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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,	§	**CHAPTER 11**
LLC, *et al.*[1]	§	**Jointly Administered**
	§	
Debtors.	§	

AMENDED[2] SUPPLEMENTAL OBJECTION OF PNC BANK, NATIONAL ASSOCIATION TO ENTRY OF FINAL ORDER (I) AUTHORIZING BORROWERS TO OBTAIN POSTPETITION FINANCING ON A SENIOR SECURED SUPERPRIORITY BASIS PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 363, AND 364, (II) GRANTING ADEQUATE PROTECTION TO PREPETITION SECURED LENDERS PURSUANT TO 11 U.S.C. §§ 361, 363 AND 364; AND (III) GRANTING RELATED RELIEF

PNC Bank, National Association ("PNC"), by its undersigned counsel, objects to entry of the Proposed Final Order (I) Authorizing Borrowers to Obtain Postpetition Financing on a Senior

[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.

[2] This Amended Supplemental Objection amends that certain Supplemental Objection of PNC Bank, National Association to Entry of Final Order (i) Authorizing Borrowers to Obtain Postpetition Financing on a Senior Secured Superpriority Basis Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364, (ii) Granting Adequate Protection to Prepetition Secured Lenders Pursuant to 11 U.S.C. §§ 361, 363 and 364, and (iii) Granting Related Relief (the "Prior Supplemental Objection"), filed on December 4, 2009 by PNC Bank, National Association.

Secured Superpriority Basis Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, and 364, (II) Granting Adequate Protection to Prepetition Secured Lenders Pursuant to 11 U.S.C. §§ 361, 363 and 364; and (III) Granting Related Relief, (the "Proposed Final Order"). PNC submits this supplemental Objection in PNC's capacity as Administrative Agent for the Lenders that are parties to various Senior Secured Project Loans having aggregate unpaid balances in excess of Two Hundred Sixty-Four Million Dollars ($264,000,000.00) (as more particularly described in the summary of the senior secured project loans attached as Exhibit "A" to the Prior Supplemental Objection (the "Summary")) and in PNC's individual capacity as a Lender of Senior Secured Project Loans. In support of this Objection, PNC states the following:

PRELIMINARY STATEMENT

The Debtors have proposed a Final Order, only recently received, that differs substantially from the Interim Order (I) Authorizing Borrowers to Obtain Postpetition Financing on a Senior Secured Superpriority Basis pursuant to 11 U.S.C. §§ 105, 361, 362, 363 and 364; (II) Granting Adequate Protection to Prepetition Secured Lenders pursuant to 11 U.S.C. §§ 361, 363 and 364; and (III) Granting Related Relief (the "Interim Order"). Most significantly, the Proposed Final Order makes material changes to the waterfall provisions that were carefully negotiated by the parties in connection with the Interim Order and approved by the Court. These waterfall provisions were the product of a two-day hearing. The proposed changes to the waterfall provisions prejudice PNC and resurrect the most problematic issue presented by the proposed debtor-in-possession financing -- cross-collateralization. As this Court is aware, construction of each project was financed on a stand-alone basis by a discrete and separate group of secured lenders. The pre-petition construction debt is not cross-collateralized between projects. In contrast, the proposed debtor-in-possession financing would be cross-collateralized

without providing the pre-petition Senior Secured Project Lenders with any adequate protection. The Proposed Final Order should not be entered as a matter of law.

The proposed debtor-in-possession financing would also include payments to non-debtor not-for-profit entities ("NFPs") that are not supported by any authority under the Bankruptcy Code or case law. There is no authority that would authorize the Debtors to pay $300,000.00 per month to the NFP's lawyers in advance, and without application or review by the Court and parties-in-interest. In addition, PNC objects to granting any relief to the corporate revolver lenders on account of alleged diminution of corporate cash. The corporate revolver lenders' cash collateral was not diminished by the Debtors' use of cash during the first two weeks of these bankruptcy cases, no cash was used at the project level, and the corporate revolver lenders are estopped from improving their position at this time.

The Proposed Final Order contemplates relief that is not requested in the Debtors' motion for approval of debtor-in-possession financing. The Court should not countenance granting relief beyond that which the Debtors requested.

Finally, the Proposed Final Order does not adequately protect the Senior Secured Project Loan Lenders. The case law is clear that maintenance of enterprise value is not sufficient adequate protection. The Proposed Final Order should not be entered.

BACKGROUND

The Senior Secured Project Loan Lenders (as defined in the Summary) hold first priority security interests in, and liens on, the assets of the Senior Secured Project Loan Borrowers (as defined in the Summary). The Debtors seek approval of a debtor-in-possession loan facility (the "DIP") to be made by ERC Funding Co. LLC (the "DIP Lender"), an affiliate of the Redwood Purchasers (as defined in the DIP Motion (as defined below)).

