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COUNSEL TO THE MICHIGAN RETIREMENT SYSTEM ENTITIES

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

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

OBJECTION OF THE MICHIGAN RETIREMENT SYSTEM ENTITIES TO THE MOTION FOR ORDER PURSUANT TO RULE 9019(a) OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE APPROVING AND AUTHORIZING THE DEBTORS TO ENTER INTO A PROPOSED SETTLEMENT WITH THE HCP ENTITIES

Strategic Ashby Ponds Lender LLC ("Ashby Ponds Lender") and Strategic Concord Landholder, LP ("Concord Landholder" and together with Ashby Ponds Lender, the "Michigan Retirement System Entities"), respectfully submit this Objection to the Motion for Order Pursuant to Rule 9019(a) of the Federal Rules of Bankruptcy Procedure Approving and

[1] The debtors in these Chapter 11 Cases are Erickson Retirement Communities, LLC ("ERC"), Ashburn Campus, LLC (the "Ashburn Debtor"), Columbus Campus, LLC, Concord Campus GP, LLC, Concord Campus, LP (the "Concord Debtor"), 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, Warminster Campus, LP (collectively, the "Debtors").

Authorizing the Debtors to Enter into a Proposed Settlement with the HCP Entities (the "HCP 9019") and in support thereof will show the Court the following:

BACKGROUND

Chapter 11 Cases

1. On October 19, 2009 (the "Petition Date"), the Debtors commenced these cases by each filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code.

2. The Debtors remain in possession of their assets and continue to operate and manage their businesses as debtors in possession pursuant to Bankruptcy Code sections 1107 and 1108.

3. On November 2, 2009, the Office of the United States Trustee (the "U.S. Trustee") appointed an Official Committee of Unsecured Creditors (the "Committee") in these cases [Docket No. 258]. No trustee or examiner has been appointed, although a motion brought by Michigan Retirement System Entities (and others) for the appointment of an examiner is currently pending before the Court.

4. On November 25, 2009, the Debtors filed their schedules (the "Schedules") and statements of financial affairs (the "SOFAs") [Docket Nos. 383-413].

Sale and Plan Process

5. On October 22, 2009, the Debtors filed their 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 [Docket No. 81] (the "Sale Motion"). Pursuant to the Sale Motion, the Debtors requested that the Court approve bidding procedures, bidding protections, a breakup fee, and the sale of the Assets.

6. On November 6, 2009, the Court entered an order approving the bidding procedures, breakup fee, and other bidding protections (the "Bidding Procedures Order") [Docket No. 272]. Pursuant to the Bidding Procedures Order, the Court set the deadline for submitting qualified bids for December 14, 2009 and scheduled an auction for December 22, 2009 (the "Auction").

7. On November 13, 2009, the Debtors filed their plan of reorganization (as subsequently amended, the "Plan") and related disclosure statement (as subsequently amended, the "Disclosure Statement") [Docket Nos. 293 and 292, respectively]. Pursuant to the Plan, the Debtors contemplated the sale of substantially all of their assets to Redwood-ERC Senior Living Holdings, LLC, Redwood-ERC Management, LLC, Redwood-ERC Development, LLC, Redwood-ERC Properties, LLC and Redwood-ERC Kansas, LLC (collectively, "Redwood") or to such other higher or better bidder determined by the Auction.

8. On December 22, 2009 and December 23, 2009, the Auction of the Debtors' assets was held.

9. Ultimately Redwood was determined to be the successful bidder at the Auction. Redwood's final bid price was $365 million, all cash. The sale of the Debtors' assets will be consummated pursuant to the terms of the Debtors' Plan. Significantly, the sale to Redwood contemplates that the Debtors assets will be sold to Redwood on a bulk basis, even though such assets are individually owned by various Debtors. Accordingly, the Court will ultimately have to determine the appropriate allocation of the sales proceeds among the various Debtors as part of the confirmation process.

10. On December 30, 2009, the Debtors filed their First Amended Plan and Disclosure Statement, which seeks to implement the transaction that is the product of the Auction [Docket Nos. 604 and 605]. That First Amended Plan clearly states, "It is anticipated that the allocation of the Transaction Proceeds will be a significant issue for the Bankruptcy Court to determine. The Debtors expect that various parties in interest will advance arguments to establish their entitlement to all or a portion of the Transaction Proceeds." See p. 33 of First Amended Plan [Docket No. 607]. The Disclosure Statement further provided "To the extent any creditor objects to the allocation provided herein, the Bankruptcy Court will determine such dispute." See Disclosure Statement for First Amended Plan at page 60 of 160 [Docket Number 604].

