IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLUMBIA

FILED
NOV 1 1 2003
Denise H. Curtis, Clerk
U.S. Bankruptcy Court for D.C.

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| In re: | |
| GREATER SOUTHEAST COMMUNITY HOSPITAL CORPORATION I, et al. | Case No. 02-2250 |
| Debtors-in-Possession | Chapter 11<br>Jointly Administered Cases |

**LIMITED OBJECTION OF HEALTH CARE REIT, INC. TO DEBTORS' DISCLOSURE STATEMENT PURSUANT TO SECTION 1125 OF THE BANKRUPTCY CODE FOR DEBTORS' JOINT PLAN OF REORGANIZATION**

Health Care REIT, Inc. ("HCN") files this Limited Objection to the Debtors Disclosure Statement and states as follows[1]:

## I. Background

1. HCN and Pacifica of the Valley Corporation ("Pacifica") are parties to a Loan Agreement dated December 31, 1996 (the "Loan Agreement"). Pursuant to the Loan Agreement, HCN agreed to provide a loan of up to $21,500,000.00 (the "Pacifica Loan") to finance Pacifica's purchase of the Pacifica of the Valley Hospital (the "Hospital"). In connection with the Loan Agreement, Pacifica gave HCN a Second Amended and Restated Note (the "Note"), in the original principal amount of $21,500,000.00. The note has a maturity date of January 1, 2003. The amount of

[1] HCN outlined its objections to the Disclosure Statement in a letter to Debtors' counsel dated October 31, 2003. The Debtors agreed to extend until November 12, 2003 the time for HCN to file its formal objection to the Disclosure Statement. On November 10, HCN had a conversation with Debtors' counsel aimed at resolving its objections. Based on that conversation, HCN believes that many of its objections are likely to be resolved in an amended version of the Disclosure Statement. Thus, at the hearing HCN may withdraw some of the objections asserted herein if they have been adequately addressed in an amended Disclosure Statement.

principal outstanding on the Note, as of the petition date, was approximately $18.8 million. Pursuant to the Note, Pacifica was obligated, among other things, to make quarterly interest payments to HCN.

2. The Note is secured by, *inter alia*, a Deed of Trust, Security Agreement, Assignment of Leases and Rents and Fixture Filing dated December 31, 1996 (the "Deed of Trust"). Pursuant to the Deed of Trust, HCN holds a perfected lien on and security interest in all of Pacifica's Property,[2] which definition includes, but is not limited to, (a) Pacifica's Real Property, Improvements, Fixtures, and Rents; (b) all equipment, inventory, and goods now or hereafter located in or on or used in connection with the Real Property, Improvements or Fixtures; and (c) all accounts, contract rights, general intangibles, instruments, documents and chattel paper now or hereafter arising in connection with the business located in or on or used in connection with the Real Property, Improvements or Fixtures.[3]

3. HCN also holds "replacement liens" and junior liens on certain property of Pacifica and its co-debtors (collectively, the "Postpetition Liens"). The Postpetition Liens were granted to HCN pursuant to the Court's orders authorizing the debtors to use cash collateral, entered on (1) November 20, 2002; (2) November 22, 2002; (3) November 26, 2002; (4) December 11, 2002; (5) January 23, 2003; (6) February 28,

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[2] Unless otherwise noted, the capitalized terms Property, Real Property, Improvements, Fixtures and Rents are intended to have the same meaning ascribed to them in the Deed of Trust.

[3] HCN's lien on the Pacifica Property is a first priority lien, subject only to the apparent claim by National Century Financial Enterprises, Inc. and its affiliated entities (the "NCFE Entities") that their interest in Pacifica's accounts receivable is senior to the interest of HCN. HCN does not concede that the NCFE Entities' interest in Pacifica's accounts receivable is senior to HCN's, and reserves all of its rights in this regard.

2003; (7) March 28, 2003; and (8) April 23, 2003, and the order approving DIP financing entered on or about May 8, 2003 (the "Prior Orders").

