

Ted A. Berkowitz (*pro hac vice pending*)
FARRELL FRITZ, P.C.
1320 RXR Plaza
Uniondale, New York 11556-1320
Telephone: (516) 227-0700
Facsimile: (516) 227-0777

PROPOSED CONFLICTS COUNSEL FOR
DEBTORS AND DEBTORS IN POSSESSION

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION**

In re:	§	CASE NO. 09-37010
	§	CHAPTER 11
ERICKSON RETIREMENT	§	
COMMUNITIES, LLC, <i>et al.</i>,¹	§	(Jointly Administered)
	§	
Debtors.	§	
<hr/>		
DALLAS CAMPUS, LP, DALLAS	§	
CAMPUS GP, LLC, and ERICKSON	§	
RETIREMENT COMMUNITIES, LLC,	§	
	§	
Plaintiffs,	§	
v.	§	
	§	
MSRESS III DALLAS CAMPUS, L.P.,	§	
	§	
Defendant.	§	

COMPLAINT FOR DECLARATORY JUDGMENT

1. Plaintiffs Dallas Campus, LP ("Dallas"), Dallas Campus GP, LLC ("Dallas GP"), and Erickson Retirement Communities, LLC ("ERC"), debtors and debtors in possession in the above captioned case, seek declaratory relief as follows:

¹ The Debtors in these chapter 11 cases are Erickson Retirement Communities, LLC, Ashburn Campus, LLC, Columbus Campus, LLC, Concord Campus GP, LLC, Concord Campus, LP, Dallas Campus GP, LLC, Dallas Campus, LP, Erickson Construction, LLC, Erickson Group, LLC, Houston Campus, LP, Kansas Campus, LLC, Littleton Campus, LLC, Novi Campus, LLC, Senior Campus Services, LLC, Warminster Campus GP, LLC, and Warminster Campus, LP.

JURISDICTION

2. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(a) and (b) and 11 U.S.C. § 157.

3. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

4. The statutory bases for the relief requested herein are 28 U.S.C. § 2201 (the “Declaratory Judgment Act”), sections 105, 365, and 541 of title 11 of the United States Code (the “Bankruptcy Code”), and Rule 7001 of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”).

PARTIES

5. Dallas, a Maryland limited liability company, constructed and developed a continuing care retirement community located in Dallas, Collin County, Texas (“Highland Springs”). Dallas’ principal place of business is 701 Maiden Choice Lane, Baltimore, Maryland.

6. ERC, a Maryland limited liability company, manages the Highland Springs community and owns ninety-eight percent (98%) of Dallas and one-hundred (100%) of Dallas GP. ERC’s principal place of business is 701 Maiden Choice Lane, Baltimore, Maryland.

7. Dallas GP, a Maryland limited liability company, has a one percent (1%) general partner interest and one percent (1%) limited partner interest in Dallas. Dallas GP’s principal place of business is 701 Maiden Choice Lane, Baltimore, Maryland.

8. Collectively, Dallas, ERC, and Dallas GP are referred to herein as the “Debtors”.

9. Upon information and belief, MSRESS III Dallas Campus, L.P. (the “Defendant”), a Delaware limited partnership, was created to enter into the transactions with Dallas described in this Complaint.

NATURE OF THE COMPLAINT

10. The Debtors seek a declaratory judgment determining that the sale/leaseback transaction, involving that (i) certain agreement styled as a purchase agreement, dated April 28, 2006, between Dallas and the Defendant, attached hereto as Exhibit A (the “Purchase Agreement”) and (ii) certain agreement styles as a ground lease, dated April 28, 2006, between Dallas and the Defendant, attached hereto as Exhibit B (the “Loan”, collectively with the Purchase Agreement, the “Highland Springs Transaction”), is a financing and not a lease.

11. Even though the Highland Springs Transaction is labeled as a sale/leaseback, the parties intended that the transaction be a financing.

12. Moreover, as alleged in more detail below, the economic substance and terms of the Highland Springs Transaction prove that it is a financing.

