

Kevin M. Lippman
Texas Bar No. 00784479
Jonathan L. Howell
Texas Bar No. 24053668
MUNSCH HARDT KOPF & HARR, P.C.
3800 Lincoln Plaza
500 North Akard Street
Dallas, Texas 75201-6659
Telephone: (214) 855-7500
Facsimile: (214) 855-7584

James A. Stempel
Illinois Bar No. 6230191
Marc J. Carmel (admitted *pro hac vice*)
Illinois Bar No. 6272032
Adam J. Goldstein (admitted *pro hac vice*)
Illinois Bar No. 6289591
KIRKLAND & ELLIS LLP
300 North LaSalle Street
Chicago, Illinois 60654
Telephone: (312) 862-2000
Facsimile: (312) 862-2200

**ATTORNEYS FOR ERC INVESTMENT HOLDINGS, LLC
A/K/A COASTWOOD**

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

In re: ERICKSON RETIREMENT COMMUNITIES, LLC, et al., Debtors.	§ § § § § § § § § §	CASE NO. 09-37010 (SGJ) CHAPTER 11 Jointly Administered
--	--	--

COASTWOOD’S BRIEF IN SUPPORT OF THE DEBTORS’ PAYMENT OF THE AUCTION FEE PURSUANT TO DEBTORS’ FOURTH AMENDED JOINT PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE

ERC Investment Holdings, LLC (“Coastwood”)¹ submits its brief (this “Brief”) in support of payment of the Auction Fee as set forth in the *Debtors’ Fourth Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code* [Docket No. 1005] (as subsequently amended from time to time, the “Plan”).² In support hereof, Coastwood respectfully states as follows:

¹ Coastwood is an entity formed by affiliates of CoastWood Senior Housing Partners, LLC, Kohlberg Kravis Roberts & Co., and Beecken Petty O’Keefe & Company, LLC.

² Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the *Disclosure Statement for Debtors’ Fourth Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code* [Docket No. 1001] (the “Disclosure Statement”).

Background

1. On October 19, 2009 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code. Shortly after the Petition Date, the Debtors filed a motion (the "Bidding Procedures Motion") [Docket No. 81] for, among other things, approval of: (i) an auction of the Debtors' assets (the "Auction"); (ii) bidding procedures for the Auction; and (iii) a break-up fee and expense reimbursement for Redwood ERC Senior Living Holdings, LLC ("Redwood"), the proposed stalking horse bidder.

2. On November 6, 2009, the Court entered an order granting the relief requested in the Bidding Procedures Motion (the "Bidding Procedures Order") [Docket No. 272]. As part of that relief, Redwood was approved as the stalking horse bidder based on an offer to purchase substantially all of the Debtors' assets for \$100 million in cash with reinstated project level secured debt. The Court also approved a break-up fee of \$1.5 million, which Redwood was permitted to credit bid at the Auction. Pursuant to the Bidding Procedures Order, the Debtors and their advisors were permitted to solicit interest from other potential purchasers and accept any bids from potential purchasers until December 14, 2009. If any other qualifying bids were submitted, the Auction was to be held on December 22, 2009. Coastwood submitted the only other qualified bid for the Debtors' assets.

3. The initial rounds of bidding at the Auction featured offers from both Redwood and Coastwood consisting of a combination of cash consideration, term loan A securities, and preferred subordinated term loan B securities. The Debtors expressed their desire to move to an "all cash" bidding format "as quickly as possible," and Coastwood responded by submitting the first "all-cash" bid of the Auction. *See* Auction Tr. at 120:11-14, 128:2-14.³

³ A true and correct copy of the transcript of the December 22, 2009 Auction is attached hereto as **Exhibit A**.

4. After several additional rounds of competitive bidding, Redwood submitted an all-cash bid of \$291.5 million, of which \$1.5 million was a credit bid of the break-up fee. *Id.* at 134:12-15. During the break following Redwood's bid, Coastwood approached the Debtors and their advisors and informed them that Coastwood intended to submit a new bid of \$305 million *only if* the Debtors—after consultation with the Debtors' constituencies in accordance with the Bidding Procedures Order—agreed that the losing bidder (whether Coastwood or Redwood) would be entitled to a fee representing 10% of the difference between the prevailing bid and \$260 million, which would replace both the \$1.5 million break-up fee authorized by the Court with respect to Redwood and a \$2 million fee previously agreed to with Coastwood. *Id.* at 134:16-136:14.