The Court conducted a hearing, on October 29 and 30, 2009 (the "Interim Hearing"), on the Debtors' motion for authority to obtain debtor-in-possession financing (the "DIP Motion"). In the course of that hearing, the Debtors offered to resolve the cross-collateralization issue by establishing a waterfall pursuant to which the DIP Lender would be repaid. Although the cross-collateralization issue was troubling to the Senior Secured Project Loan Lenders, the Court entered the Interim Order containing the waterfall provisions proposed by the Debtors and expressly found that the cross-collateralization issue was minimized based upon the addition of the waterfall provisions.

The Proposed Final Order contains a new waterfall provision which raises, again, the cross-collateralization issue. The new waterfall provision caps the corporate cash to which the DIP Lender may resort for repayment and exposes each project to the debt of other projects in an arbitrary and prejudicial fashion. The new waterfall provision proposed by the Debtors fails to adequately protect the Senior Secured Project Lenders. While not perfect, the waterfall provisions set forth in the Interim Order minimized the cross-collateralization issue. At a minimum, the Final Order should contain the same waterfall provisions that were set forth in the Interim Order.

The Debtors Have Not Offered Adequate Protection to Project Lenders

The Debtors' sole offer of adequate protection to Senior Secured Project Loan Lenders is "the preservation of the enterprise value of the Borrowers, jointly and severally" and, presumably, the flawed waterfall concept set forth in the Proposed Final Order. *See* DIP Term Sheet at p. 5. This is not sufficient to meet the Debtors' burden to show that the Senior Secured Project Loan Lenders are adequately protected.

The Debtors bear the burden of showing adequate protection. *See* 11 U.S.C. § 363(p). Adequate protection is not defined in the Bankruptcy Code, but Section 361 states that it may be

provided by cash payments, an additional or replacement lien, or granting other relief as will result in the "indubitable equivalent" of the creditors' interest in property. *See* 11 U.S.C. § 361; *See also In re Knight Energy Corp*., 2009 WL 1851739 (Bankr. N.D.Tex. 2009) (requiring the Debtors to pay monthly cash payments as adequate protection).

Courts have recognized that simply maintaining business operations, without more, may not be "adequate protection" within the meaning of Section 361. The United States Court of Appeals for the Third Circuit stated it well:

> "Congress did not contemplate that a creditor could find its priority position eroded and, as compensation for the erosion, be offered an opportunity to recoup dependent upon the success of a business with inherently risky prospects."

In re Swedeland Development Group, Inc., 16 F.3d 552, 567 (3d Cir. 1994) (finding that superpriority postpetition funding should not have been authorized because mortgagee was not provided with adequate protection). *See also In re First South Savings Association*, 820 F.2d 700 (5th Cir. 1987)(granting limited writ of mandamus where bankruptcy court's finding of adequate protection for superpriority financing was based on assumptions that were part of a plan of reorganization that had yet to be filed and whose terms were undisclosed).

Secured creditors are not investors. They do not share in the profit of their borrowers, nor should they be asked to bear the risk of loss. *In re Mosello*, 195 B.R. 277 (Bankr. S.D.N.Y. 1996) (denying request for superpriority financing). The Bankruptcy Code ensures that existing secured creditors are not treated like investors by requiring debtors to supply adequate protection before using their collateral.

The Corporate Revolver Lenders Are Not Entitled to Additional
Adequate Protection in the Form of a Priming Lien

Wilmington Trust FSB, as Agent for the corporate revolver lenders, has alleged that it suffered a diminution in the value of its collateral of $473,000.00 during the two-week interim period during which the Debtors were permitted to use cash collateral. The corporate revolver

lenders seek "adequate protection" in addition to that which was provided to them under this Court's interim order authorizing use of cash collateral. This request should be denied.

At the October 21, 2009 hearing before the Court on the Debtors' request for interim use of cash collateral, J. William Boone, Esquire consented to the use of cash collateral on behalf of the corporate revolver lenders for the two-week interim period and agreed that, as adequate protection, the corporate revolver lenders would accept a replacement lien to the extent and validity as their pre-petition liens. *See* Excerpt from October 21, 2009 Transcript at pp. 81-84, a copy of which is attached to the Prior Supplemental Objection as Exhibit "B".

The corporate revolver lenders now claim that their collateral suffered a diminution of $473,000.00 during the two-week interim period, and that they should be accorded a priming lien on <u>all</u> of the Debtors' assets in the amount of $473,000.00 as part of the Proposed Final Order.

As an initial matter, the corporate revolver lenders failed to make this request in any motion or other fashion that would afford all parties-in-interest notice of the relief that they request. Granting a replacement lien of $473,000.00 in the Proposed Final Order is outside of the scope of the DIP Motion (or any other motion, for that matter), and it is not properly before the Court.

