Case Number: PC-2017-3856
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Reviewer: Alexa G.

HEARING: JANUARY 18, 2019; 9:30 A.M.

STATE OF RHODE ISLAND
PROVIDENCE, S.C.

SUPERIOR COURT

ST. JOSEPH HEALTH SERVICES OF RHODE ISLAND, INC.

vs.

ST. JOSEPH HEALTH SERVICES OF RHODE ISLAND RETIREMENT PLAN, as amended.

C.A. No.: PC-2017-3856

PROSPECT MEDICAL HOLDINGS, INC., PROSPECT EAST HOLDINGS, INC., AND PROSPECT CHARTERCARE, LLC'S MEMORANDUM IN SUPPORT OF THEIR NOTICE OF INTENT TO SUE CHARTERCARE COMMUNITY BOARD, OR IN THE ALTERNATIVE, MOTION FOR RELIEF FROM THE INJUNCTIVE PROVISIONS OF THE PERMANENT RECEIVERSHIP ORDER

The Prospect Entities[1] bring this motion for two purposes:

1. To provide this Court with notice of their intention to sue Chartercare Community Board f/k/a Chartercare Health Partners ("CCCB")[2] for (i) CCCB's violation of the provisions of the Amended and Restated Limited Liability Company Agreement of Prospect Chartercare, LLC (the "LLC Agreement"), and (ii) contractual indemnity pursuant to the Asset Purchase Agreement ("APA"). While, as addressed below, such Lawsuits should not require leave from this Court before being filed, to the extent necessary, the Prospect Entities seek leave through this motion to file them; and

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[1] Prospect Medical Holdings, Inc. ("Prospect Medical"), Prospect East Holdings, Inc. ("Prospect East") and Prospect Chartercare, LLC ("Prospect Chartercare").

[2] Prior to the 2014 Sale, CCHP was an entity with two hospital subsidiaries: Our Lady of Fatima Hospital ("Fatima Hospital") and Roger Williams Hospital ("RWH;" collectively, "the Hospitals"). After the 2014 Sale, CCHP changed its name to CCCB. The terms CCHP and CCCB will be used herein relative to the appropriate point in time (i.e. whether before or after the 2014 Sale).

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2. The obtain relief from this Court from the injunctive provisions of the Permanent Receivership Order ("Order") to allow Prospect Chartercare to file—or instruct the Receiver to file—administrative petitions ("Administrative Petitions") with the Rhode Island Attorney General ("RIAG") and Rhode Island Department of Health ("RIDOH") regarding the contemplated change in ownership of Prospect Chartercare as a result of the Receiver's assumption of an interest in CCCB pursuant to the Settlement Agreement between CCCB, the Receiver, and others.

BACKGROUND FACTS AND PROCEEDINGS

Prior to 2014, St. Joseph Health Services, Inc. ("SJHSRI") owned and operated Fatima Hospital and, as a benefit to its employees, sponsored the St. Josephs Health Services of Rhode Island Retirement Plan ("the Retirement Plan"). However, over many years, SJHSRI sustained significant financial losses and, as a result, entered into an affiliation agreement ("Affiliation Agreement") to share operational expenses with RWH. As part of the Affiliation Agreement, RWH and SJHSRI organized into subsidiaries of CCHP.

Despite the Affiliation Agreement, CCHP continued to incur significant financial losses and ultimately solicited offers for outside capital from entities that invested in or operated hospitals. Prospect East responded to such solicitation, and in 2014, certain of CCHP's assets were sold ("2014 Sale") for (1) a cash payment of $45 million, (2) a commitment to capital project and network development, and (3) a grant to CCCB of a fifteen percent (15%) ownership interest in a newly-formed limited liability company, Prospect Chartercare, which in turn owned Prospect Chartercare SJHSRI, LLC ("Prospect SJHSRI") and Prospect Chartercare RWMC,

LLC ("Prospect RWMC").[3] The 2014 Sale was expressly conditioned upon any liability for the Retirement Plan remaining with SJHSRI. The RIAG and RIDOH reviewed, evaluated, and approved the 2014 Sale pursuant to the Hospital Conversion Act ("HCA") and the Health Care Facility Licensing Act of Rhode Island ("HLA").

The Asset Purchase Agreement Excludes the Retirement Plan and Provides for Indemnification

In connection with the 2014 Sale, SJHSRI, RWH, CCHP, and the Prospect Entities, among others, executed the APA.[4] The APA listed assets that were specifically excluded from the 2014 Sale. Among the "excluded assets" were "any Seller Plans (any and all assets associated therewith or set aside to fund liabilities related thereto), the Retirement Plan[5] and the Retirement Plan Assets[6]." *See* APA at § 2.2(d). The APA also provided that CCHP, RWH, and SJHSRI would indemnify Prospect Medical, Prospect East, and Prospect Chartercare from any liability relating to the Retirement Plan. Specifically, the APA states the following:

> Sellers[7], jointly and severally, shall indemnify, defend and hold harmless Prospect, the Prospect Member, the Company, the Company Subsidiaries and their respective Affiliates, officers, directors, trustees, employees, stockholders, partners, members, agents, representatives, successors and permitted assigns (collectively, the "Company/Prospect Indemnified Persons"), from and against any loss, Liability, claim, damage or expense (including costs of investigation and defense and reasonable attorneys' fees and expenses), whether or not involving a Third-

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[3] CCCB's fifteen percent interest in Prospect Chartercare was subject to the LLC Agreement. Prospect SJHSRI and Prospect RWMC were entities that owned the Hospitals post-2014 Sale.

