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ATTORNEYS FOR PNC BANK, NATIONAL ASSOCIATION

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

IN RE:	§	**CASE NO. 09-37010**
	§	
ERICKSON RETIREMENT COMMUNITIES, LLC, *et al.*[1]	§	**CHAPTER 11**
	§	**Jointly Administered**
	§	
Debtors.	§	

OBJECTION OF PNC BANK, NATIONAL ASSOCIATION TO DEBTORS' MOTION FOR AN ORDER (I) APPROVING COMMITMENT FEE, BREAK-UP FEE, EXPENSE REIMBURSEMENT PAYMENTS TO PLAN SPONSOR AND SHOP PROVISIONS; (II) APPROVING BIDDING PROCEDURES FOR THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS; (III) APPROVING PROCEDURES FOR THE CURE, ASSUMPTION AND ASSIGNMENT OF CONTRACTS; (IV) SCHEDULING HEARINGS TO CONSIDER (A) APPROVAL OF THE DISCLOSURE STATEMENT AND APPROVAL OF SOLICITATION PROCEDURES, AND (B) CONFIRMATION OF PLAN OF REORGANIZATION; (V) ESTABLISHING DEADLINES TO OBJECT TO THE DISCLOSURE STATEMENT AND PLAN OF REORGANIZATION; AND (VI) GRANTING RELATED RELIEF

PNC Bank, National Association ("PNC"), by its undersigned counsel, objects to the Debtors' Motion For An Order (i) Approving Commitment Fee, Break-Up Fee, Expense

[1] The Debtors in these Chapter 11 cases are Erickson Retirement Communities, LLC, Ashburn Campus, LLC, Columbus Campus, LP, 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.

Reimbursement Payments To Plan Sponsor And Shop Provisions; (ii) Approving Bidding Procedures For The Sale Of Substantially All Of The Debtors' Assets; (iii) Approving Procedures For The Cure, Assumption And Assignment Of Contracts; (iv) Scheduling Hearings To Consider (a) Approval Of The Disclosure Statement And Approval Of Solicitation Procedures, And (b) Confirmation Of Plan Of Reorganization; (v) Establishing Deadlines To Object To The Disclosure Statement And Plan Of Reorganization; and (vi) Granting Related Relief (the "Motion"). PNC submits this objection in PNC's capacity as the Administrative Agent for the "Senior Secured Project Loan Lenders" that are parties to the "Senior Secured Project Loans" having aggregate unpaid balances in excess of Two Hundred Sixty-Four Million Dollars ($264,000,000.00) (as such terms are defined on Exhibit "A" attached hereto (the "Summary")) and in PNC's individual capacity as a Senior Secured Project Loan Lender. The Senior Secured Project Loans are more particularly described by the Summary. In support of this Objection, PNC states the following:

I. PRELIMINARY STATEMENT

The sale of the Debtors' assets is the keystone of this bankruptcy case. That sale must be done in a fair, neutral, and unbiased manner designed to procure the maximum value for these assets upon the sale. The sale must be impartial in both substance and appearance. The bidding procedures proposed by the Debtor will not accomplish this end. They are designed to ensure that a favored party, Redwood Capital Investment LLC (together with its affiliates, including the proposed purchasing entities, "Redwood"), the proposed stalking horse bidder, acquire the assets on terms favorable to Redwood and unfavorable to all other interested persons.

The bidding procedures preclude a fair and level playing field for market participants to competitively bid upon the Debtors' assets. Under the bidding procedures proposed by the

Debtors, the playing field is neither fair nor level and insures the success of but one party -- Redwood. For instance,

- Undisclosed relationships exist among the owner of the Debtors and Redwood, relationships that must be disclosed if fairness in substance and appearance is to be part of the process.

- Marketing efforts to date have been anemic, designed more to minimize than to maximize the value of the Debtors' assets.

- The proposed bidding procedures are designed to chill bidding.

