

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

In re:

Sorrento Therapeutics, Inc., *et al.*,¹
Debtors.

Chapter 11

Case No. 23-90085 (CML)

(Jointly Administered)

Related ECF Nos.: 1442, 1525

**REPLY OF THE OFFICIAL COMMITTEE OF UNSECURED
CREDITORS TO THE OFFICIAL COMMITTEE OF EQUITY
SECURITIES HOLDERS' OBJECTION TO THE JOINT PLAN OF
LIQUIDATION OF SORRENTO THERAPEUTICS, INC. AND SCINTILLA
PHARMACEUTICALS, INC. UNDER CHAPTER 11 OF THE BANKRUPTCY CODE**

The Official Committee of Unsecured Creditors (the “Creditors’ Committee”) of Sorrento Therapeutics, Inc., *et. al* (the “Debtors”) in the above-captioned chapter 11 cases (the “Chapter 11 Cases”), by and through its undersigned counsel, hereby submits this reply (“Reply”) to *The Official Committee of Equity Securities Holders’ Objection to the Joint Plan of Liquidation of Sorrento Therapeutics, Inc. and Scintilla Pharmaceuticals, Inc. Under Chapter 11 of the Bankruptcy Code* [Docket No. 1525] (the “Objection”).²

Preliminary Statement

1. The Court should overrule the Objection, as it is lodged by a constituency that fails to understand the economic reality of the situation the Debtors face. The Debtors are insolvent and

¹ The Debtor entities in these chapter 11 cases, along with the last four digits of each Debtor entity’s federal tax identification number, are: Sorrento Therapeutics, Inc. (4842) (“Sorrento”) and Scintilla Pharmaceuticals, Inc. (7956) (“Scintilla”). The Debtors’ service address is: 4955 Directors Place, San Diego, CA 92121.

² Capitalized terms used but not defined herein shall have the meanings ascribed to such terms in the *Joint Plan of Liquidation of Sorrento Therapeutics, Inc. and Scintilla Pharmaceuticals, Inc. Under Chapter 11 of the Bankruptcy Code* [Docket No. 1442] (as amended from time to time, the “Plan”) or the *Disclosure Statement for Joint Plan of Liquidation of Sorrento Therapeutics, Inc. and Scintilla Pharmaceuticals, Inc. Under Chapter 11 of the Bankruptcy Code* [Docket No. 1443] (the “Disclosure Statement”), as applicable.

intend to liquidate; General Unsecured Claims will recover a fraction of their claims through a trust comprised of various litigation claims. And equity holders, far out of the money, have failed to provide any financing. As equity holders have provided no new value, the Plan rightly provides equity holders with no recovery.

2. Yet the Equity Committee argues that, in pursuing the Causes of Action, the Liquidation Trustee should owe equity holders the same fiduciary duties it will owe to holders of General Unsecured Claims. This argument is unfounded.

3. The Equity Committee fails to identify any plausible basis for asserting that the Liquidation Trustee's duty should run to equity holders. In an attempt to support this claim, the Equity Committee relies almost exclusively on the mere use of the phrase "equity security holders" in sections 1123(a)(7) and 1129(a)(5)(ii) of the Bankruptcy Code, stretching the meaning of those statutes beyond recognition. Yet the Equity Committee fails to note that in both instances, equity holders are mentioned in connection with the management of *reorganized* debtors. Here, the Debtors are liquidating. They will have no future management or operations. Accordingly, policy considerations that encourage the rehabilitation of going-concern businesses do not apply.

4. Further, proceeds from the Causes of Action will comprise the primary source of recovery from the Liquidation Trust. Under section 550 of the Bankruptcy Code, the Liquidation Trustee will be permitted to recover such proceeds only to the extent such recovery would be "for the benefit of the estate[.]" Case law instructs that where the debtor is liquidating, recoveries only benefit the estate to the extent they fund repayments of the debtor's creditors; payments to prepetition equity holders do not benefit the estate. The Liquidation Trustee therefore may be unable to pursue recoveries on behalf of equity holders. The Plan should not saddle the Liquidation Trustee with duties to a constituency that the Liquidation Trustee may effectively be prevented

from exercising.