[4] The 2014 APA is a public document posted on the RIAG's website at http://www.riag.ri.gov/CivilDivision/OfficeoftheHealthCareAdvocate.php under "Recent HCA Reviews," "CharterCARE/Prospect" and "Public Exhibits" and included thereunder as Exhibit 18.

[5] The APA defines "Retirement Plan" as "the St. Joseph Health Services of Rhode Island Retirement Plan." APA at A-13.

[6] The APA defines "Retirement Plan Assets" as "the assets, cash and investments of the Retirement Plan." APA at A-13.

[7] The APA defines "Sellers" to include CCHP, RWH, and SJHSRI, among others.

> Party Claim (collectively, "Damages"), arising from or in connection with:
>
> [. . .]
>
> (c) the Excluded Assets and Excluded Liabilities; and
>
> (d) Sellers' operation of the Business[8] prior to the Closing Date to the extent not contained in the calculation of Final Net Working Capital, including . . . (ii) Liabilities for funding of, or tax or ERISA penalties or any other liabilities with respect to, the Retirement Plan . . . .

APA at § 14.2(d).

The LLC Agreement Prohibits Transfers of a Member's Interest

Prospect Chartercare was created as part of the 2014 Sale. Pursuant to the LLC Agreement, Prospect Chartercare has two members: Prospect East and CCCB. The LLC Agreement specifically prohibits a member's ability to transfer its interest in Prospect Chartercare as follows:

> a member may not sell, assign (by operation of Law or otherwise), transfer, pledge or hypothecate ("Transfer") all or any part of its interest in [Prospect Chartercare] (either directly or indirectly through the transfer of the power to control, or to direct or cause the direction of the management and policies, of, such Member.

LLC Agreement at § 13.1. The LLC Agreement further states that

> [n]o Transfer of an interest in the Company that is in violation of this Article XIII shall be valid or effective, and the Company shall not recognize any improper transfer for the purposes of making allocations, payments of profits, return of capital contributions or other distributions with respect to such Company interest or part thereof.

Id. at § 13.6.

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[8] "Business" means "the business, operation or ownership of the Facilities and the Purchased Assets." *See* APA at A-2. The "Facilities" means the "Hospitals," which is defined as RWH and Fatima Hospital. *See id.* at A-5, A-7.

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The Retirement Plan is Placed Into Receivership

After the 2014 Sale, SJHSRI filed a petition with this Court, requesting that the Court place the Retirement Plan into receivership due to the Retirement Plan's insolvent state ("Receivership Action"). *See St. Joseph Health Services of Rhode Island, Inc. v. St. Joseph Health Services of Rhode Island Retirement Plan,* PC-2017-3856 (R.I. Super. Ct. Aug. 18, 2017). The Court appointed a temporary receiver, and ultimately appointed Stephen Del Sesto as permanent receiver ("Receiver"). The order appointing the Receiver ("Order") provides, in pertinent part, the following:

> That the commencement, prosecution, or continuance of the prosecution, of any action, suit, arbitration proceeding, hearing, or any foreclosure, reclamation or repossession proceeding, both judicial and non-judicial, or any other proceeding, in law, or in equity or under any statute, or otherwise, *against the Respondent or any of its assets or property*, in any Court, agency, tribunal, or elsewhere, or before any arbitrator, or otherwise by any creditor, corporation, partnership or any other entity or person, or the levy of any attachment, execution or other process upon or against any asset or property of the Respondent, or the taking or attempting to take into possession any asset or property in the possession *of the Respondent* or of *which the Respondent has the right to possession*, or the cancellation at any time during the Receivership proceeding herein of any insurance policy, lease or other contract with the Respondent, by any of such parties as aforesaid, other than the Receiver designated as aforesaid, without obtaining prior approval thereof from this Honorable Court, in which connection said Receiver shall be entitled to prior notice and an opportunity to be heard, are hereby restrained and enjoined until further Order of this Court.

(Emphasis added).

The Receiver Files the Federal Court Action Seeking To Hold the Prospect Entities Liable For the Underfunding of the Retirement Plan

In June 2018, the Special Counsel that was engaged by the Receiver filed suit on behalf of the Retirement Plan and several of its participants (collectively, "Federal Action Plaintiffs")

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against numerous entities, including the Prospect Entities and CCCB, in the United States District Court for the District of Rhode Island ("Federal Action"). *See Stephen Del Sesto v. Prospect Chartercare, LLC, et al*, 1:18-cv-00328-WES-LDA (D.R.I. Jun 18, 2018). Among other things, the Federal Action Plaintiffs allege that the Prospect Entities are liable for a purported underfunding of the Retirement Plan. *See e.g., id.*, ECF No. 60 at ¶ 461.

