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

IN RE	§	**IN PROCEEDINGS UNDER**
	§	
	§	**Case No. 00-33682-BJH-11**
FUTURES EQUITY L.L.C., et al.,	§	**Case No. 00-34825-BJH-11**
	§	**Case No. 00-34826-BJH-11**
	§	
Debtors.	§	**Jointly Administered Under**
	§	**Case No. 00-33682-BJH-11**

MEMORANDUM OPINION

The following motions[1] were heard by the Court commencing on September 20, 2000 and concluding on January 24, 2001: (i) the Debtors' Motion to Incur Secured Debt Pursuant to 11 U.S.C. § 364(d) (the "Loan Motion") filed by Futures Equity, LLC ("Futures Equity"), Scotland Healthcare Realty, Ltd. ("Scotland") and York Healthcare Realty, Ltd. ("York") (Scotland and York are hereinafter referred to collectively as the "Debtors"); and (ii) the Motions for Relief From Automatic Stay (the "Stay Motions") and the Motions to Dismiss or Convert (the "Dismissal Motions") filed by Comerica Bank – Texas ("Comerica") with respect to Scotland and York. The Debtors and Comerica submitted proposed findings of fact and conclusions of law on March 9, 2001.

After considering the extensive record made in connection with the Motions, and the briefs and proposed findings of fact and conclusions of law submitted by the parties, the Court issues this Memorandum Opinion which shall constitute the Court's findings of fact and

[1]The Loan Motion, the Stay Motions and the Dismissal Motions are collectively referred to as the "Motions."

conclusions of law. The Court has jurisdiction over each of the Motions under 28 U.S.C. §§ 1334 and 157. Each of the Motions is a core proceeding under 28 U.S.C. § 157(b)(2).

I. Contentions of the Parties

Comerica requests relief from the automatic stay under 11 U.S.C. §§ 362(d)(1) and (d)(2). Comerica asserts that the Debtors' efforts to modify a plan confirmed in the Debtors' prior bankruptcy cases are barred by *res judicata* and 11 U.S.C. § 1127, and that cause exists to modify the automatic stay. Comerica asserts that the Debtors have no recognizable equity in their respective nursing home facilities and have not demonstrated an ability to reorganize. Alternatively, Comerica seeks conversion or dismissal of these cases.

The Debtors oppose the Stay Motions and the Dismissal Motions. Moreover, in the Loan Motion the Debtors request approval of a $1.59 million post-petition loan secured by a senior lien (to Comerica's existing lien) on the nursing home facilities.

II. The Underlying Facts

Scotland owns real property located in De Soto, Texas and the buildings, fixtures and improvements thereon comprising a nursing home and related healthcare facilities (the "<u>Scotland Facility</u>"). York owns separate real property located in De Soto, Texas and the buildings, improvements and fixtures thereon comprising a nursing home and related healthcare facilities (the "<u>York Facility</u>"). **T1:24, L1-15**.[2] The Scotland Facility and the York Facility are collectively referred to herein as the "<u>Facilities</u>."

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[2]Citations to hearing transcripts are made as follows: First, the transcript number (*i.e.*, T1:); then page number of the transcript; then line number (L __). T1, T2, T3, and T4 mean the transcripts for the respective hearing dates of September 20, 2000, November 8, 2000, November 16, 2000, and January 24, 2001.

Williamsburg Village Healthcare Management, LLC ("Williamsburg") leases the Facilities under lease agreements (the "Lease Agreements") with the Debtors. Williamsburg holds the license necessary to operate the Facilities as skilled nursing homes. Williamsburg operates the Facilities for its own account, incurs the expenses and collects the revenue, and is required to make lease payments to the Debtors. **T1:24, L20 through T1:26, L8**. Williamsburg is not making the required lease payments to the Debtors. **T1:48, L3-9.**

Futures Equity is the general partner of Scotland and York. **T1:23, L10-14**. Williamsburg, Futures Equity, Scotland and York are controlled by Gary Sibley ("Sibley") and his family. **T1:23, L15 through T1:25, L12.** Sibley is ultimately responsible for the decisions regarding Williamsburg and the Facilities. **T1:24, L24 through T1:25, L2**. Sibley's experience in operating a nursing home has been gained through his involvement with the Facilities since they opened in 1998. **T1:26, L10-20**.

Comerica made a loan to Scotland and a separate loan to York to construct the Facilities in 1996. **T1:26, L21 through T1:27, L11.** The original Scotland and York loans are evidenced by various agreements and instruments, including two Promissory Notes ("1996 Notes") and two Deeds of Trust granting a lien against, among other things, the Facilities, certain real property owned by Futures Equity and all accounts and revenue of the Facilities. The Scotland and York loans were guaranteed by Williamsburg, Futures Equity and others. **Comerica Exhibits 17-27, 55; T1:22, L2-16.**

A. The Prior Bankruptcy Cases.

On December 14, 1998, the Debtors each filed voluntary petitions in this Court for relief under Chapter 11 of the Bankruptcy Code (the "Prior Bankruptcy Cases"). **T1:30, L15-18**. On

May 20, 1999, the Debtors filed their "Debtors' Consolidated Plan of Reorganization" (the "Prior Plan"). **Comerica Exhibit 90.** On May 20, 1999, the Debtors also filed a "Consolidated Disclosure Statement" regarding the Prior Plan (the "Disclosure Statement"). **Comerica Exhibit 91.** On or about June 18, 1999, this Court entered an Order (the "Confirmation Order") confirming the Prior Plan. **Comerica Exhibit 92.** Sibley testified on behalf of the Debtors at the confirmation hearing. **Transcript of Confirmation Hearing** filed of record in these cases on January 31, 2001 (the "Confirmation Transcript"). The Confirmation Order also approved, on a final basis, the Disclosure Statement that had been approved conditionally before votes were solicited on the Prior Plan. **Confirmation Order at ¶G.**

The Debtors asserted claims against Comerica in an adversary proceeding filed in this Court during the Prior Bankruptcy Cases. Comerica denied those claims. After negotiation, Comerica and the Debtors settled those claims as part of the Prior Plan. **Disclosure Statement at pp. 19, 20.**

1. The Business Model for the Facilities Under the Prior Plan.

The Scotland Facility has always been, since construction, a skilled nursing facility – *i.e.*, one that provides skilled nursing care to its residents. **Disclosure Statement at p. 6**, **¶A**. Initially, the York Facility was to operate entirely as an assisted living facility that would not provide nursing care. **T1:27, L18-24.**

By the time of confirmation of the Prior Plan, the Debtors believed that the assisted living market had become highly competitive and that an opportunity existed in the market to serve assisted care, Alzheimer's and skilled nursing residents. **Disclosure Statement at p. 8; T2:140, L13-25; T1:29, L15 through T1:30, L5.** The Debtors' proposed business model under the Prior

Plan was to convert the York Facility from an entirely assisted living facility into a facility that served assisted living residents and, in "care units" within a wing, provided assisted care or nursing care, such as Alzheimer's related care. **Disclosure Statement at p. 8; T2:140, L13-25; T1:29, L15 through T1:30, L5; T1:132, L17-25; T4:189, L20 through T4:190, L6.**

