IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

In re:	)	
	)	Chapter 11
Curae Health, Inc., *et al.*[1]	)	Case No. 18-05665
	)	
1721 Midpark Road, Suite B200	)	Judge Walker
Knoxville, TN 37921	)	
Debtors.	)	Jointly Administered

DEBTORS' REPLY TO THE DISCLOSURE STATEMENT OBJECTIONS OF MEDHOST OF TENNESSEE, CHS/COMMUNITY HEALTH SYSTEMS, AND THE MISSISSIPPI DIVISION OF MEDICAID

The above-captioned debtors and debtors in possession (the "**Debtors**") hereby file this reply (this "**Reply**") in response to *Medhost's Objection to Disclosure Statement Accompanying Debtors' Chapter 11 Plan* [Docket No. 782] (the "**Medhost Objection**"), the *Objection of CHS/Community Health Systems, Inc. to Debtors' Disclosure Statement* [Docket No. 780] (the "**CHS Objection**"); and the *State of Mississippi Division of Medicaid's Objection to Disclosure Statement Accompanying Debtor's Chapter 11 Plan of Liquidation* [Docket No. 784] (the "**MDOM Objection**", together with the CHS Objection and Medhost Objection, the "**Objections**"), and in further support of the *Debtors' Chapter 11 Plan of Liquidation* [Docket No. 698] (as may be amended, supplemented, or otherwise modified from time to time, the "**Plan**") and the *Debtors' Disclosure Statement in Support of Debtors' Chapter 11 Plan of Liquidation* [Docket No. 699] (as may be amended, supplemented, or otherwise modified from time to time, the "**Disclosure Statement**").[2]

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[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are Curae Health, Inc. (5638); Amory Regional Medical Center, Inc. (2640); Batesville Regional Medical Center, Inc. (7929); and Clarksdale Regional Medical Center, Inc. (4755); Amory Regional Physicians, LLC (5044); Batesville Regional Physicians, LLC (4952); Clarksdale Regional Physicians, LLC (5311).

[2] Capitalized terms not otherwise defined herein shall have the meanings ascribed to such terms in the Plan.

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PRELIMINARY STATEMENT

1. The Objections raise three issues, each of which are confirmation issues not ripe for adjudication at the Disclosure Statement Hearing. The alleged failures of the Disclosure Statement relate to: (a) releases by third parties (the "**Third Party Releases**"); (b) releases by the Debtors (the "**Debtor Releases**", together with the Third Party Releases, the "**Releases**"), and (c) the exculpation of certain parties (the "**Exculpation**").

2. With respect to the Exculpation provisions of the Plan, the Debtors have agreed with the United States Trustee to narrow the Exculpation provisions of the Plan and to provide additional information in the Disclosure Statement about both the Releases and the Exculpation provisions. Those agreements are reflected in the *Reply to United States Trustee's Objection to Disclosure Statement and Proposed Solicitation Procedures* filed on February 21, 2019 [Docket No. 785] (the "**Reply to UST Objection**"), which is hereby incorporated by reference. Based on the agreements reflected in the Reply to UST Objection, the U.S. Trustee's Objection to approval of the Disclosure Statement has been resolved and the Objections have been rendered moot as they relate to the Exculpation provisions of the Plan.[3]

3. With respect to the Third Party Releases, the Debtors have agreed with the Official Committee of Unsecured Creditors appointed in these Chapter 11 Cases (the "**Committee**") to remove the Third Party Releases from the Plan. The Objections are therefore moot as they relate to the Third Party Releases.

4. With respect to the Debtor Releases, as explained by the Debtors in detail in the *Objection to The Official Committee of Unsecured Creditors' Motion (I) to Terminate the Debtors' Exclusivity Periods to Permit the Committee to File a Plan of Liquidation, and (II) for*

[3] In the MDOM Objection, the State of Mississippi Division of Medicaid ("**MDOM**") simply joins in the United States Trustee's Objection to the Disclosure Statement without further addition or elaboration. Given that the US Trustee's Objection has been resolved it is unclear what, if anything, remains of the MDOM Objection.

Leave, Standing and Authority to Commence, Prosecute, and if Appropriate, Settle Certain Causes of Action on Behalf of the Debtors' Estates [Docket No. 786] (the "**Debtors' Objection to Committee Motion**"), which is fully incorporated herein by reference, **the releases only release claims for mere negligence, as to which Tennessee nonprofit law already provides full immunity**.

5. The Debtors believe in their business judgment such releases are necessary for the success of the Plan and maximizing the Estates' assets. Only a narrow set of claims against the directors and officers are actually released (the "**Released Claims**").

All Potential Claims Against Directors and Officers						
Released Claims	Claims that Are Not Released					
Negligence	Gross Negligence	Wanton	Willful	Bad Faith	Fraud	Illegal Conduct

The Debtor Releases simply mirror the protections already afforded officers and directors under Tennessee law. Tennessee law provides a myriad of protections to the directors and officers of nonprofit corporations, including: (i) statutory immunity for negligence claims, (ii) mandatory statutory indemnification for negligence claims, (iii) restrictions on damages awards for conflicted transactions, and (iv) a heightened business judgment rule. Under Tennessee law, the Debtors' directors and officers are either immune or shielded from liability with respect to any and all claims based on negligence. To the extent anyone can adequately plead a claim that has value against the directors and officers under Tennessee law, i.e. a claim based on more than mere negligence, such claims are not Released Claims and are expressly preserved by the Plan to be pursued by the Liquidating Trust. **In fact, due to the limited nature of the Debtor Releases and their reasonableness in light of Tennessee law, the Committee is withdrawing its**

Motion to Terminate Exclusivity and the Committee's Objection to the Disclosure Statement has been resolved.[4]

6. In the Debtors' business judgment, the Debtor Releases are essential to the Plan. The Debtor Releases provide consideration to the officers and directors for their continued cooperation post-confirmation. As set forth in the Reply to UST Objection, the Plan contemplates that such officers and directors will enter into a formal Cooperation Agreement with the Liquidating Trustee. The Debtors' Estates have valuable claims against many third parties, and such cooperation is essential to pursuit of those claims as well as the success of the Plan. The Debtors will demonstrate at the Confirmation Hearing that the Plan is confirmable and the Debtor Releases are in the best interests of the Debtors' Estates.