The Receiver And CCCB Enter Into A Settlement Agreement That Violates The LLC Agreement

In September 2018, the Receiver entered into a settlement agreement with CCCB and then filed a Petition for Settlement Instructions ("Settlement Petition") in the Receivership Action, requesting that the Court "approv[e] the Proposed Settlement as in the best interest of the Receivership Estate, the [Retirement] Plan, and the Plan participants," and "authoriz[e] and direct[] the Receiver to proceed with the Proposed Settlement." Attached to the Settlement Petition was the executed settlement agreement ("Settlement Agreement"), which was between the Receiver, the Federal Action Plaintiffs, CCCB, SJHSRI, and RWH.

The Settlement Agreement provides that CCCB will hold its interest in Prospect Chartercare "in trust for the Receiver," and the Receiver "will have the full beneficial interest therein." *See* Settlement Agreement at ¶ 17. It further provides that at the direction of the Receiver, CCCB will exercise the Put Option[9] in the LLC Agreement and remit to the Receiver the proceeds of the Put Option. *See id.* ¶ 18. Additionally, pursuant to the Settlement Agreement, (1) the Receiver has the right to sue in the name of CCCB to collect or otherwise obtain the value of the beneficial interest in Prospect Chartercare; (2) CCCB, upon the

[9] The Put Option provides that upon certain conditions, CCCB "shall have the option to sell to [Prospect East], and [Prospect East] shall have the obligation to purchase, all of the Units held by CC[CB] in exchange for a payment in case of a purchase price equal to the Appraised Value of the Units . . ." *See* LLC Agreement at § 14.5(a).

Receiver's written demand, must file a petition for its judicial liquidation and follow the request of the Receiver to marshal its assets and oppose claims of creditors; and (3) CCCB will grant a security interest in essentially all its assets, which includes its membership interest in Prospect Chartercare. *See id.* at ¶¶ 19, 24, 29. On September 4, 2018, the Receiver filed a UCC-1, asserting a purported interest in essentially all of CCCB's assets.

Prospect East Notifies CCCB of the Violation in Anticipation of Bringing Suit

Because the Settlement Agreement provides for the hypothecation of CCCB's interest in Prospect Chartercare in direct contravention of the provisions of the LLC Agreement, Prospect East sent CCCB a Notice of Dispute letter pursuant to the detailed dispute resolution procedures in the LLC Agreement. The Notice of Dispute letter informed CCCB that the transfer of CCCB's interest in Prospect Chartercare as provided in the Settlement Agreement constituted an ineffective, invalid, and prohibited transfer under the LLC Agreement.

Prospect Chartercare Files the Administrative Petitions With the Relevant State Regulators

Prospect Chartercare also filed a Petition for Declaratory Order ("Petition") with the RIAG and RIDOH pursuant to R.I. Gen. Laws § 42-35-8. The Petition sought the following declarations: (1) that the proposed transfer of CCCB's interest in Prospect Chartercare pursuant to the Settlement Agreement violated the HCA, HLA, and is inconsistent with the Final Conversion Decisions and Change in Effective Control Decision (collectively, "Decisions") issued by the RIAG and RIDOH, respectively; (2) that the proposed transfer of CCCB's interest in Prospect Chartercare pursuant to the Settlement Agreement is a conversion under R.I. Gen. Laws § 23-17.14-4(6) of the HCA and is thus not permitted absent approval by the RIAG and RIDOH; (3) that any application filed by the Receiver for review and approval of the Settlement Agreement is barred by the doctrine of administrative finality; and (4) that the Decisions bar any

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claim that Prospect Chartercare is liable for the Plan. In connection with the Petition, the Receiver filed a motion for contempt ("Contempt Motion"), requesting that the Court find Prospect Chartercare in contempt of court for violating the Order by initiating an action against the receivership estate.

The Court Rules on the Receiver's Settlement Petition and Contempt Motion, Leading to This Motion

After the Court held a hearing on the Settlement Petition, it issued a written decision ("Settlement Decision"), holding, among other things, that the Prospect Entities did not have standing to object to the Settlement Petition; and that the Settlement Agreement was in the best interest of the receivership estate. *See St. Joseph Health Servs. of R.I. v. St. Josephs Health Servs. of R.I. Ret. Plan*, 2018 R.I. Super. LEXIS 94, *25-26 (R.I. Super. Ct. Oct. 29, 2018). Subsequently, the Court issued a written decision on the Contempt Motion ("Contempt Decision"). *St. Joseph Health Servs. of R.I. v. St. Josephs Health Servs. of R.I. Ret. Plan*, 2018 R.I. Super. LEXIS 100, at *17 (R.I. Super. Ct. Nov. 14, 2018). In the Contempt Decision, the Court reserved its decision on contempt, and provided Prospect Chartercare ten days to withdraw the Petition, indicating that Prospect Chartercare should thereafter seek leave of Court to re-file the Petition after notice and hearing. *Id.* Prospect Chartercare thereafter withdrew the Petition, and this motion now follows.