- The Master Purchase and Sale Agreement ("Redwood Purchase Agreement") dictates a plan of reorganization that would violate numerous provisions of Section 1129 of the Bankruptcy Code.

- The proposed bidding procedures do not preserve the right of secured creditors to credit bid.

The bidding procedures, which will have the effect of insuring that Redwood is the successful bidder, are not proposed in good faith for the benefit of the entire estate. The proposed bidding procedures must be modified so that the estates, their creditors, and the residents are protected. The aim of this case should not be to provide a good deal to Redwood and a bad deal to everyone else.

An Emergency Does Not Exist

The approval of the sale and bidding procedures, while perhaps worthy of expedited treatment, is not an emergency necessitating a decision on one week's notice. Erickson Retirement Communities, LLC ("ERC") has approximately $35 million in cash and liquid assets, and there is absolutely no danger that any resident's care or even lifestyle will be affected, much

less compromised, by a brief delay of seven (7) to ten (10) days to enable the parties to adequately address and present the issues to the Court. The lack of an emergency situation is underscored by the Redwood Purchase Agreement in which Redwood contemplated that the bidding procedures would be approved as late as November 26, 2009 – nearly a month after the scheduled emergency hearing date. (Redwood Purchase Agreement at Art. 9.1(b)(vi)) The emergency appears both contrived and of recent vintage.

This Court, in order to make a proper and lawful decision, must have before it all of the germane facts and circumstances, with sufficient time to deliberate on the law applicable to these facts and circumstances. There is no need to precipitately rush to unjust decision solely to benefit Redwood.

II. BACKGROUND

The Process Is Suspect

The Second Circuit has counseled that "the conduct of bankruptcy proceedings not only should be right but must seem right." *In re Bidermann*, 203 B.R. 547, 549 (Bankr. S.D.N.Y. 1997) (citing In *re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966). The Debtors would have this counsel ignored.

The proposed bidding procedures facially do not seem right or fair. Both the bidding procedures and the Redwood Purchase Agreement appear to be designed to favor Redwood, to the disfavor of all other potential purchasers. The rush to obtain court approval reflects the lack of basic fairness in the process thus far. The Debtors want the procedures approved before the light of a full analysis and examination can be applied to them.

Undisclosed Relationships and Actual or Potential Conflicts of Interest

To begin, there are undisclosed (or barely disclosed) relationships between the stalking horse bidder and the Debtors' principal. John C. Erickson and Nancy Erickson, his wife, are believed to be the beneficial owners of Erickson Retirement Communities, LLC, directly or indirectly through one or more intermediaries. While not disclosed in any way in the Motion or the proposed Redwood Purchase Agreement, Redwood has agreed to give Mr. Erickson a 10% equity ownership interest in each of at least two of the purchasing Redwood entities (notwithstanding that the Debtors do not intend to pay their creditors in full). The favorable treatment being afforded to Mr. Erickson by Redwood calls into question the ability of the Debtors to exercise fairly the necessary business judgment or to act as fiduciaries to the creditors.

This relationship raises the appearance of impropriety and calls into question the marketing and sales process to date. More information concerning this relationship and arrangement should be disclosed to the Court. In light of these circumstances, the Court should view the conduct of any marketing and sale of the Debtors' assets with a critical eye and give the Debtors' proposals heightened scrutiny.

The Marketing Efforts Were Tainted From The Start

The marketing efforts of the Debtors and their advisors to date are of critical importance to the efficacy of the sales process. The past marketing efforts must be understood and taken into account when the Court fashions appropriate bidding and sales procedures. Unfortunately for creditors of these estates, the marketing process was tainted from the very beginning.

According to the Motion, the Debtors began to market the assets with the assistance of Houlihan Lokey Howard & Zukin Capital, Inc. ("Houlihan Lokey") in "mid-September."

Motion at ¶ 55. Houlihan Lokey sent a process letter (the "Process Letter") to potential purchasers indicating that preliminary proposals were to be submitted not later than Monday, October 19, 2009.