At the time of confirmation of the Prior Plan, the Debtors asserted a need for: (i) an extension of Comerica's existing loans to permit the census at the Facilities to increase and stabilize, and (ii) a need for new loans and working capital to complete the contemplated partial conversion of the York Facility, to pay off critical trade creditors, and to pay interest on Comerica's loans. **T1:32, L20 through T1:33, L18.** Under the Prior Plan, the stated maturity of the 1996 Notes was extended to June 30, 2001. Comerica also agreed to make two additional loans of up to $1,625,000 and up to $70,000 to York, Scotland, Williamsburg and Futures Equity for various purposes. **T1:34, L1 through T1:38, L1-14; Prior Plan at ¶3.2.1 through 3.2.19.**

The Debtors believed that their new business model, along with the new loans and concessions from Comerica, would allow the Facilities "to operate in the most efficient and profitable fashion possible." **Disclosure Statement at p. 19, ¶ 4**. Attached to the Disclosure Statement are projections of income and expense for each of the Facilities ("<u>1999 Plan Projections</u>") prepared by Sibley and the Debtors. **T1:32, L10-12; Disclosure Statement at pp. 3, 9, 48 (projections for Scotland) and 66 (projections for York).** The Debtors stated:

> The restructure of the Comerica obligations and the new loans contemplated by the Plan will allow the Debtors to satisfy their obligations under the Plan when coupled with the cash flow from future operations….

Disclosure Statement at p. 25, ¶A.

The Prior Plan was substantially consummated in accordance with its terms. At a closing held on June 30, 1999, Comerica made the new loans contemplated by the Prior Plan and those loan proceeds were used to pay closing costs and the Debtors' legal fees, to make payments to Comerica, and to make payments to unsecured creditors. One hundred twenty-five thousand dollars ($125,000) of the proceeds of the new loans were allocated to pay for the cost of converting the York Facility as requested by the Debtors. **T1:34 through T1:38**; **Prior Plan (Exhibits B, C, D and E)**. The Debtors have not alleged any default by Comerica under the Prior Plan.[3]

To consummate the Prior Plan, Comerica, Scotland, York, Williamsburg, Futures and others executed various documents, including two new promissory notes and two amended and restated promissory notes (collectively, the "Comerica Notes") and new and amended deeds of trust, and various security and pledge agreements (collectively, the "Comerica Plan Documents"). **T1:33, L19-25; Comerica Exhibits 28-45, 49, 52-54; Prior Plan at ¶3.2.4.** The Comerica Notes include an Amended and Restated Promissory Note executed by York in the stated principal amount of $4,848,000.00; an Amended and Restated Promissory Note executed by Scotland in the stated principal amount of $4,852,000.00; and two Promissory Notes executed by Scotland, York, Futures Equity, and Williamsburg in the respective stated principal amounts of $1,625,000.00 and $70,000.00. The stated maturity of the Comerica Notes is June 30, 2001. **Comerica Exhibits 31-34.** Comerica is the owner and holder of the Comerica Notes. **T3:191, L6-24.** The Debtors and

[3]The Debtors do complain of a delay in planting trees at the Facilities (which led to delays in obtaining the required permits to begin the York conversion) because Comerica was unwilling to fund the Prior Plan early. However, Comerica had no obligation to fund the Prior Plan until after confirmation of that plan.

others executed a release of all claims against Comerica that arose prior to and including June 30, 1999. **T1:38, L15-20; Comerica Exhibit 41.**

The obligations under each of the Comerica Notes and the Comerica Plan Documents are secured by, among other things, a perfected lien against the Facilities and all accounts and revenue generated by operation of the Facilities. **Comerica Exhibits 19, 20, 23-25, 28-30, 35-37, 40- 54; Prior Plan at 3.2.21**; **Schedule D of the Bankruptcy Schedules of Scotland and York; Comerica Proofs of Claim.**

2. Subsequent Defaults and Loan Balances.

Monthly payments of unpaid accrued interest are due and payable under the Comerica Notes. **Comerica Exhibits 31-34**. Beginning in December 1999, the borrowers failed to make the required monthly interest payments to Comerica under the Comerica Notes. **T1:41, L8-17**. A monetary default occurred under the Comerica Notes and the Comerica Plan Documents. **T3:193, L19 through T3:194, L19; Comerica Exhibit 117-A.** Comerica accelerated the maturity of each of the Comerica Notes. **T3:193, L19 through T3:194, L19; Comerica Exhibit 117-A.**

In June 2000, the Facilities were posted for a July 2000 foreclosure that was passed due to a forbearance agreement. In July 2000, the Facilities were posted for an August 2000 foreclosure. **T3:114, L23 through T3:115, L12.** On July 31, 2000, Scotland and York sought bankruptcy relief in this Court under Chapter 11 for a second time.

Scotland's schedules reflect four unsecured claims of $98,575 and York's schedules reflect twelve unsecured claims of $140,111, excluding a loan guarantee claim of Bank of the Southwest (a claim secured by property of Futures Equity with an alleged value in excess of the claim). Other than an $8,959 claim of American Express (Scotland), those unsecured creditors were treated in the Prior Plan. **Prior Plan at Exhibit C**.

The net cash flow from the Facilities has been used to pay past due trade payables of Williamsburg and accrued federal income tax liability, instead of paying Comerica. **T1:45, L13-21.** Since January 1, 2000, Comerica has received two cash payments to apply to the Comerica Notes: (i) approximately $185,000 (proceeds of a pledged letter of credit) that was applied to accrued interest in March 2000; and (ii) 20,000 in connection with the forbearance arrangement in July 2000. **T3:235, L23 through T3:236, L9; T3:237, L7-13.**

After applying a stipulated credit bid of $1,107,500 for the foreclosure of certain real property owned by Futures Equity, as of November 16, 2000, Comerica calculates the amounts owing to it under the Comerica Notes as follows:

COM. EXH. #	PRINCIPAL	UNPAID ACCRUED INTEREST	TOTAL	INTEREST PER DIEM
33	$4,479,312.71	$280,318.05	$4,759,630.76	$1,306.47
34	$4,556,961.70	$284,072.50	$4,841,034.20	$1,329.11
32	$70,000.00	$7,699.03	$77,699.03	$20.42
31	$1,625,000.00	$133,057.24	$1,758,057.24	$473.96
	$10,731,274.41	$705,146.82	$11,436,421.23	$3,129.96

Comerica Exhibit 160; T3:192 through 193; T3:234, L21 through T3:235, L15; Comerica Proofs of Claim. The amounts due include post-petition interest from July 31, 2000, to November 16, 2000, of $355,412.70 at the non-default contract rate. As calculated by Comerica, the per diem interest on the Comerica Notes is $3,129.96 (at the non-default contract rate). *Id*. Comerica also claims attorney's fees and expenses of approximately $257,080.68 as of

November 2000, including over $165,000 of fees and expenses incurred and allowed as part of the Prior Plan. **Comerica Exhibit 168; T1:123, L10-21**.