5. It should also be noted that the Equity Committee spends much of its briefing on lamenting the current situation. The Creditors' Committee, too, is disappointed. But while the Equity Committee finds blame in every participant but itself, the Creditors' Committee must note that the Equity Committee has been unable to propose a viable alternative plan or alternative financing, and has rejected requests for further capital infusion. The Creditors' Committee here provides additional context to the Equity Committee's presentation of these Chapter 11 Cases for the benefit of the Court and parties in interest.

**The Equity Committee's Objections
to the Liquidation Trust Agreement Should Be Overruled.**

A. The Liquidation Trustee Does Not Owe Equity Holders a Fiduciary Duty.

6. The Equity Committee's primary objection to the Liquidation Trust Agreement is its mistaken understanding that equity holders are owed a fiduciary duty.³ As explained below, there is no support for the Equity Committee's request.

1. It Would Be Senseless for Equity Holders to Direct the Liquidation Trustee Because Equity Holders Are Not Entitled to Any Recovery Until General Unsecured Claims Are Paid In Full.

7. The Debtors' liquidation analysis shows that General Unsecured Claims likely will receive little more than half of their claims, and equity holders are out of the money entirely.⁴ To protect junior classes, a chapter 11 plan must be "fair and equitable."⁵ Courts find that a plan is fair and equitable if "the holder of any claim or interest that is junior to the claims of an unsecured

³ In addition to objections relating to the Liquidation Trust Agreement, the Equity Committee raises concerns regarding certain tax aspects of the Plan. The Creditors' Committee understands that the Debtors will address such tax concerns in the confirmation brief, and so do not respond to such objections here.

⁴ Liquidation Analysis, Plan at Ex. C.

⁵ 11 U.S.C. § 1129(b)(1).

class [does] not receive any property on account of its claim or interest until the senior claims are repaid in full.” *Matter of Greystone III Joint Venture*, 995 F.2d 1274, 1282 (5th Cir. 1991).

8. Because General Unsecured Claims will not be paid in full, equity holders are not entitled to any recovery until General Unsecured Claims are fully satisfied. Consistent with statutory requirements, the Plan provides equity holders with no recovery (other than potential residual amounts after General Unsecured Claims are paid in full).⁶

9. Despite this, the Equity Committee demands that the Court impose fiduciary duties to equity holders on the Liquidation Trustee. There is no justification for such an absurd result.

2. The Equity Committee’s Reliance on Sections 1129(a)(5)(ii) and 1123(a)(7) of the Bankruptcy Code are Misplaced Because the Debtors Are Liquidating.

10. The public policy considerations found in sections 1129(a)(5)(ii) or 1123(a)(7) of the Bankruptcy Code, upon which the Equity Committee attempts to support its Objection, do not apply here. The purpose of section 1129(a)(5)(ii) of the Bankruptcy Code is “to ensure that *reorganized entities* will not, because of the identity, history and affiliation of their proposed management, engage in activities contrary to general public policy.”⁷ Similarly, section 1123(a)(7) of the Bankruptcy Code “was originally suggested by the Securities and Exchange Commission and was intended to make certain that discredited management will not be perpetuated, and that provision will be made in the plan for the selection—or at least for the mechanics or means of selecting—*the managements which will carry forward the reorganization in the interest of the*

⁶ Plan Art. III.C.

⁷ 7 Collier on Bankruptcy ¶ 1129.02[5][b] (2023) (emphasis added).

parties.”⁸ Go-forward operations are therefore necessary for these policy considerations to be implicated.

11. Unsurprisingly, then, courts have determined that these policy-driven plan requirements related to a debtor’s post-confirmation management do not apply where the debtor liquidates.⁹ This Court is no different, instructing that the first factor in such analysis be: “Does the proposed plan, if confirmed, keep the debtor in existence as an ongoing company or is the debtor extinguished.”¹⁰

12. The Debtors are liquidating, not reorganizing. As such, neither the Debtors nor their management will be engaging in any activities going forward. Thus, neither section 1129(a)(5)(ii) nor section 1129(a)(7) of the Bankruptcy Code apply.