ARGUMENT

The Prospect Entities raise two separate matters by way of this motion. First, they provide notice to the Court that they intend to sue CCCB in Delaware for (1) its breach of the LLC Agreement by transferring its interest in Prospect Chartercare to the Receiver; and (2) contractual indemnification arising out of the APA, inasmuch as the Receiver has alleged that the Prospect Entities are liable for the Retirement Plan's liabilities. Both of these claims

(collectively, the "Lawsuits") are founded in contracts between the Prospect Entities and CCCB and should not be deemed subject to the Order. However, to the extent that the Court finds that such lawsuits fall within the scope of the Order, the Prospect Entities seek relief from the Order to bring such lawsuits pursuant to the terms of the underlying contracts. Relief is warranted so that the Prospect Entities may take necessary action to protect their legitimate, contractual interests, and preserve and assert claims that they have against business associates.

As to the Administrative Petitions, the Court should grant Prospect Chartercare relief from the Order to file the Administrative Petitions so that the appropriate regulatory agencies—the RIAG and RIDOH—can determine whether the provisions of the Settlement Agreement—in particular, the transfer of interest from CCCB to the Receiver—comply with the HCA, HLA, and conditions of the Decisions. Prospect Chartercare respectfully requests leave to refile the Administrative Petitions or, in the alternative, asks that the Court direct the Receiver to seek the necessary regulatory input or approval regarding CCCB's transfer of its interest in Prospect Chartercare to the Receiver.

A. The Order Does Not Prevent the Prospect Entities from Suing CCCB, and the Court's Equitable Jurisdiction Does not Extend to Claims of Creditors of CCCB.

The Prospect Entities respectfully provide notice to the Court of their intent to initiate the Lawsuits against CCCB. Relief from the Order is not necessary prior to the Prospect Entities filing the Lawsuits because the Order does not prevent the Prospect Entities from suing CCCB, and the Receiver has no standing to request that the Court equitably enjoin the Prospect Entities from suing CCCB. However, to the extent the Court disagrees, the Prospect Entities respectfully request leave to bring such actions, for the reasons addressed below.

1. The Order does not enjoin suits against CCCB.

For purposes of the proposed Lawsuits, CCCB's affiliation with the Receiver solely arises out of it holding its interest in Prospect Chartercare in trust for the Receiver. However, simply because CCCB holds an interest in trust for the Receiver does not make CCCB part of the receivership estate and preclude claims by third parties against CCCB.

This Court has held that actions against parties who contract with an entity in receivership do not violate a receivership order enjoining actions against the receivership estate. *See Dulgarian v. Sherman*, 1991 R.I. Super. LEXIS 1, at 4-5 (R.I. Super. Ct. Jan 7, 1991). For instance, in *Dulgarian*, a seller sold a parcel of property ("Property") to a buyer for $459,315, which the buyer financed through (1) a note and mortgage to Atrium Financial Service Corporation ("AFSC"); and (2) a note and mortgage to the seller, which mortgage was junior to AFSC's mortgage. *Id.* at 1. Subsequently, the buyer defaulted on the terms of the note that it gave to the seller, and the seller foreclosed on the property. *Id.* at 1-2. At the time of the foreclosure, AFSC was in receivership, and an order prohibited the commencement or prosecution of any action, suit, or foreclosure against AFSC or its property. *Id.* at 2. The seller filed a lawsuit against the buyer, and sought summary judgment as to the buyer's liability on the note that it gave to the seller. *Id.* In objecting to the seller's motion for summary judgment, the buyer argued that the seller's foreclosure of the Property violated the order enjoining any action against AFSC or its assets. *Id.* at 3. The Court rejected that argument, holding that, while the order staying action against AFSC or its assets "would certainly operate to preclude foreclosure actions by [AFSC's] creditors against property owned by [AFSC], it would not preclude a foreclosure action by [seller] against the property owned by [buyer]." *Id.* at 4. The court noted that "[t]he stay does not affect the creditors of [buyer] merely because [AFSC] holds a first mortgage on the property." *Id.* The Court held that the buyer's argument that the foreclosure

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was invalid because AFSC was in receivership at the time "must fail" because "[t]he stay in the [AFSC] case operated to preclude creditor action against its property interests." *Id.* at 5. Additionally, the Court held that "[t]he foreclosure by [seller], a junior mortgagee of the property . . . had absolutely no effect on [AFSC's] rights or interest in the property" because after a junior mortgage holder forecloses, "the senior mortgage remains on the property and the purchaser takes the property subject to this mortgage." *Id.* at 5. As such, the Court concluded that "[s]ince the [] stay did not operate to preclude [seller's] right of foreclosure against [buyer], and foreclosure of the junior mortgage in no way affected [AFSC's] superior property interest, [buyer's] argument that the foreclosure sale is void must fail. *Id.*

Here, it is wholly undisputed that prior to execution of the Settlement Agreement, disputes between Prospect East and CCCB relating to Prospect Chartercare, the LLC Agreement, or APA would not be part of the receivership estate and would not be subject to the injunctive provisions of the Order. The Settlement Agreement does not change that conclusion. The Settlement Agreement provides that CCCB's interest in Prospect Chartercare is to be held by CCCB "in trust for the Receiver, and that the Receiver will have the beneficial interests therein." Settlement Agreement at ¶ 17. However, CCCB continues to hold the membership interest and thus, continues to carry the contractual and fiduciary obligations and responsibilities thereunder. Moreover, CCCB remains obligated under the APA to indemnify the Prospect Entities. The mere fact that the Receiver claims a beneficial interest in CCCB does not alter the contract rights and obligations of CCCB under the LLC Agreement or APA; CCCB is a legal entity distinct from the Receiver and is governed (1) by the LLC Agreement and the fiduciary obligations arising thereunder; and (2) the APA, which requires CCCB to indemnify the Prospect Entities.