7. Debtors' Disclosure Statement should be approved as containing adequate information pursuant to § 1125 of the Bankruptcy Code. Any issues with respect to inclusion of the Releases and Exculpation are confirmation issues and are not ripe for the Disclosure Statement Hearing. Debtors have already agreed to make changes to the Plan and Disclosure Statement that moot most of the issues raised in the Objections, and the Debtors have resolved the objections to approval of the Disclosure Statement filed by the Committee and US Trustee. As set forth more fully below, the Objecting Parties' argument with respect to the Debtor Releases is fatally flawed as it completely disregards Tennessee nonprofit law. Debtors have already addressed or resolved the issues raised by the Objections, and the Objecting Parties can make no defensible argument against approval of the Disclosure Statement. Accordingly, Debtors respectfully request that the Court overrule the Objections and approve Debtors'

[4] In the Medhost Objection, Medhost joins in the Committee's Objection to the Disclosure Statement without further addition or elaboration. Given that the Committee Objection has been resolved it is unclear what, if anything, remains of the Medhost Objection.

Disclosure Statement and Procedures Motion.[5]

BACKGROUND

8. On August 24, 2018 (the "**Petition Date**"), each of the Debtors filed a voluntary petition in this Court commencing a case for relief under chapter 11 of the Bankruptcy Code (the "**Chapter 11 Cases**"). The factual background regarding the Debtors, including their business operations, their capital and debt structures, and the events leading to the filing of the Chapter 11 Cases, is set forth in detail in the *Declaration of Stephen N. Clapp, Chief Executive Officer of Curae Health, Inc., in Support of Chapter 11 Petitions and First Day Pleadings* [Docket No. 49] (the "**First Day Declaration**") and fully incorporated herein by reference.

9. The Debtors continue to operate their businesses and manage their properties as debtors-in-possession pursuant to §§ 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been requested in the Chapter 11 Cases. On September 6, 2018, the official committee of unsecured creditors was appointed (the "**Committee**").

10. As of the Petition Date, the Debtors operated three hospitals[6] in Mississippi that provide much needed inpatient and outpatient medical services to their respective communities (each a "**Hospital**", and collectively, the "**Hospitals**"). Debtors filed these Chapter 11 Cases to keep the Hospitals open for the benefit of their respective communities and transition operations

[5] The legal arguments set forth herein are completely redundant of those already made in the Debtors' Objection to Committee Motion. They are included in this Reply so that the record is complete as it relates to approval of the Disclosure Statement given that the Debtors' Objection to Committee Motion was filed as an objection to a separate motion rather than in support of the Disclosure Statement. To the extent the reader is already familiar with the legal arguments made in the Debtors' Objection to Committee Motion, the reader need read no further.

[6] In addition to the three Debtor-run Hospitals, as of the Petition Date, Debtor Curae Health, Inc. was the sole member and sponsor of the non-debtor affiliate Russellville Hospital, Inc. which operated a hospital in Russellville, Alabama. On November 30, 2018, the Court entered the *Expedited Order (I) Authorizing the Debtors to Enter into the Member Substitution Agreement with Respect to the Russellville Hospital and (II) Granting Related Relief* [Docket No. 511] (the "**Russellville Order**"), pursuant to which the Court authorized the Debtors to enter into the Member Substitution Agreement with Dava Foundation, Inc and transition operations of the Russellville Hospital.

of the Hospitals to new operators. Debtors have made significant progress towards achieving those objectives in the first six months of these Chapter 11 Cases.

11. On December 20, 2018, Debtors filed their *Motion for Entry of an Order Extending the Exclusivity Periods for the Filing of a Chapter 11 Plan and Solicitation of Acceptances Thereof* [Docket No. 588] (the "**Debtors' Exclusivity Motion**"), pursuant to which Debtors' requested that the Court, *inter alia*, grant the Debtors' a sixty-day extension of (i) the exclusivity period for filing a plan, and (ii) the exclusive solicitation period pursuant to Bankruptcy Code section 1121(d). No objections to the Debtors' Exclusivity Motion were filed, and on January 16, 2019, the Court entered the *Order Extending the Exclusivity Periods for the Filing of a Chapter 11 Plan and Solicitation of Acceptances Thereof* [Docket No. 667] (the "**Exclusivity Order**"). Pursuant to the Exclusivity Order, the Debtors' exclusive period for filing a plan was extended through and including February 20, 2019 (the "**Plan Exclusivity Period**") and the Debtors' exclusive solicitation period was extended through and including April 21, 2019 (the "**Exclusive Solicitation Period**", together with the Plan Exclusivity Period, the "**Exclusive Periods**").

12. On January 22, 2019, well within the Plan Exclusivity Period, the Debtors filed the *Debtors' Chapter 11 Plan of Liquidation* (the "**Plan**") [Docket No. 698] and the *Debtors' Disclosure Statement in Support of Debtors' Chapter 11 Plan of Liquidation* (the "**Disclosure Statement**") [Docket No. 699]. In connection with the Plan and Disclosure Statement and pursuant to Local Rule 3016-2, Debtors filed and served a Notice of Hearing on Adequacy of the Disclosure Statement (the "**Notice of Hearing**"), setting a hearing on the adequacy of the Disclosure Statement for February 21, 2019 at 9:00 a.m.