III. The Motions

While there are many issues raised by the Motions, the appropriate starting point is the Loan Motion. If the Loan Motion cannot be approved, the Debtors concede that they cannot successfully reorganize.[4]

A. The Loan Motion.

The Loan Motion seeks approval of a $1.59 million post-petition loan (the "JDI Loan") from an entity called JDI Loans, LLC ("JDI"). As proposed, the JDI Loan will be secured, pursuant to 11 U.S.C. § 364(d), by a lien against the Facilities senior to the lien of Comerica. The JDI Loan matures in one year, with a possible six month extension, and bears interest at 15% per annum. **T1:101, L17-19; Comerica Exhibit 147.** The JDI Loan can only be repaid if the Debtors are able to obtain a new HUD loan. **T1:101, L11 through T1:102, L15**.

A debtor may borrow money post-petition under § 364(d)(4) of the Bankruptcy Code if the debtor meets its burden of establishing that the holder of the lien to be subordinated is adequately protected. 11 U.S.C. § 364(d)(2); *In re Swedeland Development Group, Inc.*, 16 F.3d 552, 564 (3rd Cir. 1994). The debtor also has the burden of demonstrating that: (i) the credit transaction is necessary to preserve the estate, and (ii) the terms of the transaction are fair and

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[4]According to the Debtors, the proceeds of the loan are necessary to complete the York room conversion – which is necessary for York to reach "stabilized" occupancy – which, in turn, is necessary for the Debtors to achieve the financial performance required before the Debtors can qualify for a HUD loan – which, in turn, will fund the take out of JDI and Comerica under the Debtors' reorganization plan in these cases. *See infra* at pp. 30-34.

reasonable given the circumstances. *In re Crouse Group, Inc.*, 71 B.R. 544, 549 (Bankr. E.D. Pa. 1987).

A transaction that is dependant upon a pre-petition secured creditor having adequate protection "should provide the pre-petition secured creditor with the same level of protection it would have had if there had not been post-petition superpriority financing." *Swedeland*, 16 F.3d at 564, *In re Mossello*, 195 B.R. 277, 292 (Bankr. S.D. N.Y. 1996) (denying debtor's motion under § 364(d) for a loan to complete a real estate project). If any risk of loss is created, the creditor must be provided some offsetting protection or compensation. *Swedeland,* 16 F.3d at 565, 566; *Mosello,* 195 B. R. at 293. The prospect of a possible sale or new loan is not adequate protection. *Swedeland,* 16 F.3d at 566.

Since superpriority financing displaces a lien relied upon by an existing secured creditor, this Court must be "particularly cautious" when assessing whether the secured creditor's interest is adequately protected. *In re First South Savings Association,* 820 F.2d 700, 710 (5th Cir. 1987). Courts approving § 364(d) loans with priming liens have required, among other things, a detailed objective fiscal analysis demonstrating adequate protection and the ability to repay the superpriority loan. *In re Snowshoe Co, Inc.*, 789 F.2d 1085, 1089 (4th Cir. 1986); *Swedeland,* 16 F.3d at 566 n.17; *Mossello*, 195 B.R. at 292. A creditor is not protected by projections of future success, particularly if those projections are themselves risky or contain speculation about successful future operations. *Swedeland*, 16 F.3d at 565-566; *Mosello*, 195 B.R. at 293. Improvements to the property financed by the post-petition loan are not adequate protection unless the debtor establishes that the improvements add value equal to, or beyond, the amount of the superpriority loan. *Swedeland,* 16 F.3d at 566.

Debtors' Exhibit 42 is the latest version of the JDI Loan. **T4:214, L14 through T4:216, L2**. Only $150,000 of the JDI Loan will be used to improve the Facilities (*i.e.*, York room conversions). The cash to pay interest on the JDI Loan is borrowed from JDI, not generated by cash flow. After a cost of $360,000 paid to JDI in fees or to fund JDI's interest reserve, the Debtors would have access to $1.23 million of loan proceeds and propose to use those proceeds to pay: (i) the York room conversion ($150,000); (ii) their professionals ($250,000); (iii) federal taxes owed by an affiliate, Williamsburg, for which Sibley is personally liable ($300,000) (**T1:93, L25)**; and (iv) certain pre-petition debts of the Debtors ($530,000 – $200,000 for working capital, including to pay Comerica interest under the New Plan (as defined hereinafter), and $330,000 to pay year 2000 property taxes). **T4:215, L9-23; T4 220, L1-23; Debtors' Exhibit 42**.

Thus, as applicable here, a priming lien can only be granted in favor of JDI if Comerica's interests in the Facilities are adequately protected. Because the Debtors have no unencumbered assets, the Debtors contend that their equity in the Facilities adequately protects Comerica's interest in the Facilities. To determine whether this equity cushion adequately protects Comerica's interests, the Court must determine the value of the Facilities and compare that value to Comerica's secured claim under § 506 of the Bankruptcy Code.

1. The Value of the Facilities.

This Court must value the Facilities in light of their actual "disposition or use," either a "replacement cost" standard (fair market value) or a "foreclosure" value standard. *Associates Comm. Corp. v. Rash*, 520 U.S. 953, 962 (1997). In the context of determining whether the

Debtors can reorganize, the Debtors' proposed use is to continue to own the Facilities, operated by Williamsburg as a going concern.[5]

a. The Competing Appraisals.

In June 1999, the Debtors stated in the Disclosure Statement that the Facilities had a combined value of $18.4 million (assuming the Facilities reached stabilized occupancy), based on appraisal reports from September and October 1998. **Disclosure Statement at p. 22; T1:79 through T1:80, L9.** Since then, the value of nursing homes generally has declined. **T3:307, L15-22; T1:79, L18-20.**

Relying on an appraisal by Diane Butler dated August 20, 2000, the Debtors now contend that the combined value of the Facilities has increased since 1998 to a value of $20.4 million today "as is" (241 beds) and will increase further to $29.5 million after the York Facility is converted (by adding 19 beds for a total of 261 beds) and "stabilized" (the "Butler Appraisal") **T1:77, L21-23; Comerica Exhibit 59.**

In the opinion of Stan Phillips, an appraiser retained by Comerica, the "as is/stabilized" value of the Scotland Facility effective July 5, 2000 is $5.7 million. **Comerica Exhibit 56, Introduction p. (vi), Valuation p. 44; T3:24, L13-18**. Phillips' appraisal of the York Facility assumes no assisted living residents and the conversion of 19 rooms into three bed wards, leading to a total of 141 skilled nursing beds for the York Facility (261 for the Facilities in aggregate), all as contemplated by the Debtors' current business plan. **Comerica Exhibit 57, Introduction p.**

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[5]The Debtors' predicted results for their new business model for the Facilities are set forth in projections (the "New Projections"). **Debtors' Exhibit 17; T1:129, L21 through T1:131, L9**. The New Projections were prepared by the same individuals (Sibley and Beardsley) who prepared the 1999 Plan Projections which were not achieved.

(ii), Valuation p. 49. Phillips used an estimated stabilized occupancy date for the York Facility of May 2002, assuming completion of the room conversion by April 2001. **T3:23, L8 through T3:24, L2; Comerica Exhibit 57, Introduction p. 9**. However, the Debtors now project that the room conversion will not occur until after 2001. In Phillips' opinion, the value of the York Facility "as is" as of July 5, 2000, is $6.75 million. This value assumes conversion into 141 beds, but also assumes that the York Facility is in a lease-up mode and has not yet reached stabilized occupancy. **Comerica Exhibit 57, Valuation p. 49.** In Phillips' opinion, the value of the York Facility will be $7.2 million, after stabilization of occupancy. **T3:22, L7 through T3:24, L18.** Comerica Exhibits 56 and 57 are referred to collectively as the "Phillips Appraisals."

