UNITED STATES BANKRUPTCY COURT
DISTRICT OF COLUMBIA

In re:	)	
GREATER SOUTHEAST COMMUNITY HOSPITAL CORPORATION I, et al.,	)	**Case No.: 02-2250 (SMT)** **Chapter 11**
Debtor.	)	**(Jointly Administered)**

HUMANA'S BRIEF ON THE REORGANIZED DEBTORS' (LACK OF) RIGHT TO REJECT CERTAIN EXECUTORY CONTRACTS

Humana Health Plan, Inc. and Humana Insurance Co. (together, "Humana"), pursuant to the Court's order of June 27, 2005 and in support of its Motion to Direct Debtor to Pay Cure Amounts, presents this Brief as its argument that the equitable doctrines of promissory estoppel and unjust enrichment prevent the Reorganized Debtors from rejecting the executory Contract between Humana and Michael Reese Hospital.

Background

From before the start of this bankruptcy proceeding, Humana and Michael Reese Hospital, one of the Debtors (the "Debtor", "Debtors" or "Michael Reese") have been parties to two third-party payor, group-health agreements (the "Contracts"). Michael Reese was in default on the Petition Date. After the Petition Date, both parties continued to perform under the Contracts, and Michael Reese has remained essentially current post-petition.

On February 24, 2004, the Second Amended Disclosure Statement (the "Disclosure Statement") was approved by this Court. On April 2, 2004, the Second Amended Joint Chapter 11 Plan of Reorganization (the "Plan") was confirmed, as modified in the Confirmation Order. The Debtors prepared the Disclosure Statement and were the Plan Proponents.

The Plan is based on a restructuring proposal presented by the Recapitalization Proponents (the "Recap Proponents"), pursuant to which they took ownership and control of the Debtors (except Pine Grove). On the Effective Date, the Recap Proponents became the Reorganized Debtors. See, generally, Recapitalization Proposal, Plan Ex. 7, esp. p. 1. The Plan allowed the Reorganized Debtors to identify certain contract-holders as "Excluded Preference Creditors", with whom the Debtors had a "critical relationship". Plan § 1.38. The contracts with Excluded Preference Creditors were assumed and protected from avoidance. The Reorganized Debtors have the right to assume or reject certain remaining contracts, and are obligated for cure amounts on any contract they determine to assume. Confirmation Order, pp. 11-12.

The Disclosure Statement at IV(C) (p. 42), and the Plan at § 8.1(b) (p. 36), both provide:

> "Any executory contract or unexpired lease not so identified [as rejected] will be deemed assumed and retained by the appropriate Reorganized Debtor(s)…. The Debtors understand that the proponents of the Recapitalization Proposal intend to assume…third-party payor agreements"
>
> (hereinafter, the "Assumption Provision").

Humana and the Reorganized Debtors are currently negotiating the cure amount. As part of their negotiations, the Reorganized Debtors assert that if they are unable to work out an acceptable cure with Humana, they will reject the Contract. However, for the reasons explained herein, the Court should not allow any such rejection.

I. Promissory Estoppel

The equitable doctrine of promissory estoppel permits reasonable reliance to substitute for consideration as the basis for enforcing a promise. *Garwood Packaging, Inc. v. Allen & Company, Inc.*, 378 F. 3rd 698 (7th Cir. 2004). *The Restatement of the Law of Contracts (Second)* § 90(1), 1981 ed., explains this doctrine:

> A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce

> such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

The District of Columbia Circuit has adopted the *Restatement* definition. *Granfield v. Catholic University of America*, 530 F. 2nd 1035, 1041 (D.C. Cir. 1976). To establish a claim for promissory estoppel in the District of Columbia, the plaintiff must show 1) a promise; 2) that the promise reasonably induced reliance on it; and 3) that the promisee relied on the promise to his or her detriment. *U.S. Office Products Co. Securities Litigation*, 251 F. Supp. 2nd 58, 73 (D.C.Cir. 2003).

Most commonly, promissory estoppel is applied to defeat the exercise of a prima facie legal right. 48 A.L.R. 2nd 1069, *Promissory Estoppel* § 3. One of the seminal cases applying the doctrine (although not the term), *Goodman v. Dicker*, 169 F. 2nd 684 (D.C. Cir. 1948), provides an example. In that case the promise was to award a radio dealership franchise. The distributor told the would-be dealers that their application for a franchise had been accepted and that they were due to receive an initial delivery of radios. The dealers expended about $1500 in reliance on this promise before the distributor informed them the franchise would not be awarded after all. The distributor defended against the dealers' claim for damages by arguing that because the dealers knew that the franchise relationship was terminable at will, his change of heart was nothing more than an exercise of his undisputed legal right to cancel. The court disagreed. "The vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is sternly forbidden." *Goodman v. Dicker*, 169 F. 2nd 684, 685 (D.C. 1948), citing, *Dickerson v. Colgrove*, (1879) 100 U.S. 578, 580, 25 L. Ed. 618.