13. Also in connection with the Plan and Disclosure Statement, Debtors filed the *Debtors' Motion for an Order (I) Approving Disclosure Statement; (II) Establishing Forms and Procedures for Solicitation and Tabulation of Votes to Accept or Reject the Plan; (III) Establishing Deadline and Procedures for Filing Objections to the Confirmation of the Plan; and (IV) Granting Related Relief* [Docket No. 700] (the "**Procedures Motion**"), which is fully incorporated herein by reference. Pursuant to the Procedures Motion, Debtors propose a confirmation process that would include a deadline for voting on the Plan to be completed by April 1, 2019 and a confirmation hearing on April 10, 2019. This schedule provides the Debtors an opportunity to confirm a plan well within the Exclusive Solicitation Period.

14. On January 25, 2019, the U.S. Trustee filed the *United States Trustee's Objection to Disclosure Statement and Solicitation* (the "**U.S. Trustee Objection**").

15. On January 28, 2019, the Committee sent an informal discovery request to the Debtors (the "**Informal Discovery Request**").

16. On January 30, 2019, instead of first filing an objection to Debtors' Disclosure Statement, the Committee filed *The Official Committee of Unsecured Creditors' Motion (I) to Terminate the Debtors' Exclusivity Periods to Permit the Committee to File a Plan of Liquidation, and (II) for Leave, Standing and Authority to Commence, Prosecute, and if Appropriate, Settle Certain Causes of Action on Behalf of the Debtors' Estates* [Docket No. 722] (the "**Committee Motion**"). On the same date, the Committee also filed an expedited motion, requesting the Court set an expedited hearing on the Committee Motion and further requesting leave to file its own plan and disclosure statement as exhibits. The Debtors consented to the Committee's proposed briefing schedule, delaying the hearing on the Debtors' Disclosure Statement to February 28, 2019 (the "**Disclosure Statement Hearing**").

17. On February 21, 2019, Debtors provided the Committee with the responsive documents and communications to the Informal Discovery Request.

18. On February 21, 2019, Debtors filed their *Reply to United States Trustee's Objection to Disclosure Statement and Proposed Solicitation Procedures* [Docket No. 785] (the "**Reply to UST Objection**"), which is fully incorporated herein by reference. The Reply to UST Objection contains certain proposed modifications to the Plan and Disclosure Statement. Relevant to this Objection, Debtors propose to, *inter alia*: limit the definition of Released Parties by taking out certain parties, including Strategic, and clarify the scope of the Debtor Releases by providing that they shall release only such claims as to which applicable Tennessee law already provides blanket immunity. On that basis, the UST Objection has been resolved.

19. On February 21, 2019, Debtors filed their *Objection to The Official Committee of Unsecured Creditors' Motion (I) to Terminate the Debtors' Exclusivity Periods to Permit the Committee to File a Plan of Liquidation, and (II) for Leave, Standing and Authority to Commence, Prosecute, and if Appropriate, Settle Certain Causes of Action on Behalf of the Debtors' Estates* [Docket No. 786] (the "**Debtors' Objection to Committee Motion**"), which is fully incorporated herein by reference. Following the filing of the Debtors' Objection to Committee Motion, the Committee has agreed to withdraw the Committee Motion.

20. Also on February 21, 2019, the Committee, Medhost of Tennessee, Inc. ("**Medhost**"), CHS/Community Health Systems, Inc. ("**CHS**"), and the State of Mississippi Division of Medicaid ("**MSDOM**", together with CHS and Medhost, the "**Objecting Parties**") filed their respective Objections. The Committee's objection to approval of the Disclosure Statement has since been resolved. Similar to the Committee Motion, the remaining Objections all focus on the impact of the Releases on the confirmability of Debtors' Plan. Debtors'

Objection to Committee Motion and Reply to UST Objection respond to all of the issues raised in the Objections. However, Debtors repeat relevant arguments from Debtors' Objection to Committee Motion in response to the Objections for purposes of creating an adequate record in support of Debtors' Disclosure Statement.

ARGUMENT

21. To begin, many of the issues raised by the Objections are confirmation issues and are not ripe for the Disclosure Statement Hearing. The Objections argue that the Disclosure Statement does not comply with Bankruptcy Code section 1125 and should, therefore, not be approved. The alleged failures of the Disclosure Statement relate to: (a) releases by third parties (the "**Third Party Releases**"); (b) releases by the Debtors (the "**Debtor Releases**", together with the Third Party Releases, the "**Releases**"), and (c) the exculpation of certain parties (the "**Exculpation**"). Debtors stand firm that inclusion of the Debtor Releases and Exculpation are essential to the implementation of any liquidating plan in these Chapter 11 Cases. To resolve the U.S. Trustee Objection and Committee Objection, the Debtors have already agreed to make certain revisions to the Plan and Disclosure Statement as set forth therein. Debtors believe that such revisions address all issues raised in the Objections relating to the Disclosure Statement.

22. The Objecting Parties have failed to assert any defensible argument against approval of the Disclosure Statement. Instead, the Objecting Parties rely heavily on the argument that the Plan should not include Debtor Releases. As set forth in Part I of this Reply, the Objecting Parties' argument with respect to the Debtor Releases is fatally flawed as it completely disregards Tennessee law. As set forth in Part II of this Reply, the Debtors will establish at the Confirmation Hearing that the Debtor Releases comply with all applicable laws and are fair, reasonable, and in the best interests of the Estates. If the Debtors cannot meet their burden in

doing so, the Debtor Releases will be removed from the Plan. Accordingly, Debtors submit that the Objections should be overruled and the Disclosure Statement should be approved.