5. Consistent with the Bidding Procedures Order,⁴ the Debtors accepted Coastwood's proposal after conferring with their advisors and their constituencies (and their constituencies' advisors) provided the bidding parties agreed to use \$275 million as the initial threshold for calculating the agreed-upon fee instead of \$260 million. *Id.* at 137:3-138:5; *see also* Disclosure Statement Hr'g Tr. at 27:9-19 ("You may recall that . . . at a certain point during the auction, there was an agreement made with everybody there in the room. The Debtor made an agreement on Coastwood and Redwood, that . . . to the extent bidding went up further, the losing bidder would get a payment equal to 10 percent of the increment over \$275 million.")⁵ Coastwood and the relevant constituencies (including Redwood) agreed to the terms of the

⁴ The Debtors were permitted to "alter the Bidding Procedures at the Auction if, in their reasonable judgment, in consultation with the NSC, the NFPs, the Lenders, and any committee, such alteration will better promote the goals of the Auction." Bid Procedures Order, Ex. A at § VI.

⁵ A true and correct copy of the transcript from the March 5, 2010 hearing on the Debtors' Disclosure Statement is attached hereto as **Exhibit B**.

Auction Fee as described by the Debtors. After reaching that agreement, Coastwood submitted an all cash bid of \$305 million.

6. At the conclusion of the Auction, Redwood was deemed to be the winning bidder after submitting an all-cash bid of \$365 million, which was more than \$70 million greater than the current bid when the Auction Fee was agreed to by all of the parties. *Id.* at 140:25-141:21. Coastwood, as the unsuccessful bidder, is entitled to receive the Auction Fee consideration in exchange for its performance throughout the bidding and Auction process, which indisputably added value to the Debtors' reorganization process and benefited the Debtors' estates. As the Debtors recently acknowledged in their Disclosure Statement:

As the unsuccessful bidder, Coastwood "is entitled to the Auction Fee of \$9 million (*i.e.*, 10% percent of the difference between \$365 million and \$275 million)." The Debtors deem the Auction Fee to be an Administrative Expense Claim. The Debtors will seek approval of the Auction Fee at the Plan Confirmation Hearing. The Auction Fee will be paid to Coastwood no later than the earlier of the Closing Date and the Effective Date.

Disclosure Statement at p. 29.

7. In accordance with the Debtors' stated intent to obtain the Court's approval of the Auction Fee in at the Plan Confirmation Hearing, Coastwood hereby submits this Brief to assist the Court in making its determination.

Argument

I. The Auction Fee Should Be Approved As An Allowed Administrative Expense Claim of the Debtors' Estates.

8. Section 503(b)(1)(A) of the Bankruptcy Code provides, in relevant part, that "actual, necessary costs and expenses of preserving the estate" are to be afforded administrative priority status. 11 U.S.C. § 503(b)(1)(A). Administrative priority is not reserved exclusively for typical trade creditors that provide goods and perform services for debtors in possession; any

postpetition transaction intended to benefit a debtor's estate may qualify. After all, "[s]ection 503(b)(1)(A)'s underlying purpose is to encourage post-petition conduct that will assist the debtor's efforts to rehabilitate the estate or organize the estate's assets in an orderly fashion to ensure an efficient sale." *In re Am. Coastal Energy, Inc.*, 399 B.R. 805, 815 (Bankr. S.D. Tex. 2009); *see also Pa. Dept. of Env't'l Resources v. Tri-State Clinical Laboratories, Inc.*, 178 F.3d 685, 689-90 (3d Cir. 1999) (noting that the statutory language and purpose of section 503(b) "suggest[] a quid pro quo pursuant to which the estate accrues a debt in exchange for some consideration necessary to the . . . rehabilitation of the estate").

9. In the Fifth Circuit, an expense is entitled to administrative priority status if it satisfies two requirements. *See NL Indus., Inc. v. GHR Energy Corp.*, 940 F.2d 957, 966 (5th Cir. 1991) (citing *In re White Motor Corp.*, 831 F.2d 106, 110 (6th Cir. 1987)).

- ***First***, the expense must arise from a transaction with the debtor in possession, as opposed to a prepetition transaction with the debtor. *See Lasky v. Phones For All, Inc. (In re Phones For All, Inc.)*, 288 F.3d 730, 732 (5th Cir. 2002); *Total Minatome Corp. v. Jack/Wade Drilling, Inc. (In re Jack/Wade Drilling, Inc.)*, 258 F.3d 385, 387 (5th Cir. 2001).
- ***Second***, the expense for which administrative priority status is sought "must have been of benefit to the estate and its creditors." *Tex. v. Lowe (In re H.L.S. Energy Co., Inc.)*, 151 F.3d 434, 437 (5th Cir. 1998); *Am Coastal*, 399 B.R. at 808-09 (holding that "actual and necessary" requirement is satisfied if payment of the expense provides a benefit to the estate and its stakeholders).

The Auction Fee negotiated between Coastwood and the Debtors—and approved by all of the Debtors' significant constituencies and Redwood—easily satisfies both of these requirements.