FACTS

13. The Debtors are a fully-integrated, privately-owned, real estate manager and developer of continuing care retirement communities (“CCRCs”), which provide affordable, high-quality senior living to middle-income seniors.

14. The Debtors’ CCRCs are large campus-style communities that offer seniors a full life-cycle of retirement services from independent living through skilled nursing on the same property.

15. The Debtors currently manage and have varying interests in twenty (20) CCRCs in various stages of completion or development in eleven (11) different states—Colorado, Illinois, Kansas, Maryland, Massachusetts, Michigan, New Jersey, Ohio, Pennsylvania, Texas, and Virginia.

16. One of the unique aspects of the Debtors' business is the fact that they associate with National Senior Campuses, Inc. ("NSC"), a not-for-profit organization, to operate the campuses. Each of the Debtors' completed communities, except two (2),² are operated by a not-for-profit operator (a "NFP"), which is a supported organization of NSC³ and which contracts with ERC to provide for the management of the communities.

17. The goal upon the completion of the construction and development of a CCRC is to sell the CCRC to the associated NFP. After the sale, the NFP owns and operates the CCRC, and ERC continues to manage it pursuant to a management agreement. This structure allows the NFPs to focus on quality of care rather than profit maximization.

A. Global Business Plan

18. Typically, each CCRC is developed and constructed in three (3) phases over a period of seven (7) to ten (10) years as described below:

i. Land Purchase

19. ERC selects a site upon which to construct a new CCRC and forms a subsidiary (a "Landowner"), such as Dallas, to purchase the property. The Landowner has ownership of both the real property and all improvements constructed on the land, until the community is sold to the NFP.

ii. Obtaining Financing and Commencing Construction

20. Once the property has been acquired, the Landowner begins the construction and development of the community. The construction is initially financed by the Landowner through a secured revolving construction loan (the "Construction Loan") from a third-party lender.

21. The Landowner and ERC enter into a development agreement, pursuant to which

² Charlestown, Inc. and Henry Ford Village, Inc.

³ Each NFP is classified as a 501(c)(3) organization based on its mission to provide affordable senior housing to seniors.

ERC agrees to plan, administer, and supervise all design, development and construction services and activities of a campus, and the Landowner pays ERC a development fee.

22. Additionally, the new community is marketed to attract new residents, and a NFP is created to operate the campus on a day-to-day basis. The NFP and ERC enter into a management agreement, pursuant to which ERC manages the community, and the NFP and the Landowner enter into a master lease agreement, pursuant to which the NFP leases the land and the improvements from the Landowner.

23. During the period that the Construction Loan is outstanding, the Landowner also enters into a community loan agreement with the NFP (the "Community Loan"), pursuant to which the NFP lends the Landowner all initial entrance deposits, which are collected from the residents, pursuant to a residence and care agreement, prior to the residents' occupancy of a unit. The proceeds of the Community Loan are used to pay the construction and development costs of a community and the debt service on the Construction Loan. The Landowner's obligations under the Community Loan are secured by a mortgage on the property in favor of the NFP and are subordinate to its obligations under the Construction Loan.

24. To secure the additional financing for the construction and development of the project, the Landowner enters into a financing agreement with a third-party lender which is subordinate to the Construction Loan and Community Loan.

25. The Debtors have structured this financing transaction as a mezzanine loan, except when the lender has labeled the transaction as a sale/leaseback.

26. When the CCRC is near completion, the NFP typically secures permanent financing through municipal bond offerings (tax-exempt bonds) (the "Project Bonds"). Upon the issuance of Project Bonds, the NFP enters into an agreement with the Landowner to ensure the

sale of the community to the NFP. Pursuant to this agreement, the bondholders receive a first priority mortgage on the property.

iii. Sale of CCRC to NFP

27. Finally, the Landowner sells the CCRC to the NFP, and ERC remains the manager of the community, pursuant to a management agreement.

B. The Highland Springs Transaction

28. Upon information and belief, the Defendant was aware of the Debtors' global business plan described above and made no objection to following that plan for the Highland Springs Transaction.

i. The Land Purchase

29. Dallas was formed by ERC on September 8, 2004 to acquire and develop certain land for the construction of the Highland Springs community.