Just as in *Dulgarian*, even though the Receiver has an arguable contingent interest in CCCB, the Prospect Entities suit against CCCB has no effect on the interest that the Receiver holds in CCCB and therefore does not violate the Order. The legal title to the membership in Prospect Chartercare remains with CCCB, and CCCB is thus subject to the terms of the LLC Agreement and the fiduciary obligations arising thereunder. Similarly, CCCB is still an independent entity and subject to the terms of the APA. Accordingly, a dispute between the Prospect Entities and CCCB with regard to the LLC Agreement and the fiduciary obligations arising thereunder, or under the APA, does not change the position of the Receiver. In other words, no matter the outcome of the Prospect Entities claims against CCCB, the Receiver's interest in CCCB will remain. The Receiver's claimed contingent, beneficial interest in CCCB cannot prevent the resolution of disputes between CCCB and third-parties (the Prospect Entities) who are outside of the receivership estate.

Indeed, any other conclusion would be exceedingly strange. The LLC Agreement and the APA place a series of obligations, restrictions and responsibilities on CCCB as a member of Prospect Chartercare. The fact that CCCB has entered into an agreement with the Receiver cannot be seen to void any of those obligations, restrictions or responsibilities. How can it be the case that the Settlement Agreement vitiates a series of contractual responsibilities and limitations? If CCCB begins simply flouting its contractual obligations, is there truly no legal remedy? The Receiver seems to contend exactly that. But, frankly, that is an unsupportable position. It would be an extraordinary exercise of power to hold that the Prospect Entities cannot seek to vindicate their contractual rights based on the actions of others.

Accordingly, the Order does not, and should not, preclude the Prospect Entities from seeking to effectuate their contractual rights pursuant to the LLC Agreement and APA.

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Therefore, the Prospect Entities respectfully provide notice to this Court of its intention to initiate a lawsuit against CCCB (1) relative to its breaches of the LLC Agreement; and (2) for indemnification under the APA.

2. *Enjoining the Prospect Entities would constitute an extension of the Court's equitable jurisdiction beyond its limits.*

In the Settlement Decision, this Court ruled that the Prospect Entities lacked standing to challenge provisions of the Settlement Agreement that they found objectionable. However, in rejecting the Prospect Entities' arguments that the Settlement Agreement included provisions that violate the LLC Agreement, the Court acknowledged that the receivership proceeding was "not the appropriate proceeding to unwind the litany of objections the Prospect Entities lodge." *St. Joseph Health Servs. of R.I.*, 2018 R.I. Super. LEXIS 94, at *26. The Court further stated that the "dispute between CCCB and the Prospect Entities belongs in a different proceeding—one where a court can dedicate appropriate judicial resources to resolving that isolated dispute." *Id.* Finding that the Prospect Entities could not contest the objectionable terms of the Settlement Agreement in the receivership proceeding, the Court recognized that the Prospect Entities nevertheless had the right to challenge objectionable terms in another proceeding. *See id.* ("Because the Prospect Entities have no right to contest the terms they find objectionable in this proceeding, they do not waive the right to do so in another"). That other proceeding is exactly what the Prospect Entities seek to initiate following this motion.

And just as the Court ruled that the Prospect Entities have no standing to challenge a contract between the Receiver and CCCB, similarly, the Receiver would have no standing in an action for CCCB's breach of contracts that it had with third parties. The LLC Agreement and the APA are contracts among CCCB and the Prospect Entities, not the Retirement Plan or the Receiver. Just as the Prospect Entities were found to be strangers to the Settlement Agreement,

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it is equally true that the Receiver is a stranger to the LLC Agreement and APA. The Receiver's claimed interest in CCCB is insufficient to confer standing on him to either participate in that litigation or to seek to enjoin it.

A party "generally must assert his own legal rights and interest, and cannot rest his claim to relief on the legal rights or interests of third parties." *Savage & Assocs., P.C. v. Mandl (In re Teligent, Inc.)*, 417 B.R. 197, 210 (Bankr. S.D.N.Y. 2009) (citing *Warth v. Seldin*, 422 U.S. 490, 498 (1975)). In the Settlement Decision, this Court elaborated on that principal:

> . . . our Supreme Court has consistently held that "strangers to a contract lack standing to either assert rights under that contract or challenge its validity." *See*, *e.g*., *DePetrillo v. Belo Holdings, Inc.,* 45 A.3d 485, 492 (R.I. 2012) (prospective purchaser lacked standing to challenge purchaser's exercise of right of first refusal where prospective purchaser was a stranger to a contract between the vendor and purchaser providing for first refusal rights); *Sousa v. Town of Coventry*, 774 A.2d 812, 815 n.4 (R.I. 2001) (rejecting argument that "an individual who is not a party to a contract may assert the rights of one of the contracting parties in order to void a contract or have it declared unenforceable").