Two other sets of appraisals were also introduced at the hearings on the Motions. **Comerica Exhibits 62, 63, 64, & 65**. The $18.4 million "as stabilized" value set forth in the Disclosure Statement for the Prior Plan was apparently obtained from two appraisal reports of Charles Bissell of Lambis Consulting dated September 9, 1998 and October 2, 1998, respectively. Those appraisals valued the Scotland Facility at $9.16 million "as is" (August 20, 1998) and at $9.4 million "upon stabilization" (June 1, 1999) and valued the York Facility at $8.09 million "as is" (August 20, 1998) and at $9.0 million "upon stabilization" (June 1, 1999). **Comerica Exhibit 64, pp.7, 111 & Comerica Exhibit 65, pp. 5, 93.** Comerica had the Bissell appraisals updated in early 1999. According to those updated appraisals, the value of the Scotland Facility "as is" (March 17, 1999) was $7.55 million and the value of the York Facility "as is" (March 17, 1999) was $6.47 million. **Comerica Exhibit 62, p. 5; Comerica Exhibit 63, p. 5**.[6]

The Court has some concerns over both of the current appraisals **–** *i.e.*, the Butler Appraisal relied upon by the Debtors and the Phillips Appraisals relied upon by Comerica. For example, at a time when the nursing home industry is in turmoil, ***see*** **T1:78, L7-9; T3:276, L5 through T1:277, L8**; financing for that industry is not readily available, ***see*** **T2:33, L11-20; T2:52, L19-23**; **T3:276, L5 through T1:277, L8**; the value of nursing homes has generally declined, **T3:307, L15-22; T1:79, L18-20**; and the Debtors have failed to achieve the financial performance for the Facilities projected by them (even as those projections have been revised downward), **T1:41, L20-25; T1:56, L13-16; T1:62, L2-11**; the Butler Appraisal concludes that the Facilities have appreciated in value by over 10% since approval of the Disclosure Statement in the Prior Bankruptcy Cases in mid 1999.[7] On the other hand, the Phillips Appraisals value the Facilities at $12.45 million, just slightly more than what Comerica's claim in these cases will be when this decision issues.[8]

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[6]Another scenario was identified in the updated Bissell appraisals – a "hypothetical prospective value of the going concern upon stabilization based upon borrower's forecasts of occupancy, absorption, income and expenses." This scenario generated a "value" of $8.49 million for the Scotland Facility (as of a projected date of June 1, 1999) and a "value" of $9.74 million for the York Facility (as of a projected date of January 1, 2000).

[7]The Debtors complain that Comerica is acting in "bad faith" here because it had a "secret" update of the Bissell appraisals that formed the basis of the Disclosure Statement's value "as stabilized" of $18.4 million. The updated Bissell appraisals established a lower value for the Facilities "as is" in March 1999 of $14.02 million. Although the Court is unsure what the Debtors' complaint in this regard is, if the complaint is that the Debtors should have been told of this lower value so that the Disclosure Statement could have been modified to reflect that more accurate value, then the Butler Appraisal is even more surprising because the Facilities have appreciated in value by over 40%.

[8]Of course, the significance of this valuation is that Comerica continues to be a fully secured creditor under § 506(a) and (b) of the Bankruptcy Code – but just barely.

On balance, however, and for the reasons discussed in detail below, the Court finds the Phillips Appraisals to be more credible than the Butler Appraisal. Under a replacement cost "fair market value" standard (continued use and ownership by the Debtors), the Court finds that the current value of the Facilities does not exceed $15 million.[9]

b. The Valuation Methods.

Both Phillips and Butler are qualified to give expert opinions regarding the value of nursing homes and other types of senior housing. Because the Court finds the Phillips Appraisals more credible, the Court will discuss those reports and Phillips' experience first. Phillips' experience includes spending the past seven years exclusively on matters pertaining to healthcare, and having done appraisals, market studies or feasibility analysis on approximately 500 senior housing properties. **T3:12, L17-19; T3:14, L7-15; T3:14, L23 through T3:15, L2; Comerica Exhibit 68.**

Phillips determined his values using generally accepted valuation methods – the income approach, the sales comparison approach and the cost approach, relying most heavily on the income approach. **T3:24, L3-12; Comerica Exhibit 57, Valuation p. 64.** The Phillips Appraisals assume the Facilities are sold as a going concern with a 12 month marketing period necessary to obtain fair market value. **T3:19, L17 through T3:20, L12; Comerica Exhibit 56, Introduction ¶¶ (i)-(ii).** Phillips relied upon historical information for the Scotland Facility and upon market assumptions, including actual operating statistics for other nursing homes. **T3:94, L7-17**. While Phillips appraised the Scotland Facility separately from the York Facility, the

[9]The Court makes certain adjustments to the Phillips Appraisals to reach its determination of value. *See infra* at p. 26.

Court finds that appraising the Facilities separately did not measurably affect the appraised values of the Facilities as a whole. **T3:21, L17 through T3:22, L2.**

While Butler is also qualified to give expert opinions on the value of real property, she currently spends about 10-15% of her time in connection with healthcare facilities. **T4:66, L3-9; T4:69, L2-10.** Butler used income and resident mix projections that were prepared by the Debtors' management. **T4:44, L23 through T:45, L1-3.** Butler made no effort to confirm whether the Facilities have actually operated as projected. **T4:87, L2-15.**

Butler's 242 bed valuation of the Facilities assumes that the Facilities have 52 assisted living residents – approximately 20% of the beds at the Facilities. Similarly, the Butler Appraisal is based upon her assumption that the Facilities are a "hybrid" because they provide something other than pure skilled nursing care, such as assisted living and Alzheimer's secured care. **T4:112, L8-11; T4:121, L23 through T4:122, L22.** This is important because serving assisted living residents is far less expensive than caring for skilled nursing residents, thereby increasing value. **T1:28, L9-12.**

However, contrary to Butler's assumptions, the Debtors' new projections and new business model are based upon admitting only skilled nursing care residents. The Facilities no longer have assisted living residents. Every bed at the Facilities is a licensed skilled nursing bed as of January 8, 2001. All of the Alzheimer's residents at the Facilities are skilled nursing care patients. **T4: 166, L3 through T:4 167, L14.** The services at the Facilities are not unusual for skilled nursing facilities. **T3:63, L22 through T3:64, L6.** Butler's 242 bed appraisal does not reflect either the actual or the intended future operation of the Facilities. On this record, Butler's "hybrid" assumption has no factual basis. **T4:90, L13-20; T3:99, L1-15.** These, and other problems discussed below, cast doubt on the validity of the Butler Appraisal.

(1) Valuation Under Sales Comparison Approach.