30. On May 25, 2005, Dallas purchased approximately ninety (90) acres located at Coit Road and Frankford Road, Dallas, Collin County, Texas (the "Property").

ii. Obtaining Initial Financing and Commencing Construction

31. Following the Global Plan, the Debtors sought to obtain financing for the construction of the Highland Springs community on the Property. The Highland Springs community was to include approximately 1600 independent living units, 100 assisted living units, 90 skilled nursing units, and accessory uses (collectively, the "Project").

32. To finance the initial construction and development of the Project, Dallas entered into a Construction Loan, dated November 30, 2005, in the original principal amount of \$70 million, as amended from time to time, between Dallas, Bank of America, N.A., as administrative agent, other lenders that are parties thereto from time to time (the "Dallas Construction Loan").

33. The Dallas Construction Loan is guaranteed by ERC and Erickson Construction, LLC and is secured by a first priority lien on (1) all assets of Dallas, including any lien rights of Dallas in the assets of Highland Springs and/or ERC, (2) all assets of ERC related to Highland Springs, (3) a pledge by ERC of its 100% membership interest in Dallas, and (4) a first mortgage on all land and buildings, except for the parcel relating to a certain promissory note to the Board of Regents of the Texas A&M University System.

34. Pursuant to the Dallas Construction Loan, Dallas is required to maintain liquid assets in the amount of \$17,500,000 (the "Liquidity Covenant"). Section 2.17 of the Dallas Construction Loan states, in pertinent part, that:

"Required Equity Contribution" means \$17,500,000, initially, plus such amount as may be required under Section 2.17 hereof, to be expended by the Company on Project Costs.

2.17 Additional Equity Requirement. The Company agrees that prior to borrowing any funds that would cause the principal amount of the Revolving Loans and LC Obligations to, in aggregate, exceed \$48,000,000, the Company shall provide evidence satisfactory to Administrative Agent that the Company has expended from its own funds, excluding funds borrowed hereunder, \$17,500,000 plus an amount equal to the product of (x) \$15,000,000 minus the amount of the Tax Increment Financing, if any, and (y) 33.33%.

35. In or about September 2005, the Debtors began the construction and development of the Highland Springs community, which opened for occupancy in or about September 2006. The development of this community is not yet completed.

iii. Obtaining Additional Financing

36. The Debtors sought additional capital to satisfy the Liquidity Covenant under the Dallas Construction Loan.

37. Toward that end, the Debtors spoke with several potential lenders, including the Defendant, in an attempt to secure the additional financing to satisfy the Liquidity Covenant.

38. The Defendant sent Dallas a letter, dated July 28, 2005, to which the Defendant attached a summary of the terms and conditions (the “Term Sheet”) of the financing it was willing to provide to Dallas. The Term Sheet provides, in pertinent part, that:

Proposed Transaction:	Sale/Leaseback – Ground Lease transaction
Investment amount:	\$17,500,000
Purpose:	The Facility will be used to partially finance the following project... purchase of approximately 89 acres of land located at 17900 Coit Road, Dallas, TX and the construction of a [CCRC]....
* * *	
Interest Rate:	14.50%
* * *	
Maturity Date:	August 2016
Liquidity:	ERC to maintain at all times cash and cash equivalents equal to the sum of: (i) an amount needed to satisfy the highest amount of liquidity required under any liquidity covenant contained in documentation relating to the Senior Indebtedness; plus (ii) 15 million.
Timing/Exit Rights:	Call rights: ERC can “call” the investment.... Put rights: Michigan can “put” the investment to ERC, at par, from August 2009 until the Maturity Date.

39. On April 28, 2006, Dallas and the Defendant entered into the following transactions executed simultaneously: (a) the Purchase Agreement, attached hereto as Exhibit A, pursuant to which Dallas purportedly sold the Property to the Defendant for \$17,500,000; (b) the Loan, attached hereto as Exhibit B, which is titled a lease, but which in substance is a financing arrangement pursuant to which Dallas was to repay the loan from the Defendant; (c) a limited guaranty and indemnity agreement, pursuant to which ERC agreed to indemnify the Defendant

under certain circumstances and to guarantee certain obligations of Dallas under the Lease; (d) a partnership interest pledge agreement, pursuant to which ERC and Dallas GP granted a security interest in their partnership interests in Dallas to the Defendant; and (e) a ground lessor tri-party agreement, pursuant to which the Defendant acknowledges and agrees that its interests in the Property are subordinate to the interests of the parties to the Dallas Construction Loan and certain other related agreements concerning Highland Springs.