However, prior to Houlihan Lokey going into the market place, the Debtors executed a letter of intent with Redwood (the "Redwood LOI"). The Redwood LOI was executed on September 17, 2009 – nearly a month before the deadline for preliminary proposals established in the Process Letter. Motion at ¶ 10. The Debtors have complex capital and debt structures. By going into the market place with a letter of intent that they had already signed, the Debtors deviated from their own stated process, chilling and stifling the bidding from the start.

Selecting a stalking horse bidder in this fashion discourages any bidding and is inimical to enthusiastic bidding by prospective purchasers who perceive a chance to be the successful bidder. *In re Bidermann Industries U.S.A., Inc.*, 203 B.R. 547 (Bankr. S.D.N.Y. 1997). The process employed by the Debtors resembles the process that Judge Tina L. Brozman rejected in *Bidermann*, when she observed:

> "And **the whole bidding arrangement is designed not to encourage but to stifle bidding.** Unlike in *Integrated*,[2] where the debtors communicated with some 30 potential bidders and the chosen bidder was a 'magnet' for the others, **the debtors here did not negotiate with third party prospective purchasers, pick the best of them and then proceed to seek approval for topping and expense reimbursement fees.** Rather, **they determined to proceed with a management-led buyout** where their chief executive officer and their majority shareholder may acquire equity in and salaries from the acquiring enterprise. When the 'window shop' provision and the indemnification of [the purchaser] are added to the equation, **it can be seen that the aim is not to foster bidding**. Significantly, discussions with the 30 potential bidders preceded the debtor's entry into the window shop clause in *Integrated Resources*. Not so here."

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[2] *In re Integrated Resources, Inc.*, 147 B.R. 650 (S.D.N.Y. 1992), appeal dismissed 3 F.3d 49 (2d Cir. 1993).

(Emphasis added). *Bidermann*, 203 B.R. at 552-53.[3]

Just as in *Bidermann*, the Debtors went to the market with an insider-friendly sale already negotiated, signed, and in hand. From the Debtors' perspective, all that was needed was immediate, emergency bankruptcy court approval obtained before the process could be exposed or the market given a chance. By proceeding in this fashion and with this aim, the Debtors stifled bidding and rendered the "shop" provisions virtually meaningless.[4]

<u>The NSC Has Tainted The Process</u>

National Senior Campuses ("NSC") pretends along with its associated not for profit entities (which are the tenants at the community level (collectively, the "NFPs")) to wear only a white hat, having as its sole interest the protection of the welfare of the residents. But NSC and the NFPs are not as independent from the Debtors as they purport to be.[5] The respective boards of NSC and the NFPs are populated by Mr. Erickson's hand picked friends and associates, many of whom have been paid to be NSC board members for many years (some making as much as $65,000 per year). NSC's (and the NFPs') manipulation of the process, done under the mantle of having a concern only for the residents, will directly benefit Mr. Erickson. And, NSC looks to increase its financial stake in management of the projects beyond what it presently enjoys – at the expense of the Debtors and their creditors.

In a letter dated September 14, 2009 (the "NSC Letter"), NSC announced a list of its "preferences" concerning the Redwood LOI. This letter is believed to have been distributed to

[3] One of the architects of the process rejected by Judge Brozman in *Bidermann* was Mr. Marsal, of Alvarez and Marsal, the same turnaround consulting firm that the Debtors seek to hire.

[4] While a few groups have submitted letters of intent, at least one group has indicated that the proposed bidding procedures are so onerous that it may not proceed under them.

[5] PNC has not had an opportunity to investigate through discovery the relationships between NSC, Mr. Erickson and the Debtors, but PNC intends to do so.

prospective bidders, a distribution that could only dampen market interest by implying Redwood was one of the announced "preferences" of NSC.