13. The Equity Committee’s reliance on *In re Beyond.com Corp.*, 289 B.R. 138, 145 (Bankr. N.D. Cal. 2003), is misplaced. In that case, involving a *reorganizing* debtor, the court found that it could not evaluate any public policy concerns relating to a liquidation trust because the requisite trustee disclosures had not been filed. By contrast, here, Mr. Weinoffer has made adequate disclosures, and there are no public policy concerns regarding the Debtors’ management because the Debtors are not reorganizing.

14. Even if sections 1129(a)(5)(ii) and section 1129(a)(7) of the Bankruptcy Code applied, the Liquidation Trust’s duty to holders of General Unsecured Claims before equity holders does not violate public policy, as the Bankruptcy Code plainly establishes this hierarchy.

⁸ 7 Collier on Bankruptcy ¶ 1123.LH[6] (2023) (emphasis added).

⁹ *See, e.g., In re Sentinel Mgmt. Grp., Inc.*, 398 B.R. 281, 308–09 (Bankr. N.D. Ill. 2008) (“§ 1129(a)(5)(A)(ii) equally does not apply. . . . the Chapter 11 Trustee, who is the Liquidating Trustee, is not an individual who would serve as a director, officer, or voting trustee of [the debtor] post-confirmation. [The debtor] will cease to exist post-confirmation.”).

¹⁰ *In re Digerati Techs., Inc.*, No. 13-33264, 2014 WL 2203895, at *5 (Bankr. S.D. Tex. May 27, 2014).

3. Section 550 of the Bankruptcy Code May Operate to Limit the Liquidation Trustee From Recovering for the Benefit of the Debtors' Equity Holders.

15. Requiring the Liquidation Trustee to owe duties to equity holders is further inappropriate because the trustee may not be able to recover for the benefit of equity holders. The primary source of recovery from the Liquidation Trust will be proceeds from the Causes of Action; section 550 of the Bankruptcy Code permits a trustee to pursue certain causes of action only if such recovery may be “for the benefit of the estate[.]” Courts interpret the phrase “for the benefit of the estate” to permit a trustee to pursue avoidance actions so long as such action would either benefit the estate directly (such as an increased distribution to creditors) or indirectly (such as an increase in the probability of a successful reorganization).¹¹ However, courts also hold that recoveries solely for the benefit of a debtor’s prepetition equity holders do not benefit the estate.¹²

16. Accordingly, the Liquidation Trustee may be limited by operation of section 550 in what recoveries it may obtain in the Causes of Action. Imposing a fiduciary duty to equity holders therefore places the Liquidation Trustee in what may be an untenable situation—if it cannot recover for the benefit of equity holders, it cannot fulfill that duty. The Plan should not place the

¹¹ *In re ASARCO LLC*, 513 B.R. 499, 506 (S.D. Tex. 2012). Other courts apply a “narrow” reading of section 550, finding that recovery would only benefit the estate if it led directly to increased creditor recovery. *See, e.g., In re Harstad*, 155 B.R. 500, 512 (Bankr. D. Minn. 1993), *aff’d*, No. BKY 4-90-869, 1994 WL 526013 (D. Minn. Jan. 20, 1994), *aff’d sub nom. Harstad v. First Am. Bank*, 39 F.3d 898 (8th Cir. 1994) (“The amorphous benefits the plaintiffs claim here [that an increase in equity’s wealth benefits creditors] do not and will not suffice.”).

¹² *In re New Life Adult Med. Day Care Ctr., Inc.*, 2014 WL 6851258, at *6 (Bankr. D.N.J. Dec. 3, 2014) (holding that “even applying the broadest application of the ‘benefit to the estate’ requirement, there is no conceivable benefit to the estate, either directly or indirectly,” in recoveries from avoidance actions that would solely benefit prepetition equity holders); *see also In re Boxall*, 188 B.R. 198, 203 (E.D. Va. 1995) (“The law is well settled in this circuit that recovery of a fraudulent conveyance of an amount more than the amount of the debtor’s insolvency benefits the debtor in his personal capacity rather than the estate and is therefore barred by § 550(a).”); *In re Dunes Hotel Assocs.*, 194 B.R. 967, 985 (Bankr. D.S.C. 1995) (“Where no creditors can benefit from the avoidance action, or where creditors benefit solely at the discretion of a debtor, the debtor does not have standing to bring the avoidance action.”); *In re ATEK Info. Servs., Inc.*, 1994 WL 263431 (Bankr. N.D. Ohio May 26, 1994) at *4 (Bankr. N.D. Ohio May 26, 1994) (determining that where all creditors had been “paid in full pursuant to the terms of Plan,” further recovery would not benefit the estate”).