I. THE COURT SHOULD OVERRULE THE OBJECTIONS BECAUSE DEBTORS' DISCLOSURE STATEMENT CONTAINS ADEQUATE INFORMATION

23. The Objections argue that the Releases make the Debtors' Plan unconfirmable. As the Debtors explain in detail in this Reply, the Objecting Parties' argument with respect to the Debtor Releases is fatally flawed as it disregards Tennessee law. Tennessee law provides a myriad of protections to the directors and officers of non-profit corporations, (i) statutory immunity, (ii) mandatory statutory indemnification, (iii) restrictions on damages awards for conflicted transactions, and (iv) a heightened business judgment rule. These protections embody an overall policy in Tennessee to shield directors and officers of nonprofit corporations from liability for mere negligence based on their services in such capacities. The Debtor Releases simply mirror and preserve these protections. In analyzing all of the costs and benefits to the Estates, Debtors believe that the Debtor Releases satisfy applicable confirmation standards as they are fair, reasonable, and in the best interests of the Debtors' Estates. Should the Court find otherwise after the presentation of evidence at the Confirmation Hearing, the releases will be removed from the Plan. Accordingly, the Debtor Releases to not make the Plan unconfirmable and Debtors' Disclosure Statement should be approved.

24. The Debtor Releases are fair, reasonable, and in the best interests of the Estates because they mirror and preserve the protections already provided under Tennessee law. The Objections claim that the Debtor Releases make the Debtors' Plan unconfirmable. However, the Objecting Parties' argument with respect to the Debtor Releases is fatally flawed as it disregards Tennessee law. Moreover, the Debtor Releases are essential to the effectiveness of the Plan, well within the Debtors' business judgment, and comply with all applicable laws.

25. Under Tennessee law, the Debtors' directors and officers are either immune or shielded from liability with respect to all claims based on mere negligence. The Debtor Releases align with public policy in Tennessee and mirror and preserve the protections already afforded officers and directors. These protections embody an overall policy in Tennessee to encourage individuals to serve nonprofit corporations by shielding directors and officers of nonprofit corporations from liability for their services in such capacities based on mere negligence. Eliminating the Debtor Releases from the Plan would send a chilling message to individuals that serve nonprofit corporations throughout the state of Tennessee.

26. Tennessee law governs any claims brought on behalf of the Debtors against the Debtors' directors and officers.[7] The Debtors are Tennessee nonprofit corporations that are exempt from federal income taxation under § 501(c)(3) of the Internal Revenue Code. The Debtors were formed under the Tennessee Nonprofit Corporation Act, T.C.A. §§ 48–51–101 *et seq.* (the "**Nonprofit Act**").[8] "Claims that involve the internal affairs of a corporation should be resolved in accordance with the law of the state of incorporation." *In re Del-Met Corp.*, 322 B.R. 781, 801 (Bankr. M.D. Tenn. 2005) (citing *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 621 (1983)). "The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation

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[7] The obvious exception being causes of action under the Bankruptcy Code. As provided in the Debtors' Reply to UST Objection, all Chapter 5 Causes of Action are excluded from the Releases.

[8] Curae Health, Inc. is a Tennessee nonprofit corporation. Curae is the sole member and sponsoring organization of Amory Regional Medical Center, Inc.; Batesville Regional Medical Center, Inc.; and Clarksdale Regional Medical Center, Inc., all of which are Tennessee nonprofit corporations. Amory, Batesville, and Clarksdale are each the sole member of a physician entity as follows: Amory is the sole member of Amory Regional Physicians, LLC; Batesville is the sole member of Batesville Regional Physicians, LLC; and Clarksdale is the sole member of Clarksdale Regional Physicians, LLC. All of the physician entities are Tennessee limited liability companies but are disregarded entities for tax purposes.

could be faced with conflicting demands." *Edgar v. MITE Corp.,* 457 U.S. 624, 645 (1982) (citing Restatement (Second) of Conflict of Laws § 302, Comment *b,* at 307–08 (1971)).

27. "Tennessee has codified the internal affairs doctrine: Tennessee corporation statutes 'do not authorize this state to regulate the organization or the internal affairs of a foreign corporation authorized to transact business in this state.'" *In re Del-Met Corp.*, 322 B.R. at 801 (quoting T.C.A. § 48–25–105(c) (2004)). In other words, Tennessee law requires a court to look to the law of the state of incorporation to determine the fiduciary duties of corporate actors. *See id.*

28. Accordingly, Tennessee law applies to all potential claims and causes of action that could be brought on behalf of the Debtors against the directors and officers.

29. This Section discusses four of the protections afforded to directors and officers of Tennessee nonprofit corporations:[9] (i) statutory immunity, (ii) mandatory statutory indemnification, (iii) restrictions on damages awards for conflicted transactions, and (iv) a heightened business judgment rule.

i. Statutory Immunity

30. The Nonprofit Act grants the Debtors' directors and officers immunity from suit arising from the conduct of the affairs of the Debtors unless their conduct amounts to willful, wanton, or gross negligence. The Debtor Releases mirror and preserve this codified immunity of nonprofit directors and officers.

[9] In addition to the protections discussed in detail in this Objection, in accordance with § 102(b)(3)(A) of the Nonprofit Act, Debtors' charters provide that "no director shall be personally liable to the Corporation for monetary damages for breach of fiduciary duty as a director . . . ." Section 102(b)(3)(A) of the Nonprofit Act provides, in relevant part, that a nonprofit corporation's "charter may set forth [a] provision eliminating or limiting the personal liability of a director to the corporation or its members for monetary damages for breach of fiduciary duty as a director; provided, that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its members; (ii) For acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or (iii) Under § 48-58-302." T.C.A. § 48-52-102(b)(3)(A).