The respective results of the sales comparison approach support the Court's determination that the Phillips Appraisals are more credible than the Butler Appraisal. The highest reported recent sales price per bed for a nursing home in Texas is around $50,000. **T3:25, L19 through T3:26, L11; T3:27, L6-14; T4:71, L15-24; T4:74, L1-4.**

Phillips appraised the Facilities at a per bed value between $47,500 for Scotland and $51,064 for York. **Comerica Exhibit 56, Introduction Section vi; Comerica Exhibit 57, Introduction Section vi.** For his comparable sales, Phillips used only nursing homes in Texas. **T3:26, L7-11.** The actual sales price per bed in the comparable sales used by Phillips was in a range of $42,500 to $50,000 per bed. **T3:25, L19 through T3:27, L13; Comerica Exhibits 56, 57 (Valuation Section p. 14)**. The adjusted sales price per bed figures used by Phillips in valuing the Facilities are within the range of actual sales prices per bed in Butler's appraisal. **T3:27, L15 through T3:28, L2**. The adjusted sales price per bed figures used by Phillips are also consistent with the average and median sales price per bed figures for nursing homes sold in 1999 in a nationwide survey. **T3:31, L15 through T3:32, L2; Comerica Exhibit 144**.

Butler appraised the Facilities at a per bed value of $84,000 (242 beds) and over $113,000 (261 beds). **Comerica Exhibit 59, p. 2, 83, 84**; **T4:78, L8-11; T3:28, L3-23.** Those values are not reasonable for nursing homes. **T3:28, L12-23.** No sales of comparable facilities in Texas within $30,000 per bed of Butler's appraised value were identified. **T4:73, L14-23; T4:87, L17-25; T3:27, L6-14.** The actual sales price per bed values in the comparable Texas sales cited by

Butler range from $29,630 per bed to $49,664 per bed. **T4:71, L18-24**; **Comerica Exhibit 59, p. 81.** The only sales price per bed figures that Butler cited that were as high as the figures she used for the Facilities (from $84,000 to over $113,000 per bed) are from sales outside of Texas, **T4:87, L17 through T4:88, L3,** and are not from sales of nursing homes. Rather, those "comparables" are derived from sales of facilities that are predominately assisted living facilities and/or are from facilities which operate in states that receive higher Medicaid rates than the Facilities receive in Texas. **T4:90, L8-17; T4:89, L12-25.** Since the Facilities were supposed to have phased out of assisted living by February 2001, those are not valid comparable sales. **T4:90, L13-20.** Butler did not rely on the actual sales in Texas.

(2) Valuation Under the Income Approach.

For each appraiser, the income approach was the most important valuation determinant. **T3:73, L13-16; T4:65, L19-22**. The most significant differences between Phillips and Butler in the income approach involved projected net income (due to the different projections of resident mix and operating expense ratio) and the capitalization rate used by the appraiser. **T3:59, L20 through T3:60, L11.** The Court finds that the respective results of this income approach support its determination that the Phillips Appraisals are more credible than the Butler Appraisal.

(a) Resident Mix.

Average monthly Medicaid census at the Facilities substantially increased during 2000 (from 2022 days in January to 3304 days in December), comprising 57% (3304/5785) of all resident days in December 2000. Average monthly Medicare days increased by a total of 183 days during the year, and as of December 2000 comprised 14% of all resident days.[10] **Comerica Exhibit 168; T4:206, L16-19**.

The New Projections assume a "fundamental" change in the resident mix of the Facilities. **T2:81, L18-22.** The New Projections project that by December 2001, average monthly Medicare census will increase to 52 (21% of total census); average monthly Medicaid census will decline substantially to 89 (37% of total census); and average monthly nursing private pay census will nearly double to 98 (41% of total census). **New Projections at p. 13 (Census Projections Year 2001).** The Debtors predict that the Scotland Facility's average Medicaid census will actually be reduced from current levels to 41 (33% of total Scotland census), with a corresponding increase in Medicare and private pay. **T2:92, L21 through T2:95, L11.** The Debtors project that the York Facility, with a total projected census of 141, will fill all but 48 of its beds with private pay and Medicare residents. *Id.*

Similarly, Butler projects for both the 242 and 261 bed Facilities a significant change in resident mix with Medicaid census below or at 40% (74 and 114) and Medicare census around 21% (46 and 55) (all derived from the projections developed in August 2000 by management of the Facilities). **T4: 117, L2-7; Comerica Exhibit 59, p. 91; T4:79, L15 through T4:80, L17.**

The Facilities are not "start ups" and have been operating for over two years. **T3:62, L10-21.** The Scotland Facility has been at stabilized occupancy since Spring 2000. **T1:51, L3-16; T3:22, L6 through T3:25, L7; T4:92, L22 through T4:93, L1; T4:95, L4 through T4:96,**

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[10]Generally, Medicaid is a healthcare funding program provided for persons deemed to not be able to afford the cost of care. Medicaid eligibility is based on income or need. Medicare is a reimbursement paid by the United States. To be eligible, a resident must be over 65, must have certain employment history, must have stayed in a hospital and must need rehabilitative care. The resident is eligible for Medicare for a maximum of 100 days. **T2:63, L12 through T2:66, L18**.

L6. The Scotland Facility has consistently had a Medicare census ratio of approximately 15% since reaching stabilization. **T3:40, L24 through T3:41, L8.** The Medicaid census at the stabilized Scotland Facility is about 51%. **T3:42, L7-21; T2:89, L17-22; T2:90, L14-22.** The Facilities, including the stabilized Scotland Facility, have never operated with the kind of Medicaid and Medicare mix predicted by the Debtors and Butler. **T2:95, L12-17.**

From July 2000 forward, average Medicaid census has never been less than 50% of total actual resident census at the Facilities. **Comerica Exhibit 168.** Nearly all the year 2000 growth in census shown in Debtors' Exhibit 37 – from 173 to 193 – has been in Medicaid nursing census. **Comerica Exhibit 168.** The average Medicare census in December 2000 was 27 out of 241 beds. **T4: 159, L20-24; Comerica Exhibit 168.**

Neither the Debtors nor Butler explained to the Court's satisfaction how and why the projected "fundamental" change in resident mix will occur. **T4:86, L4-16.** Management has attempted for two years to maximize the number of the premium Medicare rehab residents at the Facilities. **T2:74, L13 through T2:75, L9; T2:102, L22 through T2:104, L7.** The Debtors have turned away few, if any, Medicare residents due to a lack of beds, and cannot identify a significant number of private pay residents turned away due to a lack of beds. **T2:70, L6-23; T4:168, L. 7-10.** Butler testified that there are no current barriers at the Facilities to admitting more private pay residents. **T4:115, L22-25; T1:131, L1-3.** However, the resident mix has never been as predicted by the Debtors and Butler.

To support their projected resident mix, the Debtors contend that they need to obtain only 70 residents from a pool of 13,000 people identified in a market study by Butler who need Alzheimer's care and might need nursing care. **Comerica Exhibit 67; T1:121, L1-24**.

Unfortunately, that pool of 13,000 potential residents consists predominately of potential Medicaid residents, not private pay residents. **T4:104, L7 through T4:105, L25.** Most of the current Alzheimer's residents at the Facilities are Medicaid. **T2:61, L11 through T2:62, L24; T2:73, L21 through T2:74, L1.** Because Alzheimer's patients ultimately need long-term care, few of the Alzheimer's patients at the Facilities are Medicare. **T2:59, L17-25.** It is unlikely that demand for Alzheimer's beds will fill the Facilities with Medicare or private pay residents.