1. The Recap Proponents Promised to Assume Third-Party Payor Contracts

In considering promissory estoppel, the Court of Appeals for the District of Columbia defined a promise as "an expression of intention that the promisor will conduct himself in a specified way or bring about a specified result in the future, communicated in such a manner to a promisee that he may justly expect performance and may reasonably rely thereon." *Granfield v. Catholic University of America*, 530 F. 2nd 1035, 1039 (D.C. Cir. 1976), fn. 11, citing, *Corbin On Contracts* § 13 (1963).

The Assumption Provision is a promise to assume third-party payor contracts. The promise was made, among other places, in the Disclosure Statement and the Plan, documents reviewed by the Court.[1] As such, the Recap Proponents intended many parties to rely on it, the Court, the creditors who would vote on the Plan, and every party who had the ability to object to the Disclosure Statement or Plan, or to affect it in any way.

2. The Reliance was Reasonable

Reasonableness of reliance was explored in *Garwood Packaging, Inc. v. Allen & Company, Inc.*, 378 F. 3rd 698 (7th Cir. 2004). The promise in that case was that an investment deal would go through "come hell or high-water". The promise was made informally, was not made in the context of negotiation, was hyperbolic, and the promisor did not control all the parties needed to keep the promise, a fact that all involved understood. The Seventh Circuit found that promissory estoppel did not apply.

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[1] Humana does not know which party is responsible for the actual wording of the Assumption Provision. The likely candidates are the Debtors, who were the official proponents of the Plan, and the Recap Proponents, who got the Plan they wanted and, as the Reorganized Debtors, are charged with effecting it. In any event, the identity of the author is irrelevant. At a minimum, the Recap Proponents agreed to the inclusion of the Assumption Provision. See, June 27, 2005, adversary 04-10093, Hearing Transcript, 50:19 – 52:5, in which the Court said,

> "No, but my point is, on the estoppel issue, it's the debtors, not the recapitalization proponents, who filed the plan and made the representation, that they understood that the recapitalization proponents intended to assume third-party payer contracts. That's a step removed from the third-party payer saying, 'We intend to assume.' It's not very far removed because they're obviously participating in the process, and saw that statement and didn't disavow it. So maybe it doesn't make any difference, since they didn't disavow it". Transcript excerpts, attached as **Exhibit A**.

In our situation, by contrast, the same indicia all point to estoppel. The promise was made using specific legal terminology in a formal context and subject to court approval. The Reorganized Debtors (and only the Reorganized Debtors) have the power to keep their promise; no other party's cooperation is needed. Finally, the promise was made in the context of a bidding war, when the Recap Proponents were competing with other proponents of other proposals. See, Disclosure Statement II (E), pp. 30-32, Debtors' Memorandum of Law in Support of Confirmation of Debtors' Second Amended Joint Chapter 11 Plan of Reorganization, March 29, 2004, pp. 6-7 (hereinafter, "Debtor's Memorandum"). It was in this context that the Assumption Provision unequivocally establishes and limits the Reorganized Debtors rights to reject these contracts.

The Assumption Provision's initial appearance in public records was in the First Disclosure Statement, a document drafted and filed before the 5-day auction and the negotiations that followed it. At that point, the Assumption Provision read:

> In the case of the Recapitalization Proposal, its proponents will identify those executory contracts and/or unexpired leases they wish to assume for the benefit of the Reorganized Debtors. The Debtors understand that the proponents of the Recapitalization Proposal intend to . . . assume third-party payor agreements. Notwithstanding the foregoing, the Winning Bidder(s), including the proponents of the Recapitalization Proposal in the event the Recapitalization Proposal is the Winning Bid, shall retain the right to decline to assume any executory contract or unexpired lease for which the cure amount is not fixed in an amount acceptable to such Winning Bidder(s), either by agreement or a determination of the Bankruptcy Court.

However, after the conclusion of negotiations that saw the Recap Proponents prevail, in the second and operative Disclosure Statement, the provision read:

> Any executory contract or unexpired lease not so identified [as rejected] will be deemed assumed and retained by the appropriate Reorganized Debtor(s) or other entit(ies). Notwithstanding the foregoing, the proponents of the Recapitalization Proposal…shall retain the right to decline to assume any executory contract or unexpired lease for which the cure amount is not fixed in an amount acceptable to the proponents, either by agreement or a determination of the Bankruptcy

> Court. The Debtors understand that the proponents of the Recapitalization Proposal intend to assume provider agreements with…third-party payor agreements".[2]

The difference is significant. Before the auction, the Assumption Provision preceded the provision reserving the Reorganized Debtors' rejection rights, "Notwithstanding the foregoing, the proponents of the Recapitalization Proposal . . . shall retain the right to decline to assume any executory contract or unexpired lease for which the cure amount is not fixed". The Assumption Provision, in other words, is one of the "foregoing" that can be overcome by the Reorganized Debtors' rejection rights. After the auction, the sentence order was reversed so that the retention of rejection rights precedes the Assumption Provision. Although the "right to reject" still overcomes whatever is "foregoing", the Assumption Provision is no longer part of the "foregoing". While bidding against competing proposals and negotiating with numerous parties, the Recap Proponents gave up whatever right they may have had to reject third party payor contracts.