Accordingly, the Prospect Entities have the right to litigate their contract dispute with CCCB "in a different proceeding" and the Receiver has neither standing to assert rights under the LLC Agreement nor the right to impair the Prospect Entities' rights under the LLC Agreement by petitioning this Court for equitable relief.

Since the Receiver and CCCB are legally distinct, and the Receiver has no direct interest in the contract dispute between the Prospect Entities and CCCB relating to a breach of the LLC Agreement, this Court should not grant equitable relief to the Receiver by enjoining the Prospect Entities from pursuing their contract claims against CCCB. Equitable jurisdiction of the Superior Court "is not limitless" and is predicated on a litigant being entitled to some form of equitable relief. *See Ret. Bd. of the Emplees. Ret. Sys. of Providence v. Corrente*, 111 A.3d 301,

306 (2015) ("[A] litigant must seek or be entitled to some form of recognized equitable relief in order to invoke this jurisdiction"). At best, the Receiver has beneficial interest in the assets of CCCB. Such an interest should not be construed to insulate CCCB from claims by CCCB's creditors or contracting parties. The Receiver has no standing to seek equitable relief to prevent the Prospect Entities from pursuing their rights under the LLC Agreement. To hold otherwise would be to enjoin *all* actions of *all* third-parties against CCCB simply because the Receiver holds a contingent interest in CCCB; a conclusion that would stretch equity beyond its limits.

B. Even if the Court Finds That the Order Enjoins Suits Against CCCB, it Should Nonetheless Grant the Prospect Entities Relief from the Order to File the Lawsuits.

Even if the Court finds that the Order enjoins suits against CCCB and that the Lawsuits are within the equitable jurisdiction of the Court, it should nonetheless grant the Prospect Entities relief from the Order and allow them to pursue their claims against CCCB.

While this Court has yet to expressly identify factors that would warrant relief from a receivership stay, the Ninth Circuit, in *SEC v. Wencke*, 622 F.2d 1363, 1373-74 (9th Cir. 1980) ("*Wencke I*") and *SEC v. Wencke*, 742 F.2d 1230, 1231 (9th Cir. 1984) ("*Wencke II*"), addressed the standard to be employed by a federal court in determining whether to lift a receivership stay.[10] In *Wencke II*, the Ninth Circuit held that a district court should consider three factors to determine whether lifting a receivership stay is appropriate:

> (1) whether refusing to lift the stay genuinely preserves the *status quo* or whether the moving party will suffer substantial injury if not permitted to proceed; (2) the time in the course of the

[10] This Court has previously noted that "[i]n Rhode Island, the Court looks to the Bankruptcy Code for guidance in receivership matters." *Site, LLC v. Matthew Realty Corp.*, 2016 R.I. Super. LEXIS 149, at *3 (R.I. Super. Ct. Dec. 27, 2016) (citing *Reynolds v. E & C Assocs*., 693 A.2d 278, 281 (R.I. 1997)). However, where, as here, both this Court and a federal court may sit in equity in receivership matters, the federal court's jurisprudence regarding relief from a receivership stay may be more applicable than looking to the Bankruptcy Code.

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> receivership at which the motion for relief from the stay is made; and (3) the merit of the moving party's underlying claim.

742 F.2d at 1231.[11] The *Wencke II* test "simply requires the district court to balance the interest of the Receiver and the moving party . . . . [T]he interests of the Receiver are very broad and include not only protection of the receivership *res*, but also protection of defrauded investors and considerations of judicial economy." *United States v. Acorn Technology Fund, L.P.*, 429 F.3d 438, 443 (3rd Cir. 2005) (citing *SEC v. Universal Financial*, 760 F.2d 1034, 1038 (9th Cir. 1985)). The *Wencke II* standard has been widely accepted in application and has been adopted by courts in the Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Circuits.[12] In addressing a receivership stay and whether lifting a stay is appropriate, a court noted that

> the purpose of imposing a stay of litigation is clear. A receiver must be given a chance to do the important job of marshaling and untangling a company's assets without being forced into court by every investor or claimant. Nevertheless, an appropriate escape valve, which allows potential litigants to petition the court for permission to sue, is necessary *so that litigants are not denied a day in court during a lengthy stay*.

Greentree Capital, 2014 U.S. Dist. LEXIS 79277, at *11 (emphasis added).

a. The status quo.

When considering the status quo, the Court should "essentially balance[] the interests in preserving the receivership estate with the interests" of the Prospect Entities. *Stanford Int'l Bank*

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[11] While these factors were specifically crafted to apply to SEC-related receiverships, the overall rationale set forth by the courts applies to the case at bar.