Liquidation Trustee in this position.

17. If the Liquidation Trustee obtains recovery beyond that needed to pay General Unsecured Claims in full, the Creditors' Committee has agreed that such excess may be distributed to equity holders. But placing a fiduciary duty on the Liquidation Trustee to pursue recoveries that it may be statutorily barred from recovering places an unfair burden on the Liquidation Trustee. The Plan should not confer such a requirement on the Liquidation Trustee.

B. The Creditors' Committee Proposes the Following Resolution of the Equity Committee's Concerns Regarding the Trust.

18. To resolve the Equity Committee's issues with the Trust, and to avoid any further litigation or delays relating to confirmation, the Creditor's Committee proposes that the Liquidation Trust Agreement be amended to provide that, upon payment in full of General Unsecured Claims, equity holders may elect their own trustee and advisory committee members.

19. Notwithstanding such a provision, the Liquidation Trust Agreement must continue to provide that until General Unsecured Claims are paid in full, the Liquidation Trustee's fiduciary duties run only to holders of General Unsecured Claims, consistent with the Plan and Bankruptcy Code which require payment of General Unsecured Claims in full before equity holders may recover.

**Clarifying Comments to the Equity Committee's
Characterization of These Chapter 11 Cases.**

20. The Equity Committee spends most of the Objection re-hashing the events of these Chapter 11 Cases. The Creditors' Committee shares the Equity Committee's disappointment with these Chapter 11 Cases' outcome. But the Creditors' Committee recognizes that the Plan is both

the only and the best option available to the parties. And as explained below, the Equity Committee fails to acknowledge several key factors that have led the Debtors to liquidation.

A. The Equity Committee Failed to Secure Financing for the Debtors Sufficient to Develop their Products.

21. The primary reason that these Chapter 11 Cases are headed to liquidation is that the parties were unable to attract financing. The Debtors are biotechnology firms engaged in the development of therapeutic drugs; many, if not most, of the Debtors' products are in early development stages. The costs of developing such products are substantial. The Debtors already spent in excess of \$400 million in the year prior to the commencement of these Chapter 11 Cases developing their products. Tens, if not hundreds, of millions of dollars more are required just to determine if any such products have commercial value. As the Debtors cannot rely on income generated from existing products to fund their development, any plan of reorganization would not be feasible unless it contained sufficient financing to allow the Debtors to develop their products.

22. The Creditors' Committee has been working with the Equity Committee and Debtors for months in pursuit of an alternate plan. No financing sufficient to develop these products materialized. Hence, no feasible plan of reorganization exists currently.

23. Nor does the Equity Committee identify any realistic proposal.¹³ The only proposal that the Equity Committee references is a \$10 million proposed senior secured loan.¹⁴ Far from ignoring this proposal (as the Equity Committee contends), both the Debtors and the Creditors' Committee spent weeks negotiating on this proposal. Ultimately, the Debtors and the Creditors' Committee were unable to secure additional financing and determined that \$10 million was

¹³ Although the Equity Committee has yet to develop a realistic proposal, the Creditors' Committee remains open to viable alternatives.

¹⁴ Obj. at ¶ 3.

insufficient to fund development or provide any reasonable runway for these Chapter 11 Cases. In addition to lacking sufficient funding, the proposal had several other defects: it required hefty back-end payments and lacked funding for a business plan, among other issues. Indeed, the Creditors' Committee and the Debtors had previously rejected a different, \$20 million offer from this counterparty due to similar defects.

24. Moreover, the counterparty making the proposal was not new to these Chapter 11 Cases and has previously failed to close on offers during these Chapter 11 Cases. And the Creditors' Committee suspects that this counterparty had taken actions to cause the valuations of certain assets to decrease significantly in order to extract a lower sales price. Simply put, this "proposal" was not the iron-clad savior that the Equity Committee suggests. And the Equity Committee's assertion that the Debtors and Creditors' Committee did not "engage" with this proposal is untrue.

