be sold free and clear of Belfor's lien pursuant to § 363(f)(1) and (5), regardless of whether the sale generates proceeds sufficient to satisfy the lien in full. Debtors argue that under California law, Belfor's lien could be extinguished in a foreclosure proceeding. As a result, Debtors assert that a sale free and clear is appropriate under both § 363(f)(1) (authorizing sales free and clear where permitted under applicable nonbankruptcy law) and § 363(f)(5) (authorizing sales free and clear where the lienholder could be compelled to accept a money satisfaction of its interest).

F. Other Papers Filed in Connection with the Sale Motion

The Official Committee of Unsecured Creditors (the "Committee") supports the Sale Motion. The Service Employers International Union–United Healthcare Workers West (the "SEIU-UHW") does not object to the Sale Motion, but reserves its rights to assert claims against Dr. Soon-Shiong or any entities affiliated with him.

The State of California Governor's Office of Emergency Services (the "Office of Emergency Services"), which is leasing St. Vincent from the Debtors, does not oppose the Sale Motion, but filed a Reservation of Rights to insure that the Sale Order is consistent with the Lease.

II. Findings and Conclusions

A. Cal. Corp. Code § 5914 Does Not Apply to the Sale Because St. Vincent Will Cancel its License [Note 1]

Cal. Corp. Code § 5914 provides in relevant part:

> Any nonprofit corporation that … operates or controls a health facility, as defined in Section 1250 of the Health and Safety Code, or operates or controls a facility that provides similar health care, regardless of whether it is currently operating or providing health care services or has a suspended license, shall be required to provide written notice to, and to obtain the written consent of, the Attorney General prior to entering into any agreement or transaction to … [s] ell … its assets to a for-profit corporation or entity or to a mutual benefit corporation or entity … when a material amount of the assets of the nonprofit corporation are involved in the agreement or transaction.

Cal. Health & Safety Code § 1250 defines a "health facility" as

> a facility, place, or building that is organized, maintained, and operated for the diagnosis, care, prevention, and treatment of human illness, physical or mental, including convalescence and rehabilitation and including care during and after pregnancy, or for any one or more of these purposes, for one or more persons, to which the persons are admitted for a 24-hour stay or longer ….

Under California law, the "ultimate task" in statutory interpretation "is to ascertain the Legislature's intent." *People v. Massie*, 19 Cal.4th 550, 569, 79 Cal.Rptr.2d 816, 967 P.2d 29 (1998). "Ordinarily, the words of the statute provide the most reliable indication of legislative intent." *Pac. Gas & Elec. Co. v. Cty. of Stanislaus*, 16 Cal.4th 1143, 1152, 69 Cal.Rptr.2d 329, 947 P.2d 291 (1997). Only where the statutory language is ambiguous may the Court consider "evidence of the Legislature's intent beyond the words of the statute," such as the "statutory scheme of which the provision is a part, the history and background of the statute, the apparent purpose, and any considerations of constitutionality …." *Hughes v. Bd. of Architectural Examiners*, 17 Cal.4th 763, 776, 952 P.2d 641 (1998). "When statutory language is … clear and unambiguous there is no need for construction, and *courts should not indulge in it*." *Delaney v. Superior Court*, 50 Cal.3d 785, 800, 268 Cal.Rptr. 753, 789 P.2d 934 (1990) (emphasis in original). However, the "language of a statute should not be given a literal meaning if doing so would result in absurd consequences which the Legislature did not intend." *Younger v. Superior Court*, 21 Cal.3d 102, 113, 145 Cal.Rptr. 674, 577 P.2d 1014 (1978).

Here, resort to legislative history is necessary because the statute is internally contradictory. Cal. Corp. Code § 5914 states that the Attorney General has authority over a "health facility," as defined by Cal. Health & Safety Code § 1250, regardless of whether the health facility "is currently operating or providing health care services or has a suspended license." Cal. Corp. Code § 5914 therefore suggests that a facility that is no longer operating can qualify as a "health facility." This contradicts Cal. Health & Safety Code § 1250, which defines "health facility" in a manner such that only facilities that are actively providing healthcare services can qualify.

Fortunately, resort to the legislative history resolves the contradiction and makes the Legislature's intent clear. As discussed above, an earlier version of the legislation gave the Attorney General authority to review the sale of health facility, "regardless of whether it is currently operating or providing health care services or has a suspended *or cancelled* licensed." In response to the Senate Health Committee's concern that this provision was too broad, the language "or cancelled" was removed. The relevant committee report explains that the change was necessary because a facility that formerly provided health care services but whose license had been cancelled "is no longer a health facility at all." California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 5, 2017, at pp. 8–9. The broad scope of the earlier provision was of concern because "a hospital could decide to close, … but the AG would be able to continue to have final say over the disposition of those

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assets, and could control who was able to purchase the property, even when it is no longer licensed as a health facility." *Id.* This concern was eliminated after the bill's author agreed to limit the scope of the provision "by applying it only to suspended licenses," as recommended by the Senate Health Committee. *Id.*; *see also* California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 11, 2017, at p. 7 ("Per the request of the Senate Committee on Health, the author agreed to take the following amendment that would remove the AG's review of these agreements when they pertain to a non-profit health facility with a cancelled license.").