The "preferences" include an attempt to collude with potential purchasers for NSC's own financial benefit, as follows:

> "[t]he Committee will give preference to any competing proposal that provides NSC, an affiliate of NSC and/or the Retirement Communities **some form of significant participation in the economics of the management company, initially or in the future...**"

NSC Letter (emphasis added). The proposed bidding and sale procedures are rife with the requirement that the NSC consent to any proposed transaction. NSC's actions are not driven solely by its concern for the welfare of the residents: NSC wants a part of the deal. The creditors should be permitted to explore (and should be permitted to bring to the attention of this Court) any agreement of Redwood to give NSC an economic interest in the transaction or to make any payments to NSC or to the NFPs upon or after the closing of the deal. If NSC or the NFPs are financially interested, their involvement in the process must be viewed in a light different than would arise if the welfare to the residents were their sole concern.

III. LEGAL ARGUMENT

The Debtors seek approval of the bidding and sale procedures on an emergency basis under Sections 363 and 365 of the Bankruptcy Code. Recently, Judge Steen, in denying an emergency motion like that before this Court, expressed a growing judicial sentiment against the use of unnecessary emergency sale proceedings as the vehicle for determining the outcome of a bankruptcy case. *See In re Gulf Coast Oil Corp.*, 404 B.R. 407 (Bankr. S.D.Tex. 2009).

The *Gulf Coast* Factors Support Denial Of The Motion

In *Gulf Coast*, Judge Steen set forth factors that should be considered when a Section 363 motion is brought before the Court, as follows:

1. Is there evidence of a need for speed?
2. What is the business justification?
3. Is the case sufficiently mature to assure due process?
4. Is the Redwood Purchase Agreement sufficiently straightforward to facilitate competitive bids or is the purchaser the only potential interested party?
5. Have the assets been aggressively marketed in an active market?
6. Are the fiduciaries that control the debtor truly disinterested?
7. Does the proposed sale include all of a debtor's assets and does it include the 'crown jewel'?
8. What extraordinary protections does the purchaser want?
9. How burdensome would it be to propose the sale as part of confirmation of a Chapter 11 plan?
10. Who will benefit from the sale?
11. Are special adequate protection measures necessary and possible?
12. Was the hearing a true adversarial presentation? Is the integrity of the bankruptcy process protected?
13. What other factors apply to the case at hand?

Id. at 423 – 427.[6]

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[6] The United States Bankruptcy Court for the Eastern District of Virginia recently applied the factors articulated by Judge Steen and excised terms from an asset purchase agreement that furthered a *sub rosa* plan of reorganization, or which lacked a good business reason. *See In re On-Site Sourcing, Inc.*, ___ B.R. ___, 2009 WL 1789331 (Bankr. E.D. Va. June 22, 2009).

These factors lead to an inescapable conclusion: the sale procedures, as proposed, should not be approved.

- The Debtors have not shown a need for speed because there is no such need.
- The case is not sufficiently mature to assure due process, having been filed only a week ago and being in its infancy.
- The creditors' committee will not be formed before November 2, 2009; no bankruptcy schedules have been filed; and the 341 meeting is a month away (scheduled for November 30, 2009).
- The proposed Redwood Purchase Agreement is not straightforward and has been contrived to thwart competitive bidding.
- The assets have not been aggressively marketed in the active market that is believed to exist.
- The Debtors are not truly disinterested.
- The proposed sale includes all of the Debtors' assets.
- The purchaser wants extraordinary protections not justified by the circumstances of the purchase.
- Insiders will benefit substantially from the sale.
- Creditors are not adequately protected.
- Finally, the integrity of the bankruptcy process as a whole is at risk.

The Bidding Procedures Must Preserve The Right To Credit Bid

Section 363(k) of the Bankruptcy Code grants a secured creditor the right to credit bid the full face amount of its claim when the collateral securing its claim is sold outside the ordinary course of business. Section 363(k) provides:

> "At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property."