40. The Defendant purportedly purchased the Property so that the Debtors could construct and develop the Highland Springs community upon the Property. The Defendant intended for the Debtors to use the Property to construct and develop the Highland Springs community.

41. Pursuant to the Highland Springs Transaction, dated April 28, 2006, the Defendant loaned to Dallas a total of \$17,500,000. The Liquidity Covenant under the Dallas Construction Loan, dated November 30, 2005, required the Debtors to maintain combined, unrestricted liquid assets in the amount of \$17,500,000.

42. Upon information and belief, the Defendant did not conduct an appraisal of the Property in connection with the Highland Springs Transaction.

iv. Development Not Yet Completed

43. The construction of the Highland Springs community is not yet completed.

44. To date, the CCRC has not been sold to the NFP.

v. The Intent of Parties

45. The intent of the Defendant was for the Highland Springs Transaction to be a financing.

46. The intent of Dallas was for the Highland Springs Transaction to be a financing.

47. The intent of ERC was for the Highland Springs Transaction to be a financing.

48. The intent of Dallas GP was for the Highland Springs Transaction to be a financing.

vi. The Terms of the Highland Springs Transaction Confirm It Is a Financing

Treatment of the Sale/Leaseback Transaction as a Loan

49. Article XXV of the Loan provides, in pertinent part, that:

Landlord and Tenant intend that the acquisition of the Leased Property by Landlord from the Tenant and the lease of the Leased Property by Landlord to Tenant hereunder be treated for U.S. federal income tax purposes and Generally Accepted Accounting Principles ("GAAP") as a loan in an amount equal to Landlord's Original Investment Amount, the Base Rent payable by Tenant to Landlord to be treated as interest on Landlord's Original Investment Amount, and the Tenant to be treated as the owner of the Leased Property. Tenant and Landlord hereby agree not to take any position with the U.S. Internal Revenue Service (in any filing therewith or otherwise) and for financial accounting purposes, that is inconsistent with the characterization of this Lease as a loan for U.S. federal income tax and GAAP purposes or the Tenant as the owner of the Leased Property.

50. The characterization of Dallas' payments under the Loan as interest indicates that the Loan is a financing and not a lease.

Purchase Option and Option Exercise Price

51. The Loan contains an option to purchase (the "Purchase Option") the Property, which provides, in pertinent part, that:

24.2 Option to Purchase. In addition to the foregoing right, Tenant shall have the option to purchase the Landlord's entire interest in and relating to the Leased Property (the "Tenant Purchase Option") including, without limitation, the Licenses, Permits, Plans, Contracts and Warranties assigned to Landlord pursuant to that certain Assignment of Licenses, Permits, Plans, Contracts and Warranties executed by Tenant to and in favor of Landlord dated of even date herewith, as follows:

(a) Tenant shall exercise its Tenant Purchase Option hereunder at any time by giving at least sixty (60) days written notice to Landlord of Tenant's intent to exercise the Tenant Purchase Option.

(b) The "Option Purchase Price" to be paid by Tenant at closing of the Tenant Purchase Option, if exercised, shall be determined as follows:

- (i) If closing pursuant to the Tenant Purchase Option under this Section 24.2 (the "Option Closing") occurs prior to the Make-Whole Deadline (defined below): Landlord's Original Investment, plus the Make-Whole Amount (defined below).
- (ii) If the Option Closing occurs on or after the Make-Whole Deadline: the Option Purchase Price shall be equal to Landlord's Original Investment (*i.e.*, \$17,500,000).
- (c) The Option Closing shall be held in the office of Landlord's attorneys on or before a date which is sixty (60) days after Landlord's receipt of Tenant's exercise notice, or at such other time or place as shall be mutually acceptable to Landlord and Tenant.
- (d) The Option Purchase Price shall be paid at closing, in cash, by wire transfer to Landlord's account.
- (e) All expenses of closing (including Landlord's attorneys' fees) shall be paid by Tenant.
- (f) Tenant shall be deemed to have exercised and effected the Tenant Purchase Option hereunder, and shall be obligated to pay to Landlord the full Option Purchase Price immediately and without offset or credit, in the event that title to the Leased Property is transferred or conveyed to the Facility Tenant, or to the holder of any mortgage or similar lien or encumbrance or party claiming thereunder or purchasing at foreclosure thereof, pursuant to an exercise of any purchase option or foreclosure of any mortgage or other lien or encumbrance to which the Leased Property has been or is subjected at the direction or with the consent of Tenant.

For purposes of this Lease, "Make-Whole Amount" shall mean, with respect to any amounts of Landlord's Original Investment re-paid to Landlord prior to May 1, 2010 (the "Make-Whole Deadline"), an amount equal to such additional sum of money, if any, as must be added to such amount so that if such total amount (*i.e.*, such partial or full repayment of Landlord's Original Investment (as applicable) plus, without duplication, the additional sum of money) were, on such date, used to purchase non-callable United States Treasury Securities having maturity dates as close to the Make-Whole Deadline as possible, such investment would result in the same yield to Landlord that Landlord would have received had Tenant leased the Property and paid all Base Rent through the Make-Whole Deadline.

- 52. As set forth above, the Option Purchase Price is nominal under the circumstances.
- 53. The nominal Option Purchase Price is indicative of a financing and not a lease.

Ownership Obligations

54. Pursuant to Articles VI, VII, and IX of the Loan, Dallas is required to pay, among other things, the amounts owed for taxes, utilities, and insurance. In pertinent part, the Loan provides that:

Article VI

Throughout the entire Term of this Lease, Tenant shall bear, pay and discharge all taxes, assessments and other governmental impositions and charges of every kind and nature whatsoever, extraordinary as well as ordinary, and each and every installment thereof which shall or may during the term hereof be charged, laid, levied, assessed, or imposed upon, or arise in connection with, the use, occupancy or possession of the Leased Property, the Project, or any part thereof, including, without limitation, ad valorem real and personal property taxes, and all taxes charged, laid, levied, assessed or imposed in lieu of or in addition to any of the foregoing by virtue of all present or future laws, ordinances, requirements, orders, directions, rules or regulations of federal, state, county and municipal governments and of all other governmental authorities whatsoever.

Article VII

Tenant shall be liable for and shall pay directly all charges and fees, including impact, connection and/or reservation fees, (together with any applicable taxes or assessments thereon) when due for water, gas, electricity, air conditioning, heat, septic, sewer, refuse collection, telephone and any other utility charges or similar items in connection with the development, use or occupancy of the Leased Property, the Improvements or the Project.

* * *

9.1 Insurance by Tenant. Throughout the term of this Lease, Tenant shall, at its sole cost and expense, maintain, or cause to be maintained, in full force and effect the following types and amounts of insurance coverage as set forth in this Article IX.

55. As required under the Loan, Dallas did pay the taxes, utilities, and insurance.

56. These obligations assumed by Dallas reflect ownership in the Property and indicate that the Highland Springs Transaction is a financing and not a lease.

Calculation of Rent

57. The payments made by Dallas to the Defendant under the Loan were computed to provide the Defendant with a return on its investment.

58. The payments made by Dallas to the Defendant under the Loan were calculated based on the amount the Defendant borrowed to obtain the Property and not based on the fair market rental value of the Property.

59. The payments made by Dallas to the Defendant under the Loan were payments of interest on the \$17.5 million loan from the Defendant

60. Sections 3.1 and 3.2 of the Loan provides, in pertinent part, that:

3.1 Base Rent. Subject to proration as set forth below, annual base rent for the Leased Property ("Base Rent") for each Lease Year (defined below) during the Term shall be the sum of Two Million Five Hundred Thirty-Seven Thousand Five Hundred Dollars AND NO/100 DOLLARS (\$2,537,500) per year. The Base Rent to be paid by Tenant hereunder is intended by the parties to be payment of "interest" to Landlord on Landlord's Original Investment (defined in Section 3.2(b) below).