Second, PNC disputes that the corporate revolver lenders have experienced any diminution in the value of their collateral and demands strict proof thereof. Upon information and belief, the value of the corporate revolver lenders' collateral has increased above the level enjoyed on the Petition Date. Adequate protection ensures that a secured creditor's security is available for application to its debt upon completion of reorganization. *United Savings Assoc. of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 108 S.Ct. 626, 630 (1988). It is not a vehicle for improvement in position.

Finally, the corporate revolver lenders are estopped from seeking additional relief by virtue of the consent of Mr. Boone to the use of cash collateral during the two-week interim period on the condition that the Debtors provide a replacement lien to the extent that the corporate revolver lenders had a lien pre-petition. The corporate revolver lenders do not have a lien on all of the Debtors' property, and they should not be granted a lien on all of the Debtors' assets on account of prior use of cash collateral.

PNC also contests the allegation that cash collateral was used at the project level during the two-week interim period. The evidence on October 21, 2009 showed that there was to be no use of cash collateral at the project level. *See* Excerpt of October 21, 2009, Transcript at pp. 60-67, a copy of which is attached to the Prior Supplemental Objection as Exhibit "C". The "non-use" of cash collateral at the project level was confirmed by counsel for the Debtors, Vincent Slusher, Esquire at the hearing before the Court on October 30, 2009. *See* Excerpt of October 30, 2009, Transcript at pp. 63-64, a copy of which is attached to the Prior Supplemental Objection as Exhibit "D". Furthermore, there has been no showing that any part of the purported loss was the result of use of cash collateral at the campuses that are in bankruptcy.

Inclusion of a $473,000.00 lien on all of the Debtors' assets in favor of the corporate revolver lenders in the Proposed Final Order is not sustainable as a matter of law.

Provisions Relating to the NFP and NSC Are Outside of the Scope of the DIP Motion and are Not Supportable as a Matter of Law

The Proposed Final Order includes paragraphs granting the NFPs relief outside of the scope of that requested in the Debtors' DIP Motion. Specifically, the Proposed Final Order states that "The NFPs and Debtors are authorized and directed to maintain a flow of funds with respect to the Community Loan and the Working Capital Loan consistent with past practice, and subject to all Orders of this Court, including orders relating to escrowing initial entrance deposits." Proposed Final Order at ¶¶. 6(c). However, the claims under the Community Loan

documents are not held by the NFPs. Those claims are held by PNC.[3] The continued setoff of the Community Loan and Master Lease obligations appear to be in violation of the automatic stay and § 553 of the Bankruptcy Code. Among other things, the Community Loan obligations and the Master Lease obligations are not "mutual" as required for a setoff under § 553, and no motion for relief from the automatic stay has been filed to exercise such right. All rights must be reserved with regard to the "flow of funds" and rights under the Community Loan documents.

In addition, without notice to any parties-in-interest, without moving for such relief in a motion, and without any support under the Bankruptcy Code or case law, the National Senior Campuses, Inc. ("NSC") and the NSC/NFPs "persuaded" the Debtors to agree to pay $300,000.00 per month "to the NSC-NFPs to partially defray the post-petition fees and costs incurred by the NSC-NFPs, for professional services related to the Borrowers' reorganization efforts." Proposed Final Order at ¶ 6. The NSC-NFPs have demanded that their attorneys would be paid in advance and without application or review by the Court.

As a threshold matter, PNC is entitled to any funds received by the NSC-NFPs from the Debtors by virtue of the subordination agreements executed by the NSC-NFPs. Moreover, there is no provision in the Bankruptcy Code or case law that would authorize such relief. The NSC-NFPs are not debtors under the Bankruptcy Code. The Bankruptcy Code does not contemplate payment of professionals other than those engaged by debtors, appointed committees or other court-appointed officers except in the rare cases in which creditors have made a substantial contribution and have incurred attorneys' fees in doing so. *See* 11 U.S.C. § 503(b)(3).

However, relief under § 503(b)(3) is highly fact-specific. In order to recover under this section, the creditor's efforts must have resulted in "actual and demonstrable benefit" to the

[3] PNC has possession of the original promissory notes executed in connection to the Community Loans for Houston, Ashburn, Concord and Kansas. The Community Loan promissory note for the Novi facility was to be executed as a post-closing item, but was nevertheless unequivocally assigned to PNC and PNC is investigating the location of the instrument.