31. Section 601 of the Nonprofit Act, entitled *Limitation of Actions and Immunity - Breach of Fiduciary Duty*, sets forth the public policy and rationale underlying the grant of immunity:

> The general assembly finds and declares that the services of nonprofit boards are critical to the efficient conduct and management of the public and charitable affairs of the citizens of this state. Members of such nonprofit boards must be permitted to operate without concern for the possibility of litigation arising from the discharge of their duties as policy makers.

T.C.A. § 48-58-601(b); *Urbanavage v. Capital Bank*, No., 2018 WL 3203100, at *7 (Tenn. Ct. App. June 29, 2018). Section 601 of the Nonprofit Act became law in 1986. *See State By & Through Pierotti ex rel. Boone v. Sundquist*, 884 S.W.2d 438, 444 (Tenn. 1994).

32. Section 601(c) of the Nonprofit Act provides the grant of immunity:

> All directors, trustees or members of the governing bodies of nonprofit cooperatives, corporations, clubs, associations and organizations described in subsection (d), whether compensated or not, shall be immune from suit arising from the conduct of the affairs of such cooperatives, corporations, clubs, associations or organizations. Such immunity from suit shall be removed when such conduct amounts to willful, wanton or gross negligence . . . .

T.C.A. § 48-58-601(c).[10]

33. The Supreme Court of Tennessee has interpreted section 601 of the Nonprofit Act as granting "immunity to directors and officers of nonprofit corporations, except when their 'conduct amounts to willful, wanton or gross negligence.'" *State By & Through Pierotti ex rel. Boone v. Sundquist*, 884 S.W.2d at 444 (quoting § 601 of the Nonprofit Act). In *State By & Through Pierotti ex rel. Boone v. Sundquist*, the Supreme Court of Tennessee interpreted section 601 of the Nonprofit Act in connection with Tennessee's *quo warranto* statutes. *Id.* On appeal, the defendants contended that the plaintiffs could not use the *quo warranto* statutes to bring a

[10] Subsection (d) of section 601 includes "[n]onprofit corporations, associations and organizations which are exempt from federal income taxation under § 501(c)(3) of the Internal Revenue Code of 1986, codified in 26 U.S.C. § 501(c)(3), as amended."

suit in contravention of section 601 of the Nonprofit Act. *Id.* In its analysis, the Supreme Court of Tennessee noted that § 601 of the Nonprofit Act "grants immunity to directors and officers of nonprofit corporations, except when their 'conduct amounts to willful, wanton or gross negligence.'" *Id* (quoting § 601 of the Nonprofit Act); *see also* 1997 WL 277999, at *5 (Tenn. Ct. App.) (Section 601 grants "immunity . . . to directors and officers of non-profit corporations for decisions made which are not willful, wanton, or gross negligence."). The Supreme Court of Tennessee concluded that a *quo warranto* action, alleging misconduct amounting to willful, wanton or gross negligence, for which § 601 of the Nonprofit Act provides no immunity, may be brought pursuant to T.C.A. § 29–35–102. *State By & Through Pierotti ex rel. Boone v. Sundquist*, 884 S.W.2d at 444.

34. Courts in Tennessee consistently uphold the grant of immunity for mere negligence in favor of directors and officers. *See, e.g.*, *State By & Through Pierotti ex rel. Boone v. Sundquist*, 884 S.W.2d at 444; *Urbanavage v. Capital Bank*, 2018 WL 3203100, at *7 (Tenn. Ct. App. June 29, 2018); *Burke v. Tennessee Walking Horse Breeders' & Exhibitors' Assoc.*, 1997 WL 277999, at *6 (Tenn. Ct. App. May 28, 1997). In *Burke v. Tennessee Walking Horse Breeders' & Exhibitors' Assoc.*, plaintiffs brought suit against the executive director[11] and members of the executive committee of a nonprofit association. 1997 WL 277999, at *6. The trial court found that the immunity provided by § 601(c) applied to the executive director and members of the executive committee because there was no "willful, wanton, or gross negligence." *Id* (quoting the trial court's memorandum opinion). On appeal, the Tennessee Court of Appeals found that "[t]he complaint fail[ed] to allege any action by any of the individuals which would amount to willful, wanton, or gross negligence." *Id.* at *10. And the "[p]laintiffs

[11] The chief executive officer of a nonprofit corporation may be sometimes referred to as the executive director.

conceded that the individual defendants [were] immunized by T.C.A. § 48-58-601 against all conduct except that which is willful, wanton or gross negligence." *Id.*

35. Here, the Debtors' directors and officers are immune from suit based on conduct that is not willful, wanton, or gross negligence. In other words, the Estates do not have colorable claims against the Debtors' directors and officers as a matter of law unless their conduct amounts to willful, wanton, or gross negligence. *See Urbanavage v. Capital Bank*, 2018 WL 3203100, at *7 (finding that a nonprofit association's directors were "immune from suit as a matter of law unless [p]laintiffs put forth evidence establishing a material question of fact as to whether the members' conduct of the Association's affairs amounted to willful, wanton, or gross negligence" and affirming grant of summary judgment in favor of defendants on plaintiffs' breach of fiduciary duty claims). The Committee has not alleged any claims based on conduct that rises to the level of willful, wanton, or gross negligence. If the Committee could allege claims based on such conduct, such claims are clearly not subject to the Debtor Releases and will be expressly preserved and assigned to the Liquidating Trust pursuant to the Debtors' Plan. Due to the mandatory indemnification provisions discussed below, pursuit of any of the Released Claims would, in fact, harm the Estates. For this reason, the Committee has withdrawn its objection to the very same Debtor releases.

ii. Mandatory Indemnification

36. In addition to granting immunity to directors and officers, the Nonprofit Act also provides for mandatory indemnification. If directors and officers are successful in defending against a claim or cause of action brought by or in the right of the Debtors, the Debtors will be required to indemnify the directors and officers for their reasonable expenses. In light of all the statutory protections, claims and causes of action against the directors and officers based on mere

negligence have no likelihood of success. The mandatory indemnification provisions of the Nonprofit Act increase the risks to the Debtors Estates' as they would have to pay the professionals' fees on both sides of any unsuccessful litigation against the directors and officers.