11 U.S.C. § 363(k).

The right to credit bid is a fundamental protection of the secured creditor's constitutional property rights. The right "gives the secured creditor protections against attempts to sell the collateral too cheaply; if the secured party thinks the collateral is worth more than the debtor is selling it for, it may effectively bid its debt and take title to the property." 7 Lawrence P. King, Collier on Bankruptcy, ¶ 1129.05[2][b] (15th Ed. Rev. 2009).

Congress' "bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation." *United States v. Sec. Indus. Bank*, 459 U.S. 70, 75 (1982). The right to credit bid cannot be impaired without running afoul of the Fifth Amendment. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935) (recognizing the right to credit bid among those rights subject to Fifth Amendment protection).

Similarly, Section 1129(b)(2)(A)(ii) protects the right to credit bid in a cram down plan in order to ensure that the plan is fair and equitable. The Debtors will likely argue that, because they contemplate that the actual sale of the assets would be consummated pursuant to a plan, the Fifth Circuit's recent decision, *In the Matter of Pacific Lumber Co.*, ____ F.3d ____, 2009

WL 3082066 (5th Cir. Sept. 29, 2009), obviates the secured creditors' right to credit bid. This is an incorrect interpretation of the law and the decision.

In *Pacific Lumber,* the Fifth Circuit held that the right to credit bid under Section 1129(b)(2)(A)(ii) was not necessary, under the facts of that case, for a proposed plan to meet the "fair and equitable" standard. In *Pacific Lumber*, the secured creditors were paid the amount of their secured claims (judicially determined after several days of evidentiary hearings on value) under a plan -- in full and in cash -- on the effective date. The Fifth Circuit found that payment, in full and in cash, on the effective date was the "indubitable equivalent" of the secured creditors' claim. But, the Fifth Circuit also noted that the right to credit bid might be "imperative in some cases."

Pacific Lumber is inapposite to this situation. The Debtors are seeking approval of bidding procedures for a Section 363 sale, not confirmation of a plan. *See* Proposed Bidding Procedures. *Pacific Lumber* was interpreted in the last two (2) weeks by *In re Philadelphia Newspapers, LLC*, 2009 WL 3242292 (Bankr. E.D. Pa. October 8, 2009). In *Philadelphia Newspapers*, the debtors sought approval for an auction process to sell substantially all of their assets pursuant to a plan of reorganization (rather than a Section 363 sale). Similar to what the Debtors are attempting to accomplish here, the *Philadelphia Newspapers* debtors attempted to preclude their secured lenders from submitting a credit bid, arguing that Section 363(k) authorizes secured creditors to credit bid only at a Section 363 sale – and does not require that they be permitted to credit bid in a sale under a plan. In *Philadelphia Newspapers*, the Court rejected the Debtors' attempt to deny secured creditors their right to credit bid at the bid procedures stage. The Court noted that (as is the case here) the bidding procedures "could easily dictate the outcome of the case" and that there was an "insider" relationship between the debtors

and the stalking horse bidder. The Court observed that the facts before it "represent[ed] the case where the right to tender a credit bid should be an imperative."

The marketing process in the present case was tainted from the outset, and the Court is being asked to approve bidding procedures heavily stacked in favor of Redwood as the proposed stalking horse bidder. Undisclosed potential conflicts of interest are present in the relationships among the Debtors and Redwood. The Debtors' principal who stands to benefit personally from the proposed sale may well lack the ability to act as a fiduciary. The secured creditors in the present cases must be permitted to protect their Constitutional property rights and must be afforded the right to credit bid. In this case, the right to credit bid is imperative.

In order to preserve their right to credit bid, secured creditors must be deemed "Qualified Bidders" under the bidding procedures. In addition, the following aspects of the bidding procedures impair the right of the secured creditors to credit bid and should not be applicable to secured creditors: (a) the $5 Million Dollar cash deposit, (b) the consent requirement, (c) the requirement for written representations concerning availability of cash or financing, financial wherewithal and ability to close, (d) the requirement for written submission of a "Qualified Bid", and (e) the overbid requirements. The Court should modify the bidding procedures to eliminate the applicability of these provisions to secured creditors exercising their right to credit bid.