3.2 Payment and Calculation of Base Rent. Base Rent shall be paid by Tenant to Landlord in equal monthly installments, in arrears, on the first (1st) day of each calendar month for the prior calendar month commencing on the first (1st) day of the calendar month immediately following the Commencement Date. In the event of a default by Tenant of its obligations under this Lease beyond any applicable notice and cure period, the full amount of Base Rent for the remaining term of this Lease shall be immediately due and payable by Tenant to Landlord. For the purposes of this Lease:

(a) the term "Lease Year" shall mean and be defined as each twelve month period commencing on the first day of the calendar month immediately following the Commencement Date; provided, however, that the first Lease Year shall include the period from the Commencement Date to the first day of the next following calendar month. Base Rent shall be proportionately prorated for any extended or partial Lease Year (i.e., the first Lease Year and/or the final Lease Year); and

(b) the term "Landlord's Original Investment" shall mean the sum of Seventeen Million Five Hundred AND NO/100 DOLLARS (\$17,500,000), which represents, for purposes of this Lease, Landlord's

total acquisition and transactional costs incurred in acquiring the Leased Property.

61. These provisions show that the Defendant computed the payments to earn a return on its investment, which is another indication that the Highland Springs Transaction is a financing and not a lease.

Right of First Refusal

62. The Loan grants Dallas a right of first refusal and provides, in pertinent part, that:

24.1 Right of First Offer. Tenant has requested and Landlord has agreed to provide to Tenant, a right of first offer in connection with any proposed sale of the Leased Property by Landlord, including, without limitation, the Licenses, Permits, Plans, Contracts and Warranties defined in and assigned to Landlord pursuant to that certain Assignment of Licenses, Permits, Plans, Contracts and Warranties executed by Tenant to and in favor of Landlord dated of even date herewith.

63. The presence of a right of first refusal indicates that the Highland Springs Transaction is a financing and not a lease.

Defendant's Right to Require Exercise of Purchase Option

64. Under the Loan, the Defendant has the right to require Dallas to exercise the Purchase Option. Section 24.3 of the Loan provides, in pertinent part, that:

24.3 Landlord's Right to Require Tenant to Exercise the Tenant Purchase Option. Landlord shall have the absolute right, but not the obligation, to require Tenant to purchase the Property for a cash purchase price equal to the Landlord's Original Investment plus the Make-Whole Amount, and including any Additional Rent then due and owing to Landlord hereunder ("Landlord's Put") on any of the following dates or upon the occurrence of any of the following events:

(a) at any time from and after the Make-Whole Deadline, in the sole and absolute discretion of Landlord; or

(b) upon the exercise of the purchase option by the Facility Tenant under the Facility Lease; or

(c) at any time following the occurrence of an Event of Default with respect to Tenant or a default by Guarantor under the Guaranty (each as defined in Section 26.2 below).

65. The inclusion of this provision in the Loan indicates that the Highland Springs Transaction is a financing and not a lease.

Notice and Reports

66. Additionally, the Loan requires Dallas to provide the Defendant with periodic reports, not less than monthly, of the state of the business and affairs of Dallas, including certified financial statements. The Loan provides, in pertinent part, that:

5.7 Notices and Reports. Tenant shall prepare and deliver to Landlord periodic reports, not less than monthly, of the state of the business and affairs of the Tenant. Erickson Retirement Communities, LLC ("ERC"), as the sole and managing member of the General Partner of Tenant, or its delegate shall prepare statements of the financial condition of the Tenant as of the last day of each month, such financial statements for the Tenant to include (i) statements of profits or losses, (ii) balance sheets as of the close of such month, (iii) statements of cash flow, (iv) statements of changes in capital, and (v) a narrative explanation of variances to each TAB Summary....