10. First, the Auction Fee was the result of a postpetition agreement reached between the Debtors and Coastwood at the Auction and, thus, clearly arises from a transaction with a debtor in possession. The Debtors ***induced*** Coastwood to submit a cash bid in the amount of \$305 million and to continue participating in the Auction in exchange for the Debtors' agreement to the Auction Fee. This type of inducement plainly satisfies the first requirement under section

503(b)(1)(A). See *In re Gasel Transp. Lines, Inc.*, 326 B.R. 683, 687-88 (6th Cir. 2005) (“In determining whether there was a ‘transaction with the bankruptcy estate’, ‘the proper focus [is] on the inducement involved in causing the creditor to part with its goods or services’ . . . if the inducement came from the debtor-in-possession, then the claims of the creditor are given priority.”) (quoting *In re United Trucking Serv. Inc.*, 851 F.2d 159, 162 (6th Cir. 1988) and *Transfer Corp. v. Gigsby (In re White Motor Corp.)*, 831 F.2d 106, 110 (6th Cir. 1987)); *In re Jartran, Inc.*, 732 F.2d 584, 586 (7th Cir. 1984) (citing *In re Mammoth Mart, Inc.*, 536 F.2d 950, 954 (1st Cir. 1976)); see also *In re Drexel Burnham Lambert Group Inc.*, 134 B.R. 482, 489 (Bankr. S.D.N.Y. 1991) (“A creditor provides consideration to the bankrupt estate only when the debtor-in-possession induces the creditor’s performance and performance is then rendered to the estate . . . [I]f the inducement came from the debtor-in-possession, then the claims of the creditor are given priority.”).

11. Second, the Debtors’ agreement to pay the Auction Fee provided a clear and substantial benefit to the Debtors’ estates and their stakeholders. See Ex. B at 27:24-28:5 (“The Debtor agreed to [the Auction Fee], and the Debtor believed that it was helpful . . . [B]asically, the Debtor’s conceding that it’s an allowed administrative expense.”). The Auction Fee was structured in a manner so as to guarantee that any amounts bid in excess of \$275 million would result in an immediate savings to the Debtors of either \$1.5 million or \$2 million (respectively, the breakup fee for Redwood and the previously agreed-upon fee for Coastwood) plus additional proceeds of 90% of any incremental bid exceeding \$275 million to the Debtors’ estates for distribution to creditors. Accordingly, the Debtors and their constituencies recognized that Coastwood’s continued participation would result in greater sale proceeds for the estates, and that the way in which the Auction Fee was structured was a no-lose proposition for the Debtors’

estates. By inducing Coastwood's continued participation in the Auction, the Debtors ultimately obtained an additional \$81 million in cash that is available for distribution to creditors under the Plan (90% of the \$90 million difference between Redwood's prevailing bid of \$365 million and Coastwood's earlier \$275 million bid). To characterize the Debtors' agreement to pay the Auction Fee as conferring an actual benefit upon the Debtors' estates is an understatement. *See, e.g., In re Fortunoff Fine Jewelry and Silverware, LLC*, 2008 WL 618983 (Bankr. S.D.N.Y. 2008) (holding that a similar fee was actual and necessary because the fee was a component of what induced the potential buyer to submit its bid, which increased the likelihood of obtaining the best possible price for the assets to be distributed to creditors).

II. Alternatively, This Court Can Authorize Payment Of The Auction Fee On Other Grounds.

12. Coastwood is confident that the Auction Fee satisfies the requirements for administrative priority treatment pursuant to section 503(b) of the Bankruptcy Code. However, Coastwood submits that this Court already authorized payment of the Auction Fee under section 363(b) of the Bankruptcy Code when it approved the Debtors' Bidding Procedures, and that alternatively, this Court may authorize payment of the Auction Fee pursuant to section 1129(a)(4) of the Bankruptcy Code.

A. Authorization In Connection With The Bidding Procedures Order And Section 363(b) Of The Bankruptcy Code.

13. Coastwood submits that the Debtors' were already authorized by the Court to pay the Auction Fee by this Court pursuant to the Bidding Procedures Order. Section VI of the Bidding Procedures provided the Debtors with the authority to "alter the Bidding Procedures at the Auction if, in their reasonable judgment, in consultation with the NSC, the NFPs, the Lenders, and any committee, such alteration will better promote the goals of the Auction." Bidding Procedures Order, Ex. A at § VI. One of the provisions of the Bidding Procedures

established the break-up fee to be paid to Redwood if it was not the prevailing bidder, which provision was modified at the Auction in favor of a new structure to compensate either Redwood or Coastwood on the same terms in a way that incentivized continued participation by both entities. The Debtors consulted with the relevant creditor constituencies prior to agreeing to such modification. *See* Ex. A at 135:22-136:13 (“The debtor is going to take and consult with the lenders committee off the record . . . [I]n consultation with creditors[,] the debtors discussed increasing the threshold from 260 to 275 million.”). In the Disclosure Statement, the Debtors expressly acknowledged that their agreement to pay the Auction Fee in order to “ensure the continued participation of both Redwood and Coastwood in the Auction process, thereby maximizing the potential recovery to all creditors and stakeholders” was consistent with this provision of the Bidding Procedures. Disclosure Statement at p. 29.