The Bidding Procedures Must Be Fair And Must Level The Playing Field

The sale process should include "an intensive effort to drum up the best price obtainable for the creditors." *In re Bidermann Indus. U.S.A., Inc.*, 203 B.R. 547, 552 (Bankr. S.D.N.Y. 1997). Under a Section 363 sale of assets outside of the ordinary course of business, the trustee or debtor "has an obligation to maximize revenues for the estate." *In re S.N.A. Nut*

Co., 186 B.R. 98, 104 (Bankr. N.D. Ill. 1995) (internal citations omitted). "The purpose and goal of any asset sale is to maximize the recovery of value for the benefit of the bankruptcy estate." *In re Jon J. Peterson, Inc.*, 411 B.R. 131, 137 (Bankr. W.D.N.Y. 2009). The bidding process must remain fair and equitable or "competitors will refrain from the type of full participation that is needed to assure bids for the highest reasonable value." *Id.* "For these reasons, the court will not approve bidding procedures that undermine principles of fair play." *Id.*

Having skewed the process from the outset, the Debtors ask the Court to approve bidding procedures that continue to tilt the field in favor of Redwood. Bidding procedures should level the playing field; these do not. The same rules must apply to all bidders. The proposed bidding procedures are not fair; they have a chilling effect; and they put non-Redwood bidders at a significant disadvantage that frustrates competition. The proposed bidding procedures should not be approved as presented.

No Bidder (Other Than Redwood) Will Be Able to Meet the Qualified Bidder Consent Requirement

All bidders should have to meet the same requirements in order to be deemed "Qualified Bidders." The proposed bidding procedures require, as a condition to being deemed a Qualified Bidder, that the prospective bidder obtain consents from all lender groups, NSC and the NFPs. Redwood, however, is not bound by this requirement, nor is it likely to meet it, as the project lenders have not consented to a sale to Redwood. By imposing this requirement on other bidders, the proposed procedures virtually guarantee a sale to Redwood, because there will be no other "Qualified Bidders."

This artificial barrier should be eliminated. Bidders should be qualified and permitted to bid without having to obtain the consent of any party. Indeed, the consent requirement implicates Section 1125(b)'s prohibition on postpetition solicitation, and introduces the

possibility that votes may be designated under Section 1126(e). PNC reserves all rights concerning designation of any party's vote in any plan proposed by the Debtors.

Requirements to Keep Bids Open or Act as a Back-Up Bidder Should Apply to All or to None

The proposed bidding procedures require all bidders – except Redwood – to keep their bid open until a transaction is consummated. This forces bidders – other than Redwood – to tie up available significant credit and reserves for months, even if their bids were rejected. The proposed procedures also require all bidders – except Redwood – to agree in advance to be a back-up bidder. Only the winning bidder and the bidder that is selected and agrees to be a back-up bidder should be required to hold their bids open through closing.

The Provisions Related to the Bidders' Deposits Should be Changed

Similarly, under the proposed procedures all prospective bidders – other than the stalking horse bidder – must keep a $5 Million deposit in place until the consummation of a transaction. In contrast, the Debtor must return Redwood's deposit if its bid is rejected. All deposits should be returned after the auction except for those of the winning bidder and the bidder that is selected and agrees to be a back-up bidder.

In addition, the required deposit should be pro-rated for those potential bidders that want to bid on some, but not all, of the assets. Requiring bidders interested in only one campus to post the entire $5 Million deposit will eliminate such bidders and substantially decrease the pool of potential purchasers.

No Plan or Disclosure Statement Should Be Filed Until After the Auction

The proposed procedures contemplate that a Chapter 11 plan would be filed before the auction. Going forward in this fashion foments the impression that the winning bidder has been pre-ordained, will chill bidding, and is a wasteful exercise. Adequate information cannot be

provided, and creditors cannot make an informed decision about a plan until after the auction has occurred and the successful bidder's terms are known. Instead of filing the plan and disclosure statement, the Debtors should simply be required to provide a draft of Redwood's proposed plan to prospective bidders, without soliciting acceptances of it.