37. Pursuant to the Nonprofit Act, a nonprofit corporation must indemnify a director or officer that is successful in the defense of any proceeding to which the director or officer is a defendant because he or she was a director or officer of the nonprofit corporation for reasonable expenses incurred in connection with the proceeding. Section 503 of the Nonprofit Act provides the mandatory indemnification provision for directors:

> Unless limited by its charter, a corporation shall indemnify a director to the extent the director was successful, on the merits or otherwise, or who is immune from suit under § 48-58-601, in the defense of any proceeding to which the director was a party because the director is or was a director of the corporation against reasonable expenses incurred by the director in connection with the proceeding.

T.C.A. § 48-58-503.[12]

38. Section 507 of the Nonprofit Act provides the same mandatory indemnification for officers. *See* T.C.A. § 48-58-507 ("An officer of the corporation who is not a director is entitled to mandatory indemnification under § 48-58-503 . . . .").

39. Here, the mandatory indemnification provisions of the Nonprofit Act make pursuit of the Released Claims illogical. The directors and officers would prevail with respect to any lawsuit brought against them based on mere negligence, and the Estates would be liable for professionals' fees and expenses on both sides of the litigation. Not only would pursuit of the Released Claims result in unnecessary professionals' fees, but bringing frivolous lawsuits against the directors and officers will harm all other litigation efforts that require the cooperation of the Debtors' directors and officers.

[12] The Debtors' charters and bylaws explicitly incorporate the provisions of the Nonprofit Act that provide for indemnification and immunity.

iii. Restrictions on Equitable Relief and Damages

40. The Nonprofit Act also limits liability of the Debtors' directors and officers for conflicting interest transactions.

41. Under the Nonprofit Act, if a conflicting interest transaction is not a director's or officer's, a proceeding on behalf of the nonprofit corporation against the director or officer may not give rise to an award of damages or other sanctions against the director or officer. Section 702(a) of the Nonprofit Act provides that:

> A transaction effected or proposed to be effected by the corporation (or by an entity controlled by the corporation) *may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against a director or officer of the corporation*, in a proceeding by a member or by or in the right of the corporation, on the ground that the director or officer has an interest respecting the transaction, *if it is not a director's or officer's conflicting interest transaction*.

T.C.A. § 48-58-702 (emphasis added).

42. Moreover, even if a director or officer is conflicted, a proceeding against that director or officer on behalf of the nonprofit corporation cannot give rise to an award of damages or sanctions against the director or officer if, *inter alia*, the directors' action respecting the transaction was taken in compliance with section 703 of the Nonprofit Act. *See* T.C.A. § 48-58-702(b)(1). Section 702(b)(1) of the Nonprofit Act provides, in relevant part:

> A director's or officers conflicting interest transaction may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against a director or officer of the corporation, in a proceeding by a member or by or in the right of the corporation, on the ground that the director or officer has an interest respecting the transaction, if . . . Directors' action respecting the transaction was taken in compliance with § 48-58-703 at any time.

T.C.A. § 48-58-702(b)(1).

43. Pursuant to section 703 of the Nonprofit Act, a director's or officer's conflicting interest transaction is effective under section 702 if the conflicted officer or director discloses the

required information and the transaction was authorized by the vote of a majority of qualified directors. Section 703 of the Nonprofit Act provides, in relevant part:

> Directors' action respecting a director's or officer's conflicting interest transaction is effective for purposes of § 48-58-702 if the transaction has been authorized by the affirmative vote of a majority (but no fewer than two (2)) of the qualified directors who voted on the transaction, after required disclosure by the conflicted director or officer of information not already known by such qualified directors, . . . provided, that . . . [t]he qualified directors have deliberated and voted without the participation by any other director.

T.C.A. § 48-58-703.

44. Here, section 702 of the Nonprofit Act precludes awards of damages against the Debtors' directors and officers for conflicted interest transactions that complied with section 703. The Committee alleges that conduct relating to the Debtors' Hospital Management Agreement with Strategic (the "**Management Agreement**") gives rise to a colorable cause of action. However, all transactions of the Debtors' involving Strategic complied with section 703, and the directors and officers are shielded from damages awards by the protections of section 702. Pursuit of any cause of action against the directors and officers based on a conflicting interest transaction would provide no value to the Estates.

45. No conflicted directors voted to approve the Management Agreement and all amendments thereto with Strategic Healthcare. Board minutes of the Debtors demonstrate that the directors carefully considered all transactions relating to the Management Agreement. Directors were fully informed regarding Mr. Clapp's connections to Strategic. The Directors unanimously voted to commission a third party valuation company, Pershing Yoakley and Associates ("**PYA**"), to conduct a fair market valuation of the Management Agreement. After completing the valuation, PYA presented the findings of the fair market valuation to the directors. The valuation included findings that the services provided under the Management

Agreement were reasonable and necessary and the management fee was within the range of fair market values for similar hospital companies.[13] All transactions relating to the Management Agreement were authorized by a majority of qualified directors. Accordingly, the transactions complied with section 703, and the protections of section 702 apply. Thus, pursuit of any conflicted interest transaction claims against any of the directors or officers of the Debtors may not give rise to an award of damages or sanctions, and bringing such an action would be detrimental to the Estates.