11. Subsequently, on February 16, 2010, the Debtors filed their Second Amended Plan and Disclosure Statement, which made various amendments to the treatment of various creditors, including providing for treatment with respect to the HCP claims.

Rule 2004 Motion

12. On December 10, 2009, the HCP Entities filed the Expedited Motion for Order Authorizing Examination of the Debtor Under Bankruptcy Rule 2004 [Docket No. 505] (the "2004 Motion") seeking to examine the Debtors in order to determine whether there are undisclosed agreements or understandings between the Debtors and the not-for-profit entities which are the borrowers under the senior community loans, or between the Debtors and Redwood.

13. On December 21, 2009, the Court granted the 2004 Motion [Docket No. 552].

The Examiner Motion

14. The Michigan Retirement Entities and certain other parties including the HCP Entities filed the Joint Motion for Order Appointing Examiner Pursuant to 11 U.S.C. § 1104 [Docket No. 520] (the "Examiner Motion").

15. On January 6, 2010, the Debtors filed their objection to the Examiner Motion [Docket No. 631].

16. The hearing regarding the Examiner Motion was held on February 5, 2010 [Docket No. 711][2].

Adversary Proceedings

17. On December 21, 2009, Novi, Warminster, and Houston initiated the following adversary proceedings (the "Adversary Proceedings") against the HCP Entities in which they sought a declaratory judgment that the Financing Transactions were financings and not leases:

- Novi Campus, LLC and Erickson Retirement Communities, LLC v. HCP ER2, LP (f/k/a CNL Retirement ER2, LP), Adv. Pro. No. 09-03467;
- Warminster Campus, LP, Warminster Campus GP, LLC, and Erickson Retirement Communities, LLC, v. HCP ER3, LP (f/k/a CNL Retirement ER3, LP), Adv. Pro. No. 09-03469; and
- Houston Campus, LP, Senior Campus Services, LLC, and Erickson Retirement Communities, LLC. v. HCP ER6, LP (f/k/a CNL Retirement ER6, LP), Adv. Pro. No. 09-03468.

18. The Debtors contend in the adversary proceedings that the HCP Entities entered into certain sale/leaseback transactions (collectively, the "Financing Transactions") with Debtors Novi Campus, LLC ("Novi"), Warminster Campus, LP ("Warminster"), and Houston Campus,

[2] HCP withdrew as a movant under the Examiner Motion at such hearing.

LP ("Houston"). Specifically, the Financing Transactions consisted of the following: (i) on March 30, 2004, Novi entered into certain amended and restated agreements styled as a purchase agreement and ground lease with CNL Retirement ER2, LP, now known as HCP ER2, LP; (ii) on June 2, 2003, Warminster entered into certain agreements styled as a purchase agreement and ground lease with CNL Retirement ER3, LP, now known as HCP ER3, LP; and (iii) on November 18, 2004, Houston entered into certain agreements styled as a purchase agreement and ground lease with CNL Retirement ER6, LP, now known as HCP ER6, LP.

HCP Entities' Claims Against the Certain of the Debtors

19. On January 13, 2010, the HCP Entities filed proofs of claim in the Debtors' cases that arise from the Financing Transactions (the "Claims"). Specifically, HCP ER2, LP filed a claim against Novi in the amount of $17,000,000 [Claim Nos. 446, 456]; HCP ER3, LP filed a claim against Warminster in the amount of $19,500,000 [Claim Nos. 447, 458]; and HCP ER6, LP filed a claim against Houston in the amount of $23,000,000 [Claim Nos. 448, 455].

The Proposed Settlement with the HCP Entities

20. On or about February 4, 2010, the Debtors filed their Motion to Approve the HCP 9019. Pursuant to the proposed settlement agreement, the Debtors and the HCP Entities propose to resolve a variety of matters. One of the key terms of the proposed settlement is the provision that the HCP Entities will receive "an allocation of $8.2 million in cash from the Debtors which shall be allocated to repayment of the Warminster obligations owed to the HCP Entities." See HCP 9019 Motion at ¶ 22 [docket number 791].

21. Another key term is that the Settlement Agreement is explicitly subject to confirmation of a plan of reorganization which incorporates its terms. See HCP 9019 Motion at ¶ 23 [docket number 791].

OBJECTION

22. As the Court is well aware, the Debtors in these jointly administered cases each own separate estates. The Debtors' Plan of Reorganization, in its various forms, has never contemplated that the various estates will be substantively consolidated. Accordingly, it is important that the integrity of each estates assets be preserved.