25. By contrast, the Debtors' and the Creditors' Committee's efforts to obtain financing have been well-documented. As detailed in the Disclosure Statement, the Debtors obtained DIP financing,¹⁵ junior DIP financing,¹⁶ and replacement DIP financing.¹⁷ Despite these efforts, all such financing was insufficient to prevent liquidation.

26. The Debtors and Creditors' Committee have also attempted to secure financing through the piecemeal sale of assets. Various sales throughout these Chapter 11 Cases include the sale of the Debtors' common and preferred stock of Scilex (for approximately \$140 million in total

¹⁵ Disclosure Statement at § III.C.1.

¹⁶ *Id.* at III.C.3.

¹⁷ *Id.* at III.C.4.

consideration),¹⁸ common stock of Celularity Inc. (for \$3.3 million),¹⁹ and joint venture interests in ImmuneOncia Therapeutics Inc. (for \$20 million).²⁰ The parties continue efforts to sell other assets as well. However, given the significant costs required to develop the Debtors' biotechnology products, such efforts have simply not been enough.

27. This exact issue has been the basis for failing to close the sale of Ovydso to date. Although the Equity Committee contends that the "Debtors never even marketed their assets in China",²¹ the inability sell Ovydso and certain other assets has been their lack of development (and corresponding need for heavy investment), not effort.

28. In planning for the lack of viable financing or future sale options, the Creditors' Committee has adamantly preserved the Causes of Action as a potential source of recovery for creditors. As the Debtors face no viable financing options and Debtors face liquidation, any recovery by General Unsecured Claims will depend on the success of such Causes of Action.

29. Bafflingly, the Equity Committee ignores all of these efforts. The Equity Committee's baseless suggestion that the Debtors and Creditors' Committee have not even attempted to obtain financing is a gross mischaracterization of the facts.

B. The Debtors' Prepetition Finances Were Mismanaged, Causing the Debtors to Enter into the Chapter 11 Cases Facing Liquidity Concerns.

30. The Equity Committee portrays these Chapter 11 Cases as healthy companies gone bad during the chapter 11 process. This is emphatically not so. The Debtors faced significant liquidity constraints before filing these Chapter 11 Cases. And the mismanagement of the Debtors

¹⁸ *Id.* at III.C.5.

¹⁹ *Id.* at III.C.6.

²⁰ *Id.* at III.C.7.

²¹ Obj. at ¶ 5.

leading up to these Chapter 11 Cases should not be overlooked (indeed, it forms the basis for many of the preserved Causes of Action).

31. As laid out in the Schedule of Liquidation Trust Causes of Action,²² the Debtors' prepetition management, led by Dr. Henry Ji, engaged in multiple actions that siphoned money from the Debtors' to shareholders or other interested parties. Such acts include, among many others, (i) the issuance of a dividend of 76 million shares of Scilex common stock on the eve of bankruptcy,²³ (ii) approval of a 2022 debt exchange agreement under which Sorrento contributed outstanding indebtedness to Scilex (approximately \$290 million), a significant portion of which had been payable upon demand, in exchange for preferred shares of Scilex, and (iii) approval of Sorrento's guarantee of Scilex's third-party debt, as a result of which Sorrento made at least \$91.4 million in cash payments to Scilex between February and September 2022.²⁴ Indeed, even after commencement of the Chapter 11 Cases, Dr. Henry Ji's influence was a factor in the Debtors' inability to close deals.

32. By contrast, the CRO's role was quite limited at the commencement of these Chapter 11 Cases. During these Chapter 11 Cases—and only after the Creditors' Committee raised concerns about improper transactions between the Debtors and Scilex—did the CRO his current, fulsome authority. Even that authority was granted only after the Creditors' Committee began preparing a request to appoint a chapter 11 trustee.

²² Schedule of Liquidation Trust Causes of Action, *Notice of Filing of Plan Supplement for the Joint Plan of Liquidation of Sorrento Therapeutics, Inc. and Scintilla Pharmaceuticals, Inc. Under Chapter 11 of the Bankruptcy Code* [Docket No. 1491] ("Plan Supplement"), at Ex. D. The Liquidation Trust Causes of Action are based on the Creditors' Committee's investigation as described in Section III.F.2. of the Disclosure Statement.