4. Additionally, HCN is the beneficiary of an Unconditional and Continuing Guaranty dated December 31, 1996 (the "Guaranty"). Doctors Community Healthcare Corporation ("Doctors"), formerly known as Capital America Healthcare Corporation ("Capital"), is among the parties obligated as guarantors under the Guaranty. The Guaranty provides for the establishment of a debt service reserve fund (the "Reserve Fund"), which is the subject of a Cash Collateral Security Agreement between HCN and Doctors, dated December 31, 1996 (the "Security Agreement," collectively with the Note, Deed of Trust, Loan Agreement and Guaranty, the "Loan Documents").

## II. Pacifica's Default on the Pacifica Loan

5. Pacifica is in default under the Pacifica Loan because of the occurrence of several of the Events of Default specified in the Loan Documents.

6. Pacifica failed to make the quarterly interest payment due on December 31, 2002 as required under Section 3(f) of the Note.[4] Pacifica also failed to repay the outstanding balance of the Note on the January 1, 2003 Maturity Date, as required under Section 3(g) of the Note. As provided in Article 7.1.1 of the Loan Agreement, failure to pay any installment on the Note within 10 days after such payment is due constitutes an Event of Default. Other Events of Default also exist under the Loan Agreement, Note, and Deed of Trust.

[4] In response to Pacifica's failure to pay the quarterly interest due on December 31, 2002, HCN drew on a letter of credit established pursuant to Article 9 of the Loan Agreement in the amount of $748,151.

7. The Debtors filed their Chapter 11 petitions on November 20, 2003 (the "Petition Date"), and are continuing to operate their businesses and manage their affairs as debtors-in-possession under Sections 1107 and 1108 of the Bankruptcy Code. On October 24, 2003, the Debtors filed their Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for Debtors' Joint Plan of Reorganization (the "Disclosure Statement").

## III. Basis for HCN's Limited Objection

8. HCN objects to the Debtors' Disclosure Statement for the reasons described below.

### A. Amounts Owed to HCN

9. The Disclosure Statement states that HCN will hold a Class 3 "HCRI Senior Secured Claim" under the Debtors' proposed Plan of Reorganization (the "Plan"). According to the Disclosure Statement, the sum of distributions to HCN's Class 3 claim will not exceed $18.8 million, plus accrued postpetition interest at the non-default rate. However, as an oversecured creditor,[5] HCN is entitled under Section 506(b) to payment of postpetition interest at the applicable rate provided for in its agreements with the Debtor, which in this case is the default rate. See, e.g., In re Southland Corp., 160 F.3d 1054, 1059 (5th Cir. 1998) (default interest allowed under Section 506(b) to compensate lender for unforeseeable costs of default); In re Terry, L.P., 27 F.3d 241, 244 (7th Cir. 1994) (same); In re Martindale, 125 B.R. 32, 37 (Bankr. D. Idaho 1991); In re Schaumburg Hotel Owner, L.P., 97 B.R. 943, 951 (Bankr. N.D. Ill. 1989) ("A court

[5] The Debtors' representative testified at the § 341 Meeting that HCN is oversecured by a significant margin.

should allow [a] contractually bargained for default interest rate under § 506(b)"); In re Consolidated Operating Partners, 91 B.R. 113, 117 (Bankr. D. Colo. 1988) (granting postpetition interest at late payment rate equal to base rate plus 4%); In re Skyler Ridge, 80 B.R. 500, 509 (Bankr. C.D. Cal. 1987) (granting postpetition interest at default rate).

10. In addition, HCN is entitled, pursuant to Section 506(b), to payment of other reasonable costs, fees, and charges (including attorneys' fees), as set forth in HCN's proof of claim, filed on or about May 21, 2003.

11. HCN's objection to the substance of its treatment under the Debtors' Plan is a matter to be resolved at or prior to the confirmation hearing. However, for purposes of providing "adequate information" pursuant to Section 1125(a) of the Bankruptcy Code, the Disclosure Statement should specifically note HCN's claim that it is entitled to payment of interest at the applicable default rate set forth in the Loan Documents and its reasonable fees, costs, and charges (including attorneys' fees) pursuant to Section 506(b) of the Bankruptcy Code. In addition, the Plan should provide that those amounts will be paid to HCN as part of its secured claim to the extent allowed by the Court.

**B. HCN's Postpetition Liens**

12. The Prior Orders granted HCN certain postpetition liens as adequate protection. In particular, HCN holds "replacement liens" and junior liens on certain property of Pacifica and the other Debtors (collectively, the "Postpetition Liens").