The upshot is that the Legislature intended the amended statute to be interpreted in the following manner: A facility that in the past actively provided health care services but is now closed is still a "health facility" over which the Attorney General has regulatory authority, provided that the facility's license to provide healthcare services has been suspended but not cancelled. But if the same facility's license is cancelled, the facility is no longer a health facility, and the Attorney General lacks authority to regulate the facility's sale.

In addition to being consistent with the legislative history, this interpretation of the statute avoids absurd results. The purpose of the statute is to preserve access to health care to "uninsured low-income families" and the "poor, elderly, and disabled." *See* 1996 Cal. Legis. Serv. Ch. 1105 (A.B. 3101) (West) (legislative findings in support of Cal. Corp. Code § 5914, the parallel provision to Cal. Corp. Code § 5920). A closed facility whose license has been suspended can, without undue difficulty, be reopened, have its license reinstated, and continue to provide health care services. Providing the Attorney General regulatory authority over such facilities is therefore consistent with the statute's objective of preserving health care access.

By contrast, a facility whose license has been cancelled cannot provide health care services unless it obtains an entirely new license, a much more difficult process. Such a facility, as the Senate Committee Report stated, "is no longer a health facility at all." California Bill Analysis, Senate Committee, 2017–2018 Regular Session, Assembly Bill 651, dated July 5, 2017, at pp. 8. Providing the Attorney General regulatory authority over such facilities would not preserve access to health care. Where the *raison d'etre* of the Attorney General's regulatory authority is to preserve access to health care services, it would be absurd to construe the statute in a manner extending such authority to facilities that are no longer health facilities.

St. Vincent intends to cancel its license. **[Note 2]** Once the license has been cancelled, St. Vincent will no longer qualify as a "health facility," making Cal. Corp.

Code § 5914 inapplicable to the sale.

The post-*Gardens* amendments to the statute were intended to prevent a health facility from closing, suspending its license, selling its assets without Attorney General review, and then reopening and continuing to provide health care services after obtaining reinstatement of its license. That possibility does not exist here. After St. Vincent's license has been cancelled, it cannot obtain license reinstatement and continue operating as a health facility. In short, the concerns motivating the legislative response to *Gardens* simply do not apply to the present case.

B. The Court Approves the Sale, Free and Clear of the Attorney General's Alleged Authority to Review the Sale Under Cal. Corp. Code § 5914

Section 363(d)(1) authorizes non-profit entities, such as the Debtors, to sell estate assets only if the sale is "in accordance with nonbankruptcy law applicable to the transfer of property by" a non-profit entity. Section 541(f) similarly provides that property held by debtors that are § 501(c)(3) corporations under the Internal Revenue Code may be transferred, but "only under the same conditions as would apply if the debtor had not filed a case under this title." Section 363(b) permits the debtor to sell estate property out of the ordinary course of business, subject to court approval. The debtor must articulate a business justification for the sale. *In re Walter*, 83 B.R. 14, 19–20 (9th Cir. BAP 1988). Whether the articulated business justification is sufficient "depends on the case," in view of "all salient factors pertaining to the proceeding." *Id.* at 19–20. Section 363(f)(1) provides that a sale of estate property may be "free and clear of any interest in such property of an entity other than the estate, only if applicable nonbankruptcy law permits sale of such property free and clear of such interest …."

Pursuant to § 363(b) and (f)(1), the Court approves the sale of St. Vincent free and clear of the Attorney General's claim that he may impose conditions upon the terms of the sale or the use of St. Vincent after the sale. For the reasons explained above, applicable nonbankruptcy law permits the sale of St. Vincent absent the consent or review of the Attorney General.

The Attorney General's contention that he is entitled to impose conditions upon the sale constitutes an "interest in … property" of which St. Vincent may be sold free and clear. The Bankruptcy Code does not define the phrase "interest in … property" for purposes of § 363(f). The Third Circuit has held that the phrase "interest in … property" is "intended to refer to obligations that are connected to, or arise from, the property being sold." *Folger Adam Sec., Inc. v. DeMatteis/MacGregor JV*, 209 F.3d

252, 259 (3d Cir. 2000). That conclusion is echoed by *Collier on Bankruptcy*, which observes a trend in caselaw "in favor of a broader definition [of the phrase] that encompasses other obligations that may flow from ownership of the property." 3 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 363.06[1] (16th ed. 2017). The Attorney General's alleged ability to require the Debtors to submit to a regulatory review process prior to selling St. Vincent is an obligation connected to and arising from the property being sold.