B. Authorization Under Section 1129(a)(4) of the Bankruptcy Code.

14. Even assuming *arguendo* that the Auction Fee does not satisfy the requirements of section 503(b) (though Coastwood maintains that it does), the Court may approve payment thereof in connection with confirmation of the Plan so long as the payment has been disclosed and is simply deemed “reasonable.” *See In re Journal Register Co.*, 407 B.R. 520, 537 (Bankr. S.D.N.Y. 2009) (approving post-confirmation payments to certain employees under an incentive plan pursuant to section 1129(a)(4)). Section 1129(a)(4) of the Bankruptcy Code provides, in relevant part, that “[a]ny payment made or to be made by the proponent, by the debtor, or by a person . . . acquiring property under the plan, for services . . . in connection with the case, or in connection with the plan and incident to the case, . . . [must be] subject to the approval of[] the court as reasonable.” 11 U.S.C. § 1129(a)(4); *see also Leiman v. Guttman*, 336 U.S. 1, 5, 8 (1949) (noting that the statutory precursor to section 1129(a)(4) applies to a broad array of payments in connection with a chapter 11 case). The contemplated payment of the Auction Fee

was disclosed in both the Disclosure Statement and in the solicitation version of the Plan. As previously noted, no one objected to confirmation of the Plan on the basis of the Debtors' disclosed intent to pay the Auction Fee to Coastwood.

15. Moreover, Coastwood submits that the Auction Fee is "reasonable." "When assessing the reasonableness of [a] fee[] during consideration of a plan of reorganization, this Court will consider the totality of the circumstances surrounding payment of th[at] fee[]." *In re Congoleum Corp.*, 414 B.R. 44, 60 (D. N.J. 2009). Nonetheless, "Bankruptcy Courts . . . are sufficiently overburdened that they . . . should be chary about succumbing into the exhortations of litigants to turn section 1129(a)(4) into a mandate for an expensive and unnecessary inquiry." *Mabey v. Southwestern Elec. Power Co. (In re Cajun Elec. Power Coop., Inc.)*, 150 F.3d 503, 517 (5th Cir. 1998). Based on the benefit to the Debtors' estates resulting from their agreement to pay the Auction Fee, Coastwood submits that the actual payment thereof easily satisfies the requirement that the Auction Fee be "reasonable."

Conclusion

WHEREFORE, Coastwood respectfully requests that the Court: (i) authorize payment of the Auction Fee in the amount of \$9,000,000.00 to Coastwood from the Cash Transaction Proceeds on or before the Effective Date; (ii) enter an order confirming the Plan that includes the appropriate directions providing for such payment pursuant thereto; and (iii) grant such other and further relief as is just and proper. For the convenience of the Court, Coastwood's proposed language for inclusion in the Confirmation Order is attached hereto as **Exhibit C**.

Dated: April 13, 2010
Dallas, Texas

**ATTORNEYS FOR ERC INVESTMENT
HOLDINGS, LLC A/K/A COASTWOOD**

By: /s/ Kevin M. Lippman
Kevin M. Lippman
Texas Bar No. 00784479
Jonathan L. Howell
Texas Bar No. 24053668
3800 Lincoln Plaza
500 North Akard Street
Dallas, Texas 75201-6659
Telephone: (214) 855-7500
Facsimile: (214) 855-7584

MUNSCH HARDT KOPF & HARR, P.C.

-- and --

James A. Stempel
Illinois Bar No. 6230191
Marc J. Carmel (admitted *pro hac vice*)
Illinois Bar No. 6272032
Adam J. Goldstein (admitted *pro hac vice*)
Illinois Bar No. 6289591
300 North LaSalle Street
Chicago, Illinois 60654
Telephone: (312) 862-2000
Facsimile: (312) 862-2200

KIRKLAND & ELLIS LLP

CERTIFICATE OF SERVICE

The undersigned hereby certifies that, on this the 13th day of April 2010, he caused true and correct copies of Coastwood's Brief In Support of the Debtors' Payment of the Auction Fee Pursuant to Debtors' Fourth Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code to be served on all parties receiving notice through the Court's ECF system by electronic mail and on counsel for the Debtors, Vincent Slusher at DLA Piper LLP, 1700 Main Street, Suite 4600, Dallas Texas 75201, and Thomas R. Califano at DLA Piper LLP, 1251 Avenue of the Americas, New York, New York 10020, via e-mail.

By: /s/ Jonathan L. Howell
Jonathan L. Howell