The Debtors also predict that the attractiveness of the Facilities will permit the filling of the Facilities with private pay residents, instead of Medicaid residents, including in the proposed York converted three-bed wards. **T2:60, L2-16**. If that is true, the Facilities should have had a higher mix of private pay residents in 2000. Moreover, it is unlikely that the projected 19 three-bed wards in the York Facility would fill with private pay residents since those who can afford long-term care are not likely to agree to be put three to a room. **T4:77, L21-25; T2:61, L4-7.** The three-bed wards are likely to be occupied by Medicaid residents.

The Debtors have already missed the New Projections regarding resident mix – actual Medicaid census was 600 days over the amount projected for December 2000. **T4:204, L3 through T4: 205, L18.** As of December 2000, the Facilities have not gotten any closer to achieving the resident mix projection relied on by Butler in her appraisal. **T4:118, L17-21**.

On this record, the Court cannot find the Debtors' (or Butler's) projected resident mix reasonable. Based upon their historical performance and the inherent rapid turnover of Medicare residents, the Facilities are unlikely to sustain on a long-term basis the Medicare population projected by the Debtors and Butler. The Facilities are also unlikely to reduce reliance upon

Medicaid census as projected by the Debtors and Butler. **T3:38, L6 through T3:39, L3; T3:41, L22 through T3:42, L1, T2:66, L11-18; T2: 102, L22 through T2:104.**

Phillips' projected resident mix for the Facilities is 50% Medicaid, 34% private pay and 16% Medicare. **T3:34, L13 through T3:35, L8; T3: 92, L13-25; Comerica Exhibit 56, Valuation p. 30; Comerica Exhibit 57, Valuation p. 30.** While conservative, Phillips' projected resident mix is more reasonable in light of actual performance at the Facilities and is consistent with the resident mix of other nursing care facilities in Texas. **T3:35, L20 through T3:36, L4; T3:38, L20 through T3:39, L3; T3:39, L9 through T3:40, L23.**

(b) Operating Expense Ratio and Margin.

According to Butler, the typical expense ratio for a nursing home is in the range of 80 to 85%. **T4:59, L1-3; T4:92, L18-21.** The margins used by Phillips in his appraisals are 15.1% for the Scotland Facility and 15.6% for the York Facility, which equates to operating expense ratios of 84.9 and 84.4, respectively. **T3:42, L22 through T3:43, L12; T3:44, L20-24; T3:45, L22 through T3:46, L5.** The operating expense ratios used by Butler are 72.1% for 261 beds and 75% for 242 beds. **T4:91, L18 through T4:92, L7.** The margin chosen directly affects net income.

Phillips' projections of the Facilities' operating expense ratio and margin are at the high end but are not unreasonable. The margins and operating expense ratios used by Phillips are consistent with the actual experience of the nursing homes used by Phillips as comparables. **T3:43, L13-23; T3:45, L10-19.** The expense projections used by Phillips are consistent with the actual experience of the nursing homes used by Butler as comparables (a range of 83.07 up to 99.51% operating expense ratio). **T4:90, L21 through T4:91, L17.** The stabilized Scotland

Facility had an operating expense ratio in 2000 of over 91%. **T4:94, L13-18.** The Scotland Facility has not had an expense ratio as low as 75%. **T4:92, L8-11.** Butler's use of higher margins is unreasonable.

(c) Projected Net Income.

Phillips' projected annual net operating income ("NOI") for the Facilities is approximately $1.612 million, after conversion and stabilization of occupancy for the York Facility. **T3:93, L12 through T3:94, L6; T3:94, L18-25; T3:95, L12-25; Comerica Exhibit 56, following p. 40; Comerica Exhibit 57, p. 41.** While conservative, Phillips' projections of net income, based upon his projections of resident mix and margin, are not unreasonable.

Debtors' Exhibit 39, a chart of quarterly net income for the Facilities, identifies NOI of $186,166 for the fourth quarter of 2000. **T4:148, L1-7.** In the New Projections, the Debtors' project NOI of approximately $227,968 in May 2002, upon completion of the 19 bed conversion of the York Facility and the projected stabilization of the Facilities. **T3:23, L20-23; New Projections at p. 19 (Operating Projections Year 2002)**. Butler goes further projecting net income of $2.34 million upon stabilization in the 242 bed Facilities (assuming 52 assisted living residents) and $3.39 million in the 261 bed Facilities, as stabilized. **Comerica Exhibit 59, p. 104; T4:52, L17-25.** Butler predicts annual NOI per bed of $9,686 (242 beds) and $12,993 (261 beds), far greater than the range of actual NOI per bed in the seven comparable sales used by her ($3,430 to $6,000 per bed). **T4:71, L2-11; T4:70, L3-15; Comerica Exhibit 59, pp. 82, 84.**

The Debtors' income projection assumes a fundamental change in resident mix that, in turn, leads to higher daily rates for residents (daily rates for Medicare are higher than daily rates for Medicaid) and to an increase in the average daily rate per bed for the Facilities (from $100 per day in September 2000 to $134 per day by December 2001). **T2:96, L24 through T2:97, L17.** If the projected resident mix is not met – *i.e.*, if the Facilities fill with more than one-third Medicaid residents – the Facilities will not be able to meet the income projections in the Butler Appraisal. **T4:106, L5-12; T4:117, L18-21.** Any change in the resident mix percentage that Butler used in her appraisal can result in "very drastic" changes in her value. **T4:50, L5-20.**

The projected income levels relied upon by Butler and the Debtors are speculative and are not consistent with industry experience. **T3:38, L6 through T3:42, L21; T3:97, L10-23.** The Debtors contend that the accuracy of the New Projections (prepared in September 2000) for the fourth quarter of 2000 demonstrates that the New Projections are reasonable and attainable. **T4:160, L1-7**. Unfortunately, that is not persuasive since the significant increases in NOI and the fundamental changes in resident mix under the New Projections do not start until 2001. **Debtors' Exhibit 17, Operating Projections - Year 2001, p. 8.**

The Court also takes notice that after the conclusion of the hearings on the Motions, the Debtors filed a First Amended Joint Plan of Reorganization dated February 28, 2001 (the "New Plan") with yet another operating projection (the "New Plan Projections"). **New Plan; Exhibit A**. Under the New Plan Projections, fourth quarter 2001 NOI is now projected to be only $230,000, far lower than the income level assumed by Butler and the Debtors in the New Projections. No significant increase in NOI is projected until 2002, repeating the Debtors' pattern of delaying income increases further into the future with each new projection. In the New Plan Projections, by December 2001, Medicaid and Medicare census are projected to be 112 and 34, respectively, far different levels than those contemplated by them in the New Projections and the Butler Appraisal. **New Plan, Exhibit A, pp. 1, 2**.

(d) Capitalization Rate.