C. The Sale is Free and Clear of Belfor's Mechanic's Lien

The sale is free and clear of Belfor's mechanic's lien (the "Belfor Lien"), pursuant to § 363(f)(1) and (f)(5). Outside of bankruptcy, a junior lien, such as the Belfor Lien, could be extinguished in a foreclosure proceeding, even if proceeds were insufficient to satisfy the junior lien in full. *See Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freedman*, 65 Cal. App. 4th 1469, 1478, 77 Cal. Rptr. 2d 479, 484 (1998) ("Title to real property which is conveyed after foreclosure by a trustee's deed relates back to the date the trust deed was executed. The title passed is that held by the trustor at the time of execution. Liens which attached after the foreclosed trust deed was executed are extinguished and the purchaser takes title free of those junior or subordinate liens."). Thus, St. Vincent could be sold free and clear of the Belfor Lien under applicable non-bankruptcy law, making a sale free and clear appropriate under § 363(f)(1). A foreclosure proceeding is also a "legal or equitable proceeding" in which Belfor could be compelled "to accept a money satisfaction of its interest," making a sale free and clear appropriate under § 363(f)(5).

D. The Purchaser is Entitled to § 363(m) Protections

Section 363(m) provides that the "reversal or modification on appeal of an authorization … of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal."

The purpose of § 363(m) is to discourage bidders from colluding for the purpose of driving down the sales prices at bankruptcy auctions. *See Ewell v. Diebert (In re Ewell)*, 958 F.2d 276, 281 (9th Cir. 1992) ("Typically, lack of good faith is shown by fraud, collusion between the purchaser and other bidders or the trustee, or an attempt to take grossly unfair advantage of other bidders").

Having reviewed the declarations of Douglas Reed Maughan (Purchaser's

Treasurer), Richard G. Adcock (VHS' CEO), and James M. Moloney (the managing director of Cain Brothers, the Debtors' financial advisors), the Court finds that the Purchaser is a good-faith purchaser entitled to the protections of § 363(m). The Court makes this good-faith determination based upon the following findings of fact:

1) Purchaser is not a creditor of the Debtors.
2) Purchaser is not an insider of the Debtors.
3) At all relevant times, both Purchaser and the Debtors were represented by counsel.
4) Purchaser complied with the procedures set forth in the Bidding Procedures Order.
5) Purchaser did not collude with any other potential bidders to chill bidding.

The fact that Dr. Soon-Shiong, an affiliate of the Purchaser, also holds an interest in NantWorks, whose secured claim will be partially or fully satisfied from the sales proceeds, in no way weighs against a good-faith finding. "[T]he cases are clear that a creditor can also be a good faith purchaser." *Matter of Youngstown Steel Tank Co.*, 27 B.R. 596, 599 (W.D. Pa. 1983). Bankruptcy courts routinely allow secured creditors to serve as stalking horse bidders in § 363 auctions, and grant § 363(m) protections if the secured creditor emerges as the winning bidder at the auction.

III. Conclusion

Based upon the foregoing, the Sale Motion is **GRANTED** in its entirety. Notwithstanding Bankruptcy Rule 6004, the order approving the sale (the "Sale Order") shall take effect immediately upon entry. Prompt closing of the sale is necessary given the estates' precarious financial position. In addition, there is a risk that the Purchaser will walk away if the sale does not close promptly, since the purpose of the sale—establishing a research center to address the Covid-19 pandemic—would be defeated absent a prompt closing.

Note 1

On the morning of the hearing, the Purchaser filed a declaration stating that the Foundation had assigned its rights under the APA to the Purchaser. The Purchaser is not a non-profit corporation. Therefore, to the extent the Attorney General has authority to review the sale, it would be under Cal. Corp. Code § 5914, not under § 5920. The parties briefed the Sale Motion under the assumption that § 5920 was the

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controlling provision. The language of § 5914 is substantially identical to § 5920; the only difference is that § 5914 governs sales to for-profit corporations and § 5920 governs sales to non-profit corporations. The change in the buyer's identity does not affect the analysis of whether the Attorney General has authority to review the sale.

Note 2

At the hearing, the Debtors should be prepared to address whether St. Vincent can unilaterally cancel its license or whether cancellation requires government approval. Debtors should also be prepared to address the timeline for license cancellation.

Party Information

Debtor(s):

Verity Health System of California,	Represented By Samuel R Maizel John A Moe II Tania M Moyron Claude D Montgomery Sam J Alberts Shirley Cho Patrick Maxcy Steven J Kahn Nicholas A Koffroth