[12] *See SEC v. Stanford Int'l Bank Ltd.*, 465 Fed. App'x. 316, 320, (5th Cir. 2012); *Chizzali v. Gindi*, 642 F.3d 865, 872-73 (10th Cir. 2011); *United States v. Acorn Tech. Fund, L.P.*, 429 F.3d 438, 443 (3rd Cir. 2005); *SEC v. Universal Fin.*, 760 F.2d 1034, 1038 (9th Cir. 1985); *United States SEC v. N.D. Devs., LLC*, 2016 U.S. Dist. LEXIS 94016, *8 (D.N.D. Mar. 10, 2016); *United States v. JHW Greentree Capital, L.P.*, 2014 U.S. Dist. LEXIS 79277, *11 (D. Conn. June 11, 2014); *Belsome v. Rex Venture Group, LLC*, 2013 U.S. Dist. LEXIS 181160, *3, (W.D.N.C. Dec. 30, 2013); *SEC v. One Equity Corp.*, 2010 U.S. Dist. LEXIS 124013, *19 (S.D. Ohio Nov. 23, 2010); *FTC v. 3R Bancorp*, 2005 U.S. Dist. LEXIS 12503, *5 (N.D. Ill. Feb. 23, 2005)

Ltd., 424 F. App'x at 341; *see also Schwartzman v. Rogue Int'l Talent Grp., Inc.*, 2013 U.S. Dist. LEXIS 16493 (E.D. Pa. Feb. 7, 2013) (first factor requires court "to balance the Receiver's interest in maintaining the status quo with any injury the moving party may suffer if the stay remains in place"); *U.S. v. ESIC Capital, Inc.*, 675 F. Supp. 1462, 1463 (D. Md. 1987) (court must assess "the competing interests of the injury to the moving party versus preserving the status quo").

Here, the status quo is that the Receiver has placed a number of issues into dispute in litigation instituted by the Receiver *after* the injunctive provisions of the Order allowed the Receiver to investigate unimpeded. The litigation commenced by the Receiver and the Receiver's proposed settlement with CCCB give rise to other disputes that must be resolved. Even the Special Counsel represented to the Court that all of these issues have to be resolved. Accordingly, it would do substantial injury to the Prospect Entities if the Receiver were able to continue to litigate these issues while the Prospect Entities were unfairly restricted by the injunctive provisions of the Order. In contrast, the status quo will be maintained because even if the Lawsuits proceed to judgment in favor of the Prospect Entities, the Receiver's interest in CCCB will remain unaffected.

b. The time at which the motion for relief is made.

The timing factor is fact-specific and "based on the number of entities, the complexity of the scheme, and any number of other factors." *Stanford Int'l Bank Ltd.*, 424 F. App'x at 341; *see also SEC v. Wing*, 599 F.3d 1189, 1197 (10th Cir. 2010) ("the timing factor is case-specific"). The Ninth Circuit, in *Wencke I*, explained that

> [w]here the motion for relief from the stay is made soon after the receiver has assumed control over the estate, the receiver's need to organize and understand the entities under his control may weigh more heavily than the merits of the party's claim. As the receivership progresses, however, it may become less plausible for

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> the receiver to contend that he needs more time to explore the affairs of the entities. The merits of the moving party's claim may then loom larger in the balance.

Wencke I, 622 F.2d at 1373-74. Similarly, the Third Circuit has concluded that

> [f]ar into a receivership, if a litigant demonstrates that harm will result from not being able to pursue a colorably meritorious claim, we do not see why a receiver should continue to be protected from suit. On the other hand, very early in a receivership even the most meritorious claims might fail to justify lifting a stay given the possible disruption of the receiver's duties.

Acorn Tech. Fund, L.P., 429 F.3d at 443-44.

Generally, courts are reluctant to lift litigation stays early in a receivership where lifting a stay would disrupt the receiver's duty to organize and understand its assets. *JHW Greentree Capital, L.P.*, 2014 U.S. Dist. LEXIS 79277, at *20. However, "a lift of the stay is more palatable later in a receivership's lifetime, after the receiver has had sufficient time to conduct its duties." *Id.*; *see S.E.C. v. Provident Royalties, L.L.C.*, 2011 U.S. Dist. LEXIS 74304 (N.D. Tex. July 7, 2011) (timing factor weighed heavily in favor of lifting stay where receivership was almost two years old, receiver had marshaled almost all receivership assets and had proposed a plan of distribution); *SEC v. Private Equity Mgmt. Grp., LLC*, 2010 U.S. Dist. LEXIS 126337, (C.D. Cal. Nov. 18, 2010) (second factor cut against receiver where receivership was well over one year old and receiver had progressed sufficiently in the effort to organize and understand the entities under his control, as evidenced by regular status reports to the court).

Here, this receivership is not at a stage where the Lawsuits should be enjoined. The Receiver has had ample time to collect and assume control over the estate, evidenced by the numerous subpoenas Special Counsel has issued; the Federal Court Action; a motion to intervene in a *cy pres* proceeding; the initiation of a state suit; the negotiated settlement with several parties, resulting in two settlement agreements, and over one year since the receivership was

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initiated. In essence, the Receiver, after an exhaustive investigation, has brought action against all persons and/or entities that the Receiver thinks are liable to the Receivership Estate. The time and the course of the receivership is such that the Receiver has concluded a lengthy investigation and has instituted wide-ranging litigation that requires a number of issues to be addressed. In this instance, the Receiver has had over a year with complete subpoena powers to determine how to proceed. The Receiver has determined to proceed with the Federal Court Action and the contingent settlement thereof with CCCB. Indeed, it was only because the Receiver initiated litigation and then entered into the Settlement Agreement with CCCB that the claims that are the subject of the Lawsuits ripened. Accordingly, the Court should grant the Prospect Entities relief from the Order.

c. The merits of the underlying claims.