13. If Pacifica's assets are sold pursuant to the Debtors' Plan and the proceeds are not sufficient to satisfy HCN's claim in full, HCN will have recourse to the

Postpetition Liens. The Disclosure Statement and the Plan should be amended to include HCN's rights pursuant to the Postpetition Liens.[6]

## C. Treatment of Deficiency Claims

14. As noted above, it appears that HCN is an oversecured creditor based on the value of the Pacifica assets. However, there is some possibility that in the event of a sale of the Pacifica assets, the proceeds would not be sufficient to pay HCN's claim in full. In that event, HCN should have an allowed deficiency claim (except to the extent that it has (i) received payment of its claim as a superpriority administrative expense under Section 507(b), or (ii) recovered all amounts owed to it by recourse to the Postpetition Liens, as discussed above). The Disclosure Statement does not, however, describe how secured creditors' deficiency claims, if any, will be treated (nor does it address the impact that such claims would have on distributions to the class of unsecured creditors). The Disclosure Statement is deficient in this regard, and should include information with respect to secured creditors' potential deficiency claims.

## D. Relief from Automatic Stay in Future Bankruptcy

15. HCN has signed commitment letters agreeing, subject to the terms and conditions set forth therein, to restructure existing debt and to advance additional financing in connection with the Recapitalization Proposal[7] set forth in the Plan (the "HCN Refinancing Commitment").

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[6] The Plan should also preserve any claim HCN may have under §507(b) of the Bankruptcy Code.

[7] Unless expressly defined herein, all capitalized terms shall have the meaning attributed to them in the Disclosure Statement and Plan.

16. As set forth in the commitment letters attached to the Disclosure Statement as Exhibits 7(D) and 7(E), in partial consideration for the HCN Refinancing Commitment, the proponents of the Recapitalization Proposal agreed that

> the loan documents and the plan of reorganization and the confirmation order shall contain provisions acceptable to HCN providing that in the event Borrower becomes subject to future bankruptcy proceedings and any default exists under the Loan (whether such default arose before or after commencement of such proceedings), HCN shall be entitled to immediate relief from the automatic stay to foreclose on its collateral and/or to exercise any other rights or remedies relating to its collateral as are available under the loan documents or applicable law.

17. This provision is a material term of the HCN Refinancing Commitment, from HCN's perspective, since HCN is not willing to restructure its debt and extend new financing in order to enable the Debtors to emerge from bankruptcy, only to find itself mired in another bankruptcy a few years down the road.

18. The "relief from stay" provision is material and is a condition of the HCN Refinancing Commitment, which is in turn a condition of the Recapitalization Proposal. It should therefore be included in the Plan and described in the Disclosure Statement.[8]

**E. Releases and Exculpations**

19. Pursuant to Article 12.1 of the Plan, the Debtors would grant broad releases to their officers, directors, employees and shareholders. In deciding whether to support the Plan's grant of such a broad release, creditors need information with respect to the nature of any potential claims against the Released Parties. However, there is no

[8] This Court approved a similar provision in the Columbia Hospital for Women Chapter 11 case. See Debtors' Amended Joint Plan of Reorganization (Second Revised) Under Chapter 11 of the Bankruptcy Code Dated October 25, 1998 (Case Nos. 98-200 and 98-201 Bankr. D. D.C. Jan. 12, 1999) at § 11.6(g).

information in the Disclosure Statement with respect to what claims, if any, the Debtors may have against any Released Parties, or whether any party has undertaken an investigation of possible claims.[9] Absent such a discussion, there is not adequate information to determine whether or support or reject the Plan.

20. In addition, Article 12.1 of the Plan provides that individual creditors of the Debtors will be deemed to release the Released Parties if such creditors vote in favor of the Plan and accept distributions under the Plan. Moreover, Article 12.1 provides that any Releasing Creditor will be deemed to have released third parties to the extent those parties have claims for indemnification or contribution against the Released Parties. Even assuming that the Debtors are entitled to a discharge, this provision appears to be contrary to applicable law, including Section 524(e) of the Bankruptcy Code.[10] Moreover, this third-party release provision gives creditors an incentive to either vote against the Plan or to abstain from voting on the Plan, in order to preserve any claim they might have against any of the Released Parties. The Disclosure Statement should explain the legal basis, if any, for such release, as well as the possible effect of such a release on the prospects for confirmation of the Plan.