Bidders Need More Time to Submit Bids

Bidders need more than twenty (20) days from the date that they receive the details of the Redwood proposal (including the proposed plan) to submit a competitive bid. Bidders should be given a minimum of forty-five (45) days from the date that they receive the complete Redwood proposal to submit their final bids.

The Court Should Conduct the Auction, Not the Debtors

The procedures leave far too much in the discretion of the Debtors. The Debtors control the bidders' access to information. The proposed procedures expressly remove any consequences from the Debtors' failure to provide access to information to prospective bidders. Motion at p. 11. The Debtors determine who is a qualified bidder. Motion at p. 11. The Debtors may reject any bid, without limitation. Motion at p. 14.

A successful auction is critical to the creditor constituencies in this case. The Court's "Guidelines for Early Disposition of Assets in Chapter 11 Cases" provides that, "[u]nless the court orders otherwise, all sales governed by these guidelines, including auctions or the presentation of competing bids, will occur at the hearing before the court." In light of the manner in which the process has been handled to date, the best way to give bidders assurance of a fair auction is for the Court to conduct the auction, not the Debtors.

Assumption Of The Redwood Purchase Agreement Is Premature And Unnecessary

The Motion does not affirmatively state, but the proposed order provides, that the Redwood Purchase Agreement would be assumed. The Debtors have not moved to assume the Redwood Purchase Agreement in the Motion, nor have they given sufficient notice if that is their intention. Assumption of the Redwood Purchase Agreement exposes the Estates to significant liability and further gives the impression that all is not right with the bidding process. Assumption at this time is premature and unnecessary. Indeed, the Redwood Purchase Agreement is incomplete and references twenty-one (21) disclosure schedules – none of which are attached to the Redwood Purchase Agreement filed with the Motion.[7]

Assumption of the Redwood Purchase Agreement exposes the Estates to significant liability, including the following:

- The Redwood Purchase Agreement makes it impossible for the Debtors to fulfill their fiduciary duties to creditors. The Redwood Purchase Agreement provides that

  > "[w]ithout the consent of the Redwood Parties, the Debtors shall not take any significant action with respect to the Reorganization Plan or Transactions that is inconsistent with the transactions and terms contemplated by this Agreement."

  Redwood Purchase Agreement, Article 7.1(b).

- The Redwood Purchase Agreement requires the Debtors to pay fees to Redwood in circumstances that go well beyond a typical break up fee. Under the Redwood

[7] The Redwood Purchase Agreement provides that the parties will attempt to agree on final versions of schedules and exhibits within ten (10) days of execution of the agreement – which is the same date that the Debtors ask the Court to permit them to "assume" the Redwood Purchase Agreement. Redwood Purchase Agreement, Article 7.13.

Purchase Agreement, the Debtors must pay Redwood a $1.5 Million fee (perhaps multiple times) if any of the following occur:

(a) Closing does not occur within one hundred twenty (120) days of the Petition Date,

(b) Confirmation is not obtained by one hundred twenty (120) days of the Petition Date,

(c) Any confirmation order is not final within one hundred thirty (130) days after the Petition Date,

(d) The conditions precedent to Redwoods' obligation to close become incapable of fulfillment other than as a result of a breach of Redwood,

(e) The Debtors have filed "any pleading or entered into any agreement (other than this Agreement and other than the Bidding Procedures Motion approved by Redwood) relating or otherwise regarding (A) the sale, transfer, lease or other disposition, directly or indirectly, of a material portion of the Purchased Assets or (ii) [sic] a proposed plan of reorganization that is not acceptable to Redwood or that differs from the terms of this Agreement,"

(f) The Bankruptcy Court does not approve the bidding procedures by November 26, 2009, or such order is stayed as of such date,

(g) The Debtors select a bid other than Redwood as the highest and best offer,

(h) Any secured lender exercises its right to credit bid under Section 363(k), or

(i) All exhibits and schedules to the Redwood Purchase Agreement are not agreed upon by the tenth (10th) day after the execution date.