iv. Business Judgment Rule

46. In addition to the protections granted nonprofit directors and officers in the Nonprofit Act, Tennessee's business judgment rule provides further protection to the Debtors' directors and officers. "There is a policy against substituting the judgment of a court for the judgment of a corporate board or employee." *Burke v. Tennessee Walking Horse Breeders' & Exhibitors' Assoc.*, 1997 WL 277999, at *5 (Tenn. Ct. App. May 28, 1997) (quoting the trial court's opinion). "This policy is reflected both in the business judgment rule and also in the immunity granted to directors and officers of non-profit corporations for decisions made which are not willful, wanton, or gross negligence." *Id.*

47. "Tennessee's courts have consistently followed a noninterventionist policy with regard to internal corporate matters. They have recognized that directors have broad discretion . . . . These decisions squarely align Tennessee with the jurisdictions recognizing and following the 'business judgment rule.'" *Hall v. Tennessee Dressed Beef Co.*, 1996 WL 355074, at *7 (Tenn. Ct. App. June 28, 1996), *aff'd in part, rev'd in part,* 957 S.W.2d 536 (Tenn. 1997); *Lewis v. Boyd,* 838 S.W.2d 215, 220 (Tenn. Ct. App. 1992).

[13] All documents referenced in this Reply have been provided to the Committee throughout these Chapter 11 Cases and in connection with the Informal Discovery Request. Debtors are prepared to present all such documents as exhibits at the Disclosure Statement Hearing and will provide them to any other party upon request.

48. In Tennessee, Plaintiffs have "a *heavy burden* to overcome [the business judgment rule] to succeed on the merits." *In re Pacer Int'l, Inc.*, 2017 WL 2829856, at *7 (Tenn. Ct. App. June 30, 2017) (emphasis added). "Tennessee courts are loathe to substitute their judgment for that of a corporation's board of directors." *Id.* Tennessee courts "presume that a corporation's directors, when making a business decision, acted on an informed basis, in good faith, and with the honest belief that their decision was in the corporation's best interests." *Id*; *see also Franklin Capital Assocs., L.P. v. Almost Family, Inc.*, 194 S.W.3d 392, 399–400 (Tenn. Ct. App. 2005), *abrogated by Keller v. Estate of McRedmond*, 495 S.W.3d 852 (Tenn. 2016). "[A] plaintiff must show that the majority of the board acted in a manner that rise[s] to the level of gross negligence before a court may second guess its business judgment." *Campbell v. Potash Corp. of Saskatchewan*, 238 F.3d 792, 800 (6th Cir. 2001), *as amended on denial of reh'g* (Oct. 31, 2001) (applying Delaware's business judgment rule) (citations omitted).

49. "The foregoing rules for ordinary corporations *apply with even greater effect in regard to not-for-profit corporations* in which there are no stockholders holding a property interest to suffer loss as a result of corporate action." *Burke v. Tennessee Walking Horse Breeders' & Exhibitors' Assoc.*, 1997 WL 277999, at *9 (finding that "the action of the executive committee has the benefit of presumed good faith and reasonable grounds") (emphasis added).

50. Here, to the extent there are any Released Claims that are not covered by the statutory protections of the Nonprofit Act, Tennessee's business judgment rule provides another significant hurdle to success in a suit against the Debtors' directors and officers. To overcome Tennessee's business judgment rule, a plaintiff would have to plead at least gross negligence. *See Campbell v. Potash Corp. of Saskatchewan*, 238 F.3d at 800. Although Debtors firmly believe

that no such claims exist, any potential claims based on conduct that rises to the level of gross negligence are not covered by the Debtor Releases and will be assigned to the Liquidating Trust. The Debtor Releases only cover claims as to which there is little to no likelihood of success and would be detrimental to the Estates if pursued.

51. The Objections rely entirely on an uninformed assessment of the Debtor Releases. The Debtor Releases simply mirror and preserve the extensive protections already provided by Tennessee law while also preventing the Estates from engaging in wasteful litigation. Any claims that could potentially provide value to the Estates are not being released under the Plan. Moreover, the Debtor Releases provide consideration to the directors and officers for their continued cooperation post-confirmation.

52. Debtors submit that the Disclosure Statement contains adequate information regarding the Debtor Releases. At the request of the U.S. Trustee, Debtors have agreed to include additional language with respect to the Debtor Releases in the Disclosure Statement. As provided in the Debtors' Plan and Disclosure Statement and throughout these Chapter 11 Cases, Debtors believe that the valuable causes of action of the Estates are not against the Debtors directors and officers, but against other third parties. The Liquidating Trustee will need the cooperation of Debtors' officers and directors to pursue such causes of action. In light of all the protections already afforded to the Debtors' directors and officers and weighing all of the costs and benefits of the Debtor Releases, Debtors firmly believe that the Debtor Releases are fair, reasonable, and in the best interests of the Debtors' Estate and creditors. To the extent the Court finds otherwise after the presentation of evidence at the Confirmation Hearing, the Debtor Releases will have to be removed from the Plan. Accordingly, Debtors believe that the Objections should be overruled and the Disclosure Statement should be approved.

II. THE DEBTOR RELEASES COMPLY WITH ALL APPLICABLE LAW AND ARE FAIR, REASONABLE, AND IN THE BEST INTERESTS OF THE ESTATES

53. The Objections are, in fact, objections to confirmation. All of the issues raised by the Objections with respect to the Debtor Releases are confirmation issues. The Objecting Parties have essentially converted the Debtors' Disclosure Statement Hearing into a confirmation hearing in violation of the Debtors' rights under the Bankruptcy Code. *See, e.g.*, *In re Cardinal Congregate I*, 121 B.R. 760, 764 (Bankr. S.D. Ohio 1990) (Courts should be careful "so as not to convert the disclosure statement hearing into a confirmation hearing, and to insure that due process concerns are protected."). Although the Objecting Parties have prematurely raised these issues, this Part sets forth Debtors' argument in support of the Debtor Releases under the appropriate standards for confirmation. However, Debtors reserve all rights with respect to all confirmation issues.