Phillips' choice of a cap rate of 13% is reasonable. **T3:46, L15-17.** Phillips' 13% cap rate is supported by his mortgage/equity capitalization analysis, as well as by cap rates from comparable sales of other nursing homes and an industry survey of lenders and investors with information pertaining to 52 actual sales of nursing facilities. **T3:46, L9 through T3:48, L15; Comerica Exhibit 144.** Bissell also used a 13% cap rate in his 1999 appraisal of the Scotland Facility. **T3:49, L10 through T3:50, L23; Comerica Exhibit 63.**

Butler chose a cap rate of 11.5% which is low for nursing home facilities. **T4: 52, L17 through T4:53, L15; T3:48, L22 through T3:49, L9.** In general, a higher rate should be used in an appraisal that relies on projections instead of current or historical performance. **T4:120, L2-11.** As noted previously, Butler's appraisal was based on projections. **T4:44, L19-25.** Butler's cap rate is too low.

(3) Valuation Under the Cost Approach.

Butler identified several differences between her values and Phillips' values that pertained to the Cost Approach, including a difference in the underlying value of the land ($680,000), the anticipated life of the Facilities (50 vs. 60 years), and the costs of FF&E ($4,000 vs $5,000). These criticisms of the Phillips Appraisals are valid. However, since both appraisers relied primarily on the income approach, **T3:73, L13-16; T4:65, L19-22. Comerica Exhibit 59, p. 115; Comerica Exhibit 57, Valuation p. 64,** these differences in the cost approach are of less significance to the Court's determination of value. **T3:85, L4-6; T3:85, L24 through T3:86, L1; T4:55, L13-16.**

As noted previously, the Court finds the Phillips Appraisals to be more credible than the Butler Appraisal. While the judgments which underlie the Phillips Appraisals are not unreasonable, they are conservative and have generated a relatively low value for the Facilities. Thus, an upward adjustment in value is appropriate. A 20% adjustment to Phillips' value results in a value of approximately 14.94 million for the Facilities. A 20% adjustment adequately compensates for the conservative judgments which underlie the Phillips Appraisals. Thus, the Court finds that the current value of the Facilities is no more than $15 million.[11]

2. Equity Cushion and Adequate Protection.

According to Comerica's calculation, principal and interest owing to Comerica on June 30, 2001 will be $12,143,633.99. Comerica contends that it has incurred fees and expenses of $257,080.68 through November 30, 2000. With fees and expenses from November 30, 2000 through June 30, 2001, the Court expects that Comerica will claim approximately $12.5 million as of June 30, 2001.

The JDI Loan is a 12 month loan, with a possible 6 month extension. **T1:101, L17-19; T1:107, L16-19**. Since JDI is permitted due diligence before it is required to close and fund, the Court assumes that the JDI Loan would be funded no earlier than April 30, 2001. Based on this projected funding date and assuming no extension,[12] the JDI Loan would mature and have to be

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[11]A $15 million value for the Facilities is consistent with Bissell's "hypothetical prospective value upon stabilization" for the Scotland Facility of $8.49 million (Scotland has now reached stabilized occupancy) and either Bissell's "as is" value of the York Facility of $6.47 million (for a combined value of $14.96 million) or Phillips' "as is" value for the York Facility of $6.75 million (for a combined value of $15.24 million).

[12]Of course, if the maturity date of the JDI Loan was extended, additional interest would accrue and have to be paid to Comerica as part of the take out of Comerica and JDI under a reorganization plan.

repaid by April 30, 2002. Since the Debtors have admitted that they cannot repay the JDI Loan from operating cash flows (the Facilities barely break even without debt service to Comerica), a plan of reorganization would have to be confirmed by that date and the Facilities would have to be sold or refinanced. The Debtors are relying on the availability of a loan from HUD under a federal lending program known as the Section 232 Program to "take out" both the JDI Loan and Comerica as part of their reorganization plan.

From June 30, 2001 through April 30, 2002, Comerica would accrue additional interest of $951,507.84 (304 days at $3,129.96 per day at the non-default rate), for a total estimated claim of approximately $13.5 million as of April 30, 2002 (without any additional attorneys fees or costs after June 30, 2001).[13] The Debtors contend that they would use a portion of the JDI Loan proceeds (supplemented by operating cash flow) to pay some interest monthly to Comerica (approximately $30,000 per month). Assuming that the Debtors make a $30,000 per month payment to Comerica while the JDI Loan is outstanding, that would reduce the Comerica claim to approximately $13.1 million as of April 30, 2002 (without any attorneys fees or costs after June 30, 2001).

Since a portion of the JDI Loan is being reserved to insure that JDI gets its 15% interest, the amount of the JDI Loan as of April 30, 2002 would be its original principal amount of $1.59 million. Thus, the combined secured debt against the Facilities as of April 30, 2002 would be approximately $14.7 million.

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[13]Of course, Comerica would incur additional attorneys fees in connection with its opposition to approval of a recently filed disclosure statement attendant to the New Plan and thereafter in connection with its opposition to confirmation of the New Plan.

Based upon the Court's determination that the value of the Facilities does not exceed $15.0 million, the maximum equity cushion available to "adequately protect" Comerica is approximately $300,000. For the reasons explained below, the Court concludes that the Loan Motion must be denied.

First, the Debtors have not met their burden of showing that the JDI Loan is needed to preserve the estate, or that the Debtors' estates or the Facilities will benefit from the JDI Loan. Very little of the JDI Loan is actually used to enhance the Facilities or the operation of the Facilities – $150,000 for York room conversions. While using JDI Loan proceeds to pay professional fees ($250,000), a small amount of interest to Comerica ($200,000 denoted in Debtors' Exhibit 42 as working capital, with the remaining $160,000 to be paid to Comerica to come from operating cash flows (assuming the Facilities begin to generate that amount of excess cash flow)), the claims of the United States (payroll taxes of $300,000 for which Sibley is personally liable), and the claims of the real property taxing authorities (a reserve of $330,000) fixes the effective interest expense on those claims at 15%, it does not change the amount of the claims. The only real benefit of the JDI Loan to the Debtors is to allow York to complete its proposed room conversion.

Second, the JDI Loan impairs Comerica's collateral position and imposes risk on Comerica. The JDI Loan cannot be repaid from operating cash flows of the Facilities. Any increase in the value of the Facilities that may result from $150,000 of the JDI Loan – *i.e.*, the York room conversion – is speculative. Thus, as a result of the JDI Loan, the Facilities are encumbered by an additional $1.59 million of debt that is senior to Comerica's claim and is secured by the same collateral.

The Debtors have not met their burden of proving adequate protection of Comerica's interests in the Facilities. Comerica's interest in the Facilities is not adequately protected by an equity cushion of approximately $300,000. The Debtors have not offered any additional property as adequate protection. The payments to Comerica from proceeds of the JDI Loan simply replace Comerica's debt secured by the Facilities with debt owed to JDI (at a higher interest rate) and are not adequate protection. The Debtors have not demonstrated a likelihood of meeting the New Projections or of obtaining a HUD loan sufficient to pay off the JDI Loan and Comerica. If the Debtors' new business model fails or if the Debtors cannot obtain the HUD loan, Comerica would, in all likelihood, be forced to pay the JDI Loan to protect its position. **T3:107, L7 through T3:108, L19**.

For each of these reasons, the Loan Motion must be denied.