bankruptcy estate. *See In re Speeds Billiards & Games, Inc.*, 149 B.R. 434, 437 (Bankr. E.D. Tex. 1993). The benefit must be "tangible." *In re Buttes & Oil Co.*, 112 B.R. 191, 194, 195 (Bankr. S.D. Tex. 1989) (denying application for substantial contribution and stating that it "is axiomatic that legal services provided fully for the benefit of a creditor or client are not compensable from the bankruptcy estate.") *See also In re BP Partners Ltd. Partnership*, 106 F.3d 667, 672-75 (5th Cir. 1997). The benefit cannot be merely incidental, where the debtor also benefits from actions that the claimant takes in furtherance of its own interests. *See Lebron v. Mechem Fin. Inc.*, 27 F.3d 937, 944 (3d Cir. 1994). Nor may such activities be those that would have been undertaken absent an expectation of reimbursement from the estate. *See id.* Rather, the activities must "transcend" self protection. *See id.*

United States Bankruptcy Judge Leif Clark thoughtfully analyzed the substantial contribution standard in the case *In re American Plumbing & Mechanical, Inc.*, 327 B.R. 273 (Bankr. W.D.Tex. 2005). Judge Clark held that the substantial contribution inquiry was a factual one, and that the substantial contribution statute should be narrowly construed and applied only in unusual or rare cases. The applicant must show by a preponderance of the evidence that a substantial contribution was rendered. *Id.* at 279. The applicant must also show that its services had a causal relationship to the alleged substantial contribution. *Id.* at 280. Judge Clark discussed the Fifth Circuit's base-line cost-benefit test and observed that no substantial contribution is made when the cost exceeds the benefit or when the cost involves duplication of time and effort. *Id*. at 281-282. While the benefit need not be reduced to monetary terms, Judge Clark held that "expected or routine activities in a Chapter 11 case do not constitute substantial contribution." *Id*. at 283. Such expected and routine activities that do not confer a substantial contribution include "reviewing documents and attending hearings, negotiating reductions in fee applications, reviewing the debtor's financial status, proposing agreeable terms through

negotiations, and commenting on the disclosure statement and plan of reorganization." *Id*. at 283.

The determination of substantial contribution, being an intensively factual determination, cannot be made in advance. It is premature to award any attorneys' fee to NSC-NFPs, particularly without application or notice to creditors. It is also premature to award fees before the case has sufficiently developed to enable the Court and the parties to determine that there has been any benefit conferred by the NSC-NFPs' attorneys. Nor should any fee be paid without application to the Court so the parties may determine whether the fees are reasonable. The United States Court of Appeals for the Fifth Circuit has ruled that an award of substantial contribution to pay attorneys' fees requires an evaluation of the reasonableness of the fees under the standard articulated in *Johnson v. Georgia Highway Express*, 488 F.2d 714 (5th Cir. 1974). *BP Partners,* 106 F.3d at 674. Under the controlling law of this Circuit, the prospective award of attorneys' fees to the NSC-NFPs is unfounded and should not be a part of the Proposed Final Order.[4]

The Court Should Not Protect Non-Debtors in the Final Order

The Proposed Final Order provides that "all persons or entities, including, without limitation, the Prepetition Secured Lenders shall (i) be prohibited from taking any action to foreclose upon or recover in connection with any lien granted thereto pursuant to the Prepetition Secured Loans or any other lien or security interest or Final Order". Proposed Final Order a ¶¶. 7(b).

[4] Additionally, the consistent testimony in this case has reflected that all of the Debtors' assets are subject to the liens of secured creditors. In order for the NSC-NFPs to receive the proposed payment out of the secured creditors' collateral, even if the NSC-NFPs are able to show that they have benefited the Debtors' estates (as Bankruptcy Code § 503(b)(3) would require for the NSC-NFP's to recover an administrative claim), they would still need the Debtors to make the additional showing, pursuant to Bankruptcy Code § 506(c) that the NSC-NFP's attorneys' fees and costs were incurred as "the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim[.]" The Debtors have filed no surcharge motion pursuant to Bankruptcy Code § 506(c) – even if the requisite showing were potentially possible, the proposed relief could not be granted on the DIP Motion.

Protection of non-debtor entities and property does not fall within the scope of the DIP Motion, and is, indeed, outside of the relief that may be granted under the Bankruptcy Code absent a specific request to extend the automatic stay pursuant to Section 105 of the Bankruptcy Code. No requests to extend the automatic stay have been made. Paragraph 7(b) of the Final Order should be limited to the exercise of rights against the Debtors and their property.

CONCLUSION

The proposed DIP financing should not be approved.

WHEREFORE, PNC respectfully requests that the Court enter an Order (i) denying the Motion, and (ii) granting PNC such other and further relief as may be just and proper.

Dated: December 7, 2009

By: */s/ Daniel I. Morenoff*

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ATTORNEYS FOR PNC BANK,
NATIONAL ASSOCIATION

CERTIFICATE OF SERVICE

I hereby certify that on December 7, 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*
Daniel I. Morenoff