- In the Redwood Purchase Agreement the Debtors warrant that there is no broker entitled to any fee or commission in connection with the transactions. Yet, the Debtors have filed a motion to hire Houlihan Lokey and to pay it substantial fees in connection with the transaction. Redwood Purchase Agreement, Article 5.21.

The Redwood Purchase Agreement requires the Debtors to act in a manner that chills bidding, including

- Under the Redwood Purchase Agreement, the "Shop Period End Date" is the Petition Date, and the Debtors are prohibited from soliciting arms-length alternative proposals after the Shop Period End Date. Redwood Purchase Agreement, Article 7.5(b). While the Redwood Purchase Agreement prohibits virtually all marketing activities "[e]xcept as authorized and directed by the Bidding Procedures Order," the Redwood Purchase Agreement also affirmatively prohibits discussions and negotiations after the Shop Period End Date, and further requires the Debtors to seek the return or destruction of any information provided to prospective bidders. Redwood Purchase Agreement, Article 7.5(a), (f).
- The Redwood Purchase Agreement gives Redwood a contractual right to access to information that is not available to other prospective bidders. Redwood Purchase Agreement, Article 5 generally.

The Redwood Purchase Agreement is drafted in a manner that requires its terms to be incorporated into a plan. But, the Redwood Purchase Agreement dictates a plan that would violate numerous provisions of the Bankruptcy Code, including the following:

- The Redwood Purchase Agreement attempts to eliminate secured creditors' rights to credit bid under Sections 363(k) and 1129(b)(2)(A)(ii).
- The Redwood Purchase Agreement contemplates a distribution of assets in violation of the absolute priority rule of Section 1129(b)(2)(B)(i).
- The Redwood Purchase Agreement contemplates a distribution of assets that violates the best interest of creditors test in Section 1129(a)(7)(A)(ii).

- The Redwood Purchase Agreement lacks full disclosure of Mr. Erickson's role in the transaction, as well as the roles of other insiders, in violation of Section 1129(a)(5)(A)(i) and (a)(5)(B).
- The Redwood Purchase Agreement was not proposed in good faith, and any plan supporting it fails the good faith requirement of Section 1129(a)(3). Any plan proposed in support of the Redwood Purchase Agreement, and any sale under the Redwood Purchase Agreement, will not have been proposed in good faith.
- The Redwood Purchase Agreement requires the Debtors to solicit approval of a plan before a disclosure statement is approved, in violation of Sections 1129(a)(1) and 1125(b).

IV. CONCLUSION

The sale of the Debtors' assets is of great importance to all persons with an interest in these cases. The sale process must be designed to yield the highest and best offer, and it must encourage and enable competitive bidding, including credit bidding by secured creditors. The Court should revise the bidding and sale procedures to address the points raised in this objection, decline to assume the Redwood Purchase Agreement as presented, and closely supervise the process. This is a case that needs the Court to conduct or closely supervise the auction to assure prospective bidders and creditors that the auction is fair and not simply a mechanism for Redwood to exploit the Debtors and their assets.

WHEREFORE, PNC respectfully requests that the Court enter an Order (i) denying the Motion or, in the alternative, modifying the proposed bidding procedures as set forth in this objection, and (ii) granting PNC such other and further relief as may be just and proper.

By: *\/s/ Daniel I. Morenoff*

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CERTIFICATE OF SERVICE

I hereby certify that on this 28th day of October, 2009, a true and correct copy of the foregoing was served via email through the Bankruptcy Court's Electronic Case Filing System on those parties that have consented to such service, including the movant-Debtors.

By: */s/ Daniel I. Morenoff*
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