21. The Disclosure Statement should also specifically and prominently advise creditors that if they do not wish to release claims against the Released Parties, they must either not vote, or vote to reject the Plan.[11]

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[9] We note that the Committee has filed Rule 2004 motions seeking information about any such claims, but the result of those investigations, if any, are not available to HCN or other creditors.

[10] Section 524(e) provides that "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

[11] A better approach might be for ballots to allow creditors to make a separate decision as to (1) whether they support the Plan, and (2) whether they wish to release any and all claims they may

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## IV. Request to Extend Time for HCN to Make 1111(b) Election

22. For the reasons described below, HCN seeks an extension of its time to make the "Section 1111(b) election," if it chooses to do so, until one day before the hearing on confirmation of the plan. The Debtors' counsel has agreed to this request.

23. Section 1111(b)(2) of the Bankruptcy Code allows a secured creditor to elect to have its claim treated as a secured claim to the full extent such claim is allowed, notwithstanding Section 506(a), which provides for bifurcation of undersecured claims into secured claims and unsecured deficiency claims.[12] However, Section 1111(b)(1)(B)(ii) provides that "A class of claims may not elect application of paragraph (2) of this subsection if . . . the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan."

24. Rule 3014 provides that an election under Section 1111(b)(2) "may be made at any time prior to the conclusion of the hearing on the disclosure statement or within such later time as the court may fix."

25. Under the dual-track approach described in the Debtors' Disclosure Statement, there are at least two possibilities with respect to HCN's collateral: (1) the Pacifica Hospital may be sold pursuant to the Plan, or (2) the Pacifica Hospital will be retained by the reorganized debtor pursuant to the Recapitalization Proposal. Given this

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have against the Released Parties. This would permit creditors to vote to accept or reject the Plan based on its merits, without tying that decision to a waiver of rights against third parties. The Court of Appeals for this Circuit has suggested that such an approach would be appropriate. See In re AOV Indus., 797 F.2d 1004, 1008-09 (D.C. Cir. 1986).

[12] As noted above, HCN does not believe its claim is undersecured, and its request for an extension of time to make the § 1111(b) election should not imply otherwise. HCN is simply seeking this extension as a precaution.

uncertainty, it is impossible for HCN to determine whether it can, or should, make a Section 1111(b)(2) election prior to the conclusion of the hearing on the Disclosure Statement.

26. The plain language of Rule 3014 grants the Court discretion to extend the deadline for HCN to make an election under Section 1111(b)(2). Moreover, courts have extended the period to make a Section 1111(b)(2) election in similar circumstances. See In re Bjolmes Realty Trust, 134 B.R. 1000, 1003 n.3 (Bankr. D. Mass. 1991) (extending deadline to make Section 1111(b)(2) election until date of confirmation hearing); see also In re Stanley, 185 B.R. 417, 427 (Bankr. D. Conn. 1995) ("the electing class 'must know the prospects of its treatment under the plan before it can intelligently determine its rights under § 1111(b)'").

27. Accordingly, HCN requests that the Court extend the deadline for HCN to make an election under Section 1111(b)(2) until a day before the confirmation hearing.

## IV. Conclusion

For the foregoing reasons, the Debtors' Disclosure Statement should not be approved unless and until the issues raised above are addressed appropriately.

Respectfully submitted,

ARNOLD & PORTER

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## Certificate of Service

I hereby certify that on the 11th day of November, 2003, I caused a copy of the foregoing **Limited Objection of Health Care REIT, Inc. to Debtors' Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code for Debtors' Joint Plan of Reorganization** to be served upon the following by electronic mail and first class mail, postage prepaid:

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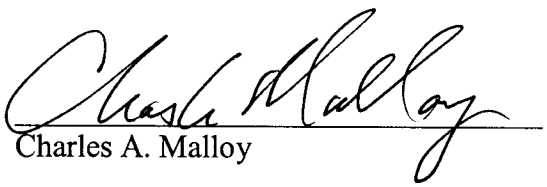

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