54. Debtor releases are explicitly allowed under the Bankruptcy Code. Pursuant to Bankruptcy Code section 1123(b)(3)(A), debtors may release claims "if the release is a valid exercise of the debtor's business judgment, is fair, reasonable and in the best interests of the estate." *U.S. Bank Nat'l Ass'n v. Wilmington Trust Co. (In re Spansion)*, 426 B.R. 114, 143 (Bankr. D. Del. 2010); *accord In re DBSD N. Am., Inc.*, 419 B.R. 179, 217 (Bankr. S.D.N.Y. 2009), *aff'd*, 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010), *aff'd in part, rev'd in part*, 627 F.3d 496 (2d Cir. 2010) (finding that the "releases and discharges of claims and causes of action by the Debtors, pursuant to section 1123(b)(3)(A) of the Bankruptcy Code, represent a valid exercise of the Debtors' business judgment, and are fair, reasonable and in the best interests of the estate"); *see also In re Midway Gold US, Inc.*, 575 B.R. 475, 509 (Bankr. D. Colo. 2017); *In re Pac. Gas & Elec. Co.*, 304 B.R. 395, 416 (Bankr. N.D. Cal. 2004).

55. “The decision of whether to approve a particular compromise lies within the discretion of the Bankruptcy judge and pursuant to Bankruptcy Rule 9019(a).” *In re Texaco Inc.*, 84 B.R. 893, 901 (Bankr. S.D.N.Y. 1988). “Whether the compromise is effected separately or in the body of a reorganization plan will not affect the approval analysis required of the bankruptcy court.” *In re Dow Corning Corp.*, 192 B.R. 415, 421 (Bankr. E.D. Mich. 1996) (citing *In re Texaco Inc.*, 84 B.R. at 901 (“Compromises may be effected separately during reorganization proceedings or in the body of the reorganization plan itself.”)).

56. “A proposed settlement should only be approved by the bankruptcy judge upon a determination that the settlement is ‘fair and equitable.’” *In re Dow Corning Corp.*, 192 B.R. at 421 (citing *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)). “[T]he court need not conduct a mini-trial on the merits of the settlement.” *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991); *In re Energy Co-op., Inc.*, 886 F.2d 921, 927 n.6 (7th Cir. 1989). Instead, the obligation of the court is to “canvass the issues and see whether the settlement ‘falls below the lowest point in the range of reasonableness.’” *In re Drexel Burnham Lambert Group, Inc.*, 134 B.R. 493, 497 (Bankr. S.D.N.Y. 1991) (quoting *In re W.T. Grant Co.,* 699 F.2d 599, 608 (2d Cir. 1983), *cert. denied, Cosoff v. Rodman,* 464 U.S. 822 (1983)); *see also In re Dow Corning Corp.*, 192 B.R. at 421.

57. “Any factor ‘relevant to a full and fair assessment of the wisdom of [a] proposed compromise’ should be considered by the bankruptcy court.” *In re Dow Corning Corp.*, 198 B.R. 214, 222 (Bankr. E.D. Mich. 1996) (quoting *TMT Trailer,* 390 U.S. at 424). “However, in determining whether a proposed settlement agreement is fair and equitable, courts have found the following factors to be the most pertinent:

> The balance between the likelihood of the plaintiff's or defendant's success should the case go to trial compared to the present and future benefits offered by the settlement; the prospect of complex, costly and protracted litigation if settlement is not approved; the proportion of class members who do not object or who affirmatively support the proposed settlement; the competency and experience of counsel who support the settlement; the relative benefits to be received by individuals or groups within the class; the nature and breadth of releases to be obtained by officers and directors; and the extent to which the settlement is the product of arm's length bargaining.

In re Dow Corning Corp., 198 B.R. at 222–23 (citing *In re Texaco Inc.,* 84 B.R. at 902).

58. With respect to release of causes of action against a debtor's directors and officers, Courts also consider the effect of indemnification provisions. In *In re Texaco Inc.*, the Bankruptcy Court for the Southern District of New York found that "[t]he value of the derivative actions against Texaco's own officers and directors [was] further diminished by the fact that under Texaco's By-laws, its officers and directors [were] indemnified for liabilities incurred while acting on behalf of Texaco." 84 B.R. at 904. Because "the claims asserted by the derivative plaintiffs would be offset pursuant to the By-law indemnifications[,]" the court found that "[t]he issuance of releases and indemnifications under the Plan to Texaco's officers and directors would represent no additional relinquishment of causes of action by Texaco." *In re Texaco Inc.*, 84 B.R. at 904–05 (holding that the debtor's plan satisfied all requirements to confirmation).

59. Here, as discussed in Part I, the Debtor Releases are fair, reasonable, and in the best interests of the Debtors' Estates. The Debtor Releases simply mirror and preserve the extensive protections already provided by Tennessee law while also preventing the Estates from engaging in wasteful litigation. Any claims that could potentially provide value to the Estates are not being released under the Plan, which preserves all causes of action against officers and directors as to which they are not immune. Moreover, the Debtor Releases provide consideration to the directors and officers for their continued cooperation post-confirmation. The Liquidating

Trustee will need the cooperation of Debtors' officers and directors to pursue valuable causes of action. Weighing all of the costs and benefits of the Debtor Releases, Debtors firmly believe that the Debtor Releases are fair, reasonable, and in the best interests of the Debtors' Estates and creditors.

CONCLUSION

60. In light of the foregoing, Debtors submit that the Objections should be overruled, and the Court should approve the Disclosure Statement and Procedures Motion.

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Nashville, Tennessee

Respectfully submitted,

POLSINELLI PC

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