Comparing the promise made in the Assumption Provision to the promise made in *Garwood's* "hell or high-water", it is obvious why the reliance here was reasonable. Far from being a casual phrase intended to show determination and personal commitment, the Assumption Provision, and its exact placement vis a vis related provisions, was a part of the give and take of intense, multi-party[3] negotiations, and was made knowing it would be subject to Court scrutiny. If a party cannot rely on a promise subject to approval of and enforcement by the Court, it is hard to imagine that reliance could ever be justified.

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[2] The provision in the Plan is identical.

[3] The parties included at least, the Debtors, the NCFE Entities, the Committee, the Recap Proponents, and their respective advisors. See, Findings of Fact and Conclusions of Law, April 2, 2004, p. 16.

3. If the Promise is Not Kept Humana and Others Will Suffer Detriment

Humana forbore from exercising certain undeniable rights because it relied on the Assumption Provision. It could have asked the Court to compel the Debtor to make a decision on the Contract. In addition, or in the alternative, Humana could have sought to be named an Excluded Preference Creditor. This would have guaranteed assumption and protected Humana from the preference complaint it is currently fighting. Finally, Humana could have voted against the Plan. But the reality was that, on an ongoing basis, the Reorganized Debtors continued to utilize Humana's third party group health services, under the Assumption agreements approved by this Court. Humana did not earlier exercise its legal rights, as there was absolutely no indication in the Reorganized Debtors legal position in this case or its business conduct with Humana that Reorganized Debtors were treating these executory contracts as anything but assumed.

Other parties forbore from exercising rights in reasonable reliance on the Assumption Provision and will also be detrimentally affected if the Reorganized Debtors prevail. For example, other proposals offered the Debtors more cash. See, Debtors' Memorandum p. 6. That health benefits would be provided by a nationally-known and respected carrier was certainly among the reasons that employees chose employment at Michael Reese instead of elsewhere. Had Michael Reese understood that this important benefit was at risk, it might have resisted the Recap Proponents and their Plan, or insisted that Humana be named an Excluded Preference Creditor.

4. Estoppel Applies in a Bankruptcy Context

The estoppel doctrine applies to a plan of reorganization. In *In re Momentum Manufacturing Corp. (Momentum Manufacturing Corp. v Employee Creditors Committee)*, 25 F. 3rd 1132 (2nd Cir. 1994), the debtor convinced his employees to support the plan by promising severance pay. Shortly after the plan was confirmed however, he moved to cancel claims to the

extent they sought severance pay. The Second Circuit found that he was estopped from doing so. It emphasized that disclosure is of prime importance in the reorganization process and that the employees had relied un the debtor's misleading statements in voting for the plan. *Momentum* involved an intentional misstatement, and the court applied the doctrine of equitable estoppel, not promissory estoppel which Humana seeks. The case is significant nonetheless in showing how seriously courts treat promises made in a plan of reorganization.

II. Unjust Enrichment

If the Reorganized Debtors are allowed to reject third-party payor contracts, they will be unjustly enriched at the expense of Humana and other parties. To establish unjust enrichment, a plaintiff must show:

1. a benefit conferred upon the defendant by the plaintiff;
2. an appreciation or knowledge by the defendant of the benefit; and
3. the acceptance or retention by the defendant of the benefit under such circumstances as to make it inequitable for the defendant to retain the benefit without payment of value.

International Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America (Airline Division) v. Association of Flight Attendants, AFL-CIO, 864 F. 2nd 173, 175 (D.C. Cir. 1988), citing, S. Williston, *A Treatise on the Law of Contracts* § 1479, at 276 (3rd ed. 1970).

All elements are present here. The Reorganized Debtors received a benefit because the plan they wanted was confirmed and they are in charge, a fact they not only understand but fought for. Because the Debtors proposed and supported the Plan based, in part, on the Recap Proponents' promise, and because Humana refrained from exercising its rights, including the right to seek Excluded Preference Creditor status, in reliance on the same promise, it would be inequitable if at a point when neither Humana nor the Debtors are capable of exercising prior rights, the Reorganized Debtors were to go back on their promise.

CONCLUSION

For the reasons set out herein, Humana asks that this Court rule that the Reorganized Debtors are estopped from rejecting their Contract with Humana.

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Humana Health Plan Inc., Humana HealthChicago, Inc., Humana HealthChicago Insurance Company, and Humana Insurance Company

By: /s/ Frank S. Swain
One of their Attorneys

Jessica Tovrov
Arnstein & Lehr
120 South Riverside Plaza
Suite 1200
Chicago, Illinois 60606
Tel: 312-876-7842
Fax: 312-876-0288

Frank Swain
(DC Bar #427792)
Baker & Daniels LLP
805 15th Street, N.W., Suite 700
Washington, DC 20005
Tel: 202-312-7416
Fax: 202-312-7441