23. In the proposed settlement with the HCP Entities, however, the "Debtors" [as defined in the Motion to include ERC, as well as other debtor entities] are obligated to pay $8.2 million to HCP, which amount is allocated solely to the Warminster obligations owed to the HCP Entities. Accordingly, the Michigan Retirement System Entities object to the HCP 9019 Motion because of the ambiguity of the source of this payment and, without additional information it may be completely inappropriate for the assets of one debtor to be used to pay the debts associated with another debtor.

24. Secondly, the Michigan Retirement System Entities are concerned that in the HCP 9019, the Debtors may surreptitiously be seeking to determine an allocation of a portion of the sales proceeds from the Redwood transaction on a piecemeal basis because the language in the HCP 9019 Motion says the HCP Entities "will receive an allocation of $8.2 million in cash from the Debtors which will be allocated to repayment of the Warminster obligations. . .."

25. The proper allocation of the sales proceeds is the central issue in these cases and will need to be addressed comprehensively as part of the plan confirmation process. Accordingly, the Michigan Retirement System Entities object to the Motion on the basis that any issues regarding the allocation of the sales proceeds can only be considered on a global basis in connection with confirmation of a plan of reorganization.

26. The proper and fair allocation of the sale proceeds from the proposed restructuring transactions (as defined in the Debtors' Plan, the "Restructuring Transactions") to

each individual estate is the most fundamental unresolved issue in these cases. That determination can only be made after the Court has a full and complete opportunity to consider all of the evidence regarding the proposed transaction, which is currently set to be considered in connection with confirmation of the Debtors' Plan of Reorganization. Significantly, the HCP 9019 Motion is also subject to confirmation of the Debtors' Plan. Accordingly, the Michigan Retirement System Entities respectfully request that the Court defer consideration of any issue involving allocation of any sales proceeds until confirmation and hereby objects to the HCP 9019 to the extent it seeks a determination of any issues regarding allocation of sales proceeds in advance of confirmation.

27. In addition, the Michigan Retirement System Entities object to the HCP 9109 Motion to the extent the Debtors seek approval of any allocation to the HCP Entities based on the Debtors' business judgment. The law requires that this Court independently make findings of fact on the allocation of sale proceeds in order to preserve the integrity of the separate estates. *See Mission Iowa Wind Co., et al., v. Enron Corp. (In re Enron)*, 291 B.R. 39, 43 (S.D.N.Y. 2003) (reversing a sale order because the bankruptcy court did not make an independent and objective allocation of sale proceeds). Such undertaking is particularly vital where there is a risk that a subjective allocation may have been designed and proffered to favor one group of debtors and their creditors at the expense of others. *Id.*

28. On this fundamental question, it is "incumbent on the Bankruptcy Court . . . not to defer in conclusory fashion to the debtors' business judgment but to consider on the merits whether the price allocated to [certain assets is] a fair reflection of those assets' relative value and to make findings of fact on that question." *In re Enron*, 291 B.R. at 43. On an appeal of an order allocating sale proceeds, the *Mission Iowa* district court vacated the bankruptcy court's

allocation order. *Id.*[3] Although the bankruptcy court had found the total consideration paid was fair and reasonable, it avoided a detailed analysis and findings on the allocation of sale proceeds, and instead deferred to the debtor's and buyer's business judgment. *Id.* The district court held that the bankruptcy court should have made an *independent* determination of whether the allocation was fair and reasonable, and that such scrutiny was particularly appropriate there because of the parent-debtor's potential interest in allocating the purchase price in its own favor. *Id.* The need for the court "to preserve the integrity of separate estates" required that there be a "full scrutiny" of the allocation. *Id.*

29. Accordingly, because the HCP 9019 Motion may be seeking, in part, in effect a pre-determination regarding the allocation of the sale proceeds under the Debtors' Plan, this aspect of its approval must be properly deferred until the issues of the allocation are properly presented to the Court in connection with the confirmation process. Because the approval is contingent on the confirmation of such plan, no party is in any way prejudiced by such deferral.

For all of these reasons, the Michigan Retirement System Entities respectfully request that the Court either (i) deny approval of the HCP 9019 Motion or (ii) postpone consideration of the HCP 9019 Motion until the Court rules on the allocation issue more globally in connection with the confirmation of the Debtors' Plan and (iii) grant the Michigan Retirement System Entities all other relief that is just and proper.

[*signature page follows*]

[3] The court also separately held that although the validity of the sale itself was insulated from review under the doctrine of equitable mootness, the allocation issues were not. *Mission Iowa,* 291 B.R. at 41.

Dated: February 24, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned certifies that on this, the 24th day of February, 2010, a true and correct copy of this Objection was served by email through the Bankruptcy Court's Electronic Case Filing System on those parties that have consented to such service and on all parties listed on the service list filed on February 12, 2010 [Docket No. 814].

/s/ *Artoush Varshosaz*
One of Counsel