67. The Debtors have complied with section 5.7 of the Loan.

68. The independent auditor's report for Dallas' financial statements for the years ended December 31, 2005 and 2006 states, in pertinent part, that:

8. Real Estate Financing Obligation

On April 28, 2006, DAL entered into a Real Estate Purchase Contract and a Ground Lease Agreement with an unaffiliated company to secure additional financing for the project. Proceeds from the sale of the land were the sales price of \$17,500,000, less closing costs. The Ground Lease Agreement calls for annual interest (lease) payments of \$2,441,250, payable monthly in arrears, on the first day of the month by DAL. Expenses incurred during 2006 and 2005, related to the lease were \$1,658,712 and \$-0-, respectively. The term of the lease expires on April 27, 2017. The lease agreement provides DAL with a right of first offer and an option to purchase the land at its original purchase price plus a make-whole amount as defined in the lease agreement. Therefore, this transaction has been accounted for as a financing transaction by DAL. The make-whole provision expires May 1, 2010. After the expiration of the make-whole period, the purchase price is fixed at the original investment. As a result of obtaining the lease financing, \$17,368,542 was transferred to ERC as a distribution during 2006.

69. The independent auditor's report for Dallas' financial statements for the years ended December 31, 2006 and 2007 contains a substantially similar provision.

70. Upon information and belief, the Defendant has received Dallas' financial statement, which demonstrates that the Highland Springs Transaction is a financing and not a lease.

71. Upon information and belief, the Defendant never objected to the characterization of the Highland Springs Transaction as a financing in Dallas' financial statements.

COUNT I

72. The Debtors incorporate the allegations set forth in paragraphs 1 through 65 above as if set forth in full below.

73. The economic realities of the Highland Springs Transaction and the terms of the agreement prove that the relationship between the Defendant and Dallas is a borrower/lender relationship and not a lessee/lessor relationship.

74. The parties intended the Highland Springs Transaction to be a financing and not a lease.

75. The Property was purchased by the Defendant for the Debtors' use.

76. The Highland Springs Transaction was necessary to fund the Liquidity Covenant.

77. Upon information and belief, there was no appraisal report prepared in connection with the Highland Springs Transaction.

78. The Highland Springs Transaction provides Dallas with a Purchase Option at the end of the term.

79. The Purchase Option Price is not calculated based on fair market value, but rather, is calculated based on the maturity date of the loan.

80. The Purchase Option is nominal under the circumstances.

81. Dallas' obligations under the Highland Springs Transaction are obligations normally associated with ownership of the Property.

82. The payments under the Highland Springs Transaction were interest payments and were computed to provide the Defendant with a return on its investment.

83. The payments under the Highland Springs Transaction were calculated based on the amount the Defendant borrowed to obtain the Property.

84. In the event that the Defendant chooses to sell the Property, Dallas has a right of first refusal under the Lease.

85. The Defendant can require Dallas to exercise the Purchase Option under certain circumstances.

86. The parties never intended for title of the Property to remain with the Defendant after the term of the Lease ended.

87. All of these facts and provisions demonstrate that the Highland Springs Transaction is a financing and not a lease.

88. Because the Highland Springs Transaction is a financing and not a lease, section 365 of the Bankruptcy Code does not apply.

PRAYER FOR RELIEF

WHEREFORE, the Debtors respectfully request that upon final hearing, a judgment be entered as follows:

- A. Declaring that the Highland Springs Transaction, attached hereto as Exhibits A and B, is a financing, not a lease;
- B. Declaring that 11 U.S.C. § 365 does not apply to the Highland Springs Transaction, attached hereto as Exhibits A and B; and
- C. Granting the Debtors such other and further relief as the Court may deem just and proper.

Dated: December 21, 2009
Uniondale, New York

Respectfully Submitted,

By: /s/ Ted A. Berkowitz

FARRELL FRITZ, P.C.
Ted A. Berkowitz (*pro hac vice pending*)
1320 RXR Plaza
Uniondale, New York 11556-1320
Telephone: (516) 227-0700
Facsimile: (516) 227-0777
tberkowitz@farrellfritz.com

Proposed Conflicts Counsel for Debtors
and Debtors in Possession

Interwoven\1277540.1