²³ In order to ensure that this transfer could be pursued and unwound, the Creditors' Committee obtained an order enjoining recipients from selling such securities. *Order Extending the Application of the Automatic Stay to Continue the Restricted Trading Period for Shares of Scilex Stock Distributed to the Debtors' Shareholders* [Docket No. 1237].

²⁴ Essential to the preservation of the Causes of Action has been ensuring that neither Dr. Ji nor other prepetition directors and officers of the Debtors obtain releases or exculpations relating to their conduct.

33. After the CRO obtained an expanded role, the Creditors' Committee appreciated the CRO's and Debtors' counsel's transparency and readiness to provide information and updates regarding the status of these Chapter 11 Cases. Such transparency allowed the Creditors' Committee and Equity Committee to comment on and participate in sale and financing processes.

34. Similarly, Moelis & Company, the Debtors' financial advisor, provided the Creditors' Committee with regular updates and options during these Chapter 11 Cases. Because of such regular updates and open process, the Creditors' Committee (although disappointed) can make an informed judgment that the Plan is the best plan available.

35. It appears that the purpose of Equity Committee's characterization of the mismanagement during these Chapter 11 Cases is self-serving effort to elevate hopes for an alternative plan which, as of now, does not exist.

C. Despite Months of Opportunities, the Equity Committee Has Failed to Produce an Alternative Plan and Refuses to Prove New Value.

36. The Equity Committee contends that the Creditors' Committee did not sufficiently promote the Equity Committee's alternative plan that relied on (a) uncommitted financing and (b) a non-backstopped rights offering from retail shareholders. Such a plan can have little foundation in reality and relies primarily on hope. Had the Equity Committee been able to obtain a commitment for its financing or found an investor willing to backstop its proposed rights offering, the Creditors' Committee would have been open to such a proposal. Having neither, such a plan lacks substance and plainly could not satisfy confirmation.

37. Moreover, the proposed terms of the Equity Committee's alternative plan were unsuitable to the Creditors' Committee. It required releases of certain Causes of Action, implying and even greater uncertainty of recovery for General Unsecured Claims. In addition to being illusory, the plan threatened creditor recoveries.

38. The Equity Committee fails to acknowledge the most likely source of new liquidity: existing equity holders. The Creditors' Committee approached the Equity Committee multiple times to request that the Equity Committee obtain proposals from existing equity holders to protect their interests by investing new capital in the Debtors. At the end, not a single equity holder was willing to invest a dime into the Debtors.

39. If equity holders do not believe it worthwhile to finance or invest with the Debtors, the Equity Committee should not feign surprise that the Debtors and Creditors' Committee was unable to secure sufficient commitments from third parties.

40. Moreover, the consequence of equity holders failing to provide new value to the Debtors is clearly established. Equity of an insolvent debtor obtains no recovery or right to participate in the plan. Yet not only does the Equity Committee demand participation—it demands the same fiduciary owed to General Unsecured Claims. Equity holders have made no contribution deserving of such status.

Conclusion

41. Despite the efforts of the parties involved, the Debtors were unable to secure the financing necessary to continue developing their products and successfully reorganize their businesses. As a result, General Unsecured Claims stand to receive only an uncertain recovery, and equity holders are to receive none.

42. In light of this situation, the Equity Committee's insistence that the Liquidation Trustee owes equity holders the same fiduciary duties as that owed to General Unsecured Claims lacks merit. The Court should overrule the Objection.

Dated: November 27, 2023

Respectfully submitted,

By: /s/ Ryan Manns

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CERTIFICATE OF SERVICE

I, Ryan Manns, hereby certify that on the 27th day of November, 2023 a copy of the foregoing Reply of the Official Committee of Unsecured Creditors to the Official Committee of Equity Securities Holders' Objection to the Joint Plan of Liquidation of Sorrento Therapeutics, Inc. and Scintilla Pharmaceuticals, Inc. Under Chapter 11 of the Bankruptcy Code was served via Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

By: /s/ Ryan Manns
Ryan Manns