In considering the merits of the movant's claims, a "court need only determine whether the party has colorable claims to assert which justify lifting the receivership stay." *Acorn Tech.*, 429 F.3d at 449. The more meritorious a movant's underlying claim, the more heavily this factor will weigh in the movant's favor. *See Wencke I*, 622 F.2d at 1373 ("Where the claim is unlikely to succeed (and the receiver therefore likely to prevail), there may be less reason to require the receiver to defend the action now rather than defer its resolution").

The Rhode Island Supreme Court, in *Reynolds v. First NLC Fin. Servs., LLC*, has determined with reference to an automatic stay provision in the bankruptcy context that granting a relief from stay "is merely a summary proceeding of limited affect," which is "determination of whether the parties seeking relief has a colorable claim to the property of the estate," and a decision on a motion for relief from stay "is not a determination of the validity of those claims, but merely a grant of permission from the Court allowing the creditors to litigate its substantive claims elsewhere without violating the automatic stay." 81 A.3d 1111, 1117 (R.I. 2013).

Here, there are a number of "colorable" disputes that must be resolved in accordance with the dispute resolution provisions of the LLC Agreement, including the following:

1. The "purposes" of Prospect Chartercare are specifically related to a community healthcare mission. *See* LLC Agreement at § 3.1. CCCB, as a member of Prospect Chartercare and its designees to the Board of Directors of Prospect Chartercare, who exercise fifty percent voting control, have to exercise their duties and fiduciary obligations to advance those purposes, not the purposes of the Receiver in the Federal Court Action.
2. There is a dispute as to whether the contingent transfer of beneficial rights to the Receiver violates Article 13 of the LLC Agreement. Moreover, the Receiver has argued that the transfer meets the requirements of the LLC Agreement because it is to an "affiliate," which Prospect East disputes. However, even if one were to put that issue aside, the transfer still had to secure regulatory approval. *See* LLC Agreement at § 13.1(c).
3. Prospect Chartercare and Prospect East have more than a "colorable" claim to indemnity, under the LLC Agreement and the APA.

Accordingly, as the Prospect Entities have colorable claims against CCCB, the Court should grant the Prospect Entities relief from the Order to initiate the Lawsuits against CCCB.

C. The Court Should Also Grant Prospect Chartercare Leave to File the Administrative Petitions Because the RIAG and RIDOH's Involvement is Necessary; or the Court Should Order that the Receiver Seek Appropriate Regulatory Input or Decisions Relative to CCCB Transferring its Interest to the Receiver.

For the same equitable balancing arguments made above, Prospect Chartercare should be entitled to relief from the injunctive provisions of the Order to request that the regulatory

authorities determine the preclusive effect of the HCA and CEC decisions and whether the contingent, beneficial transfer agreed to by and between CCCB and the Receiver requires regulatory approval.

As to the first issue regarding preclusive effect, CCCB has repeatedly admitted that the "Acquiror" in the 2014 Sale (Prospect, Prospect East, Prospect Chartercare, and others) did not acquire the Retirement Plan or any Plan liability. In fact, CCCB advocated for such an approval. Thus, it is critical that a process be advanced to determine the preclusive effect of that regulatory process that was clearly quasi-judicial. *See Town of Richmond v. Wawaloam Reservation, Inc.*, 850 A.2d 924, 933-934 (R.I. 2004).

As to regulatory approvals, CCCB was bound to secure necessary regulatory approvals for any transfer of its interest. *See* LLC Agreement at §13.1(c). Moreover, a transfer of CCCB's rights to exercise fifty percent of the voting authority on Prospect Chartercare's Board of Directors as structured in this specific HCA and CEC decisions is a "conversion" as that term is defined under the HCA. *See* R.I. Gen. Laws § 23-17.14-4(6). At oral argument on the Contempt Motion, the Special Counsel noted Prospect Chartercare's argument that CCCB and/or the Receiver did not exhaust administrative requirements for the sought remedy. Thus, the Special Counsel argued that such a position could be an "affirmative defense" in the Federal Court Action. However, the Receiver cannot seek to abrogate regulatory authority in that fashion. The regulatory issues that have arisen as a result of the Receiver's actions must be resolved, and must be resolved by the appropriate state regulatory agencies, not by a federal court.

For these reasons, a balancing of the equities requires that Prospect Chartercare be granted such relief from the injunctive provisions of the Permanent Receivership Order.

CONCLUSION

Because the Order does not preclude the Lawsuits against CCCB, the Prospect Entities respectfully provide notice to the Court that they intent to initiate the Lawsuits. However, to the extent that the Court finds that the Order enjoins the Lawsuits, the Court should nonetheless grant the Prospect Entities relief from the Order to file the Lawsuits. Further, the Court should provide the Prospect Entities relief from the Order to file the Administrative Petitions, or instruct the Receiver to seek the input or appropriate decisions from the RIDOH and RIAG in connection with it taking a beneficial interest in CCCB.

[Signature page to follow]

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CERTIFICATE OF SERVICE

I hereby certify that on this 2nd day of January, 2018, the within document was electronically filed through the Rhode Island Superior Court Case Management System by means of the EFS and is available for downloading by all counsel of record.

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