B. The Stay Motions.

1. Cause Exists To Modify The Automatic Stay.

Section 362(d)(1) of the Bankruptcy Code provides that the Court may lift the automatic stay for "cause." *See* 11 U.S.C. § 362(d)(1). However, the Bankruptcy Code does not define the term "cause," and the term is applied by the courts on a case specific basis. *See Claughton v. Mixson*, 33 F.3d 4, 5 (4th Cir. 1994) ("Because the Bankruptcy Code provides no definition of what constitutes 'cause,' the courts must determine when discretionary relief is appropriate on a case-by-case basis.") (citations omitted); *Christensen v. Tucson Estates, Inc. (In re Tucson Estates, Inc.),* 912 F.2d 1162, 1166 (9th Cir. 1990) ("'Cause' has no clear definition and is determined on a case-by-case basis.") (citations omitted); *Hudgins v. Security Bank of Whitesboro (In re Hudgins)*, 188 B.R. 938, 946 (Bankr. E.D. Tex.1995) ("[T]he Bankruptcy

Code does not define the term 'cause.' 'Cause' under § 362(d)(1) is not limited to those situations where the property of a party lacks adequate protection in the bankruptcy estate. Instead 'cause' encompasses many different situations . . . .") (citations omitted); *In re Texas State Optical*, 188 B.R. 552, 556 (Bankr. E.D. Tex. 1995) ("11 U.S.C. § 362(d)(1) provides for the modification of the automatic stay for cause. 'Cause' as used in § 362(d)(1) has no clear and limited definition and, therefore, is determined on a case by case basis. 'Cause' is an intentionally broad and flexible concept that permits the Bankruptcy Court, as a court of equity, to respond to inherently fact-sensitive situations.") (citations omitted); *cf In re Novak*, 103 B.R. 403, 411-12 (Bankr. E.D.N.Y. 1989) (finding in a Chapter 12 case, debtor's failure to timely confirm plan is "cause" for relief from automatic stay, despite the existence of an equity cushion).

In light of the denial of the Loan Motion, there is no reasonable prospect for a successful reorganization of the Debtors within a reasonable period of time. At the hearings, the Debtors described the New Plan as containing the following terms: (i) the Debtors obtaining a loan from JDI of $1.59 million payable no earlier than in twelve (12) months; (ii) payment of Comerica's claim being extended for at least twelve months after the closing of the JDI Loan; (iii) Comerica being paid $30,000 per month, in part with cash borrowed from JDI, plus amounts of possible cash flow; and (iv) the Debtors seeking and obtaining a refinancing loan from HUD to pay Comerica and JDI. **T4:214-215, 217-221, L13.**

As the New Plan was described at the hearings, the Debtors intend to satisfy the Comerica claims and repay the JDI Loan by obtaining a refinancing loan. The only source for such a refinancing loan for the Debtors is a HUD 232 loan. **T1:102, L1-15; T1:152, L10-25.**

The Debtors concede that their reorganization depends on obtaining this HUD loan. **T1:155, L16-17**. In September 2000, the Debtors planned to apply for a HUD loan in January 2001. **T1:106, L16-25.** By the conclusion of these hearings, the Debtors needed until 2002 to obtain a HUD loan.[14] **T4: 218, L5-9**.

According to the Debtors, HUD loans have a requirement of at least a 1.1 to 1 debt service coverage ratio. **T1:106, L2-10.** The Debtors will have to borrow closing costs of $600,000. **T1:104, L1-9.** With a HUD loan, in addition to the loan interest rate, the Debtors have to pay a mortgage insurance premium of .50% plus a reserve for replacements. **T1:104, L13-25.** Sibley testified that as of September 2000, the mortgage constant, or cost, including interest, of a HUD loan was 9%. **T1: 104, L20 through T1:105, L8.**

The Debtors' actual cash receipts above actual cash expenses were only $2,500 in December 2000, and were anticipated to be only $12,500 in January 2001. **Comerica Exhibit 166; T4:179, L14 through T4:182, L7.** Of course, these actual cash numbers are before any debt service to Comerica. **T1:48, L2-12**.

To obtain a HUD loan, the Facilities must increase current cash flow to an amount needed to service over $14.7 million in debt and closing costs.[15] Without the proceeds from the JDI

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[14]The New Plan has now been filed. The New Plan provides that the refinancing loan will be obtained within fifteen months of the Effective Date unless the Reorganized Debtors and Williamsburg elect to extend that date by an additional ninety days. However, unlike the description of the New Plan offered at the hearings, no monthly interest payments ($30,000 per month) are made to Comerica until the Effective Date of the New Plan. The Effective Date of the New Plan will not occur for some time.

[15]*See supra* at pp. 25-26. *See* **T1:102, L23 through T1:104, L11** ("Q. How much of a loan are you going to seek from HUD? A. We are going to seek a loan somewhere between $12 million and $16 million dependent on the net operating income -- excuse me. Based on the net operating income at the time that we were able to propose the plan to -- make our loan proposal to Malone Mortgage. Q. Are you going to try to borrow enough to pay off the existing indebtedness on the property? A. Yes. Q. How much will that be come next August? A. Assuming that we have – Q. A plan confirmed. A. -- a plan

Loan, the Debtors cannot complete the York room conversion.[16] In turn, completion of the York room conversion is essential to York achieving a stabilized occupancy.[17] In turn, York

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confirmed – Q. And you got the JDI loan? A. And we got the JDI loan, that is going to be -- those two loans will be approximately $12,900,000. Q. What number are you using for Comerica's debt when you come up with that number? A. 11,300,000. Q. 11,300,000? A. Yes. Q. So if you tack another million dollars onto that figure, then you have to seek another million loan -- further million dollars in loan proceeds? A. Yes, sir. Q. So it would be around, as I appreciate then about a $14 million loan? A. You have 11.3, the 1.6 million -- if you have the 1.6 million, that's 12.9 million. So we would need to secure a loan that 12.9 million that would also include closing costs. So somewhere around $13.5 million. Q. Closing costs, give or take $600,000? A. Yes. Q. So what you're trying to do, then, is get enough -- try to get a HUD loan that will pay off Comerica and have JDI and the closing costs? A. That's correct. Q. Whatever that works out to be? A. Yes."); **T3:308, L12-22** ("Q. And how much money are you trying to borrow for these debtors permanently? A. On a permanent basis, somewhere around 14 million. Q. Okay. And where did you come up with that number? A. We came up with that number based on what we anticipate the cash flow being. Q. Did it have any relationship to how much the debtor actually owes people? A. That is a factor in determining how much you want to borrow. Also, a factor would be what your appraised value is and your debt service coverage.").

[16]*See* **T1:83, L20 through T1:84, L5** ("Q. Okay. Why don't you tell the Court how these loan proceeds were going to be used? A. Your Honor, what we are proposing is that we reserve enough funds for interest and taxes for the new additional loan from JDI loans and also for Comerica's current loan. We would be paying 15 percent of the JDI loan and we would be paying 10 percent on the Comerica loan, as we proposed. There's $1,150,000 that are there for interest and tax reserve of which about somewhere between 325 and 350,000 are for the year 2000 taxes. The patient room conversion, which includes furniture and equipment, is $150,000."); **T1:87, L24 through T1:88, L4** ("Q. The patient room conversions, Mr. Sibley, $150,000, right? A. Yes. Q. That's the only money that's going to go directly into the property, correct? A. Actually, into the real estate."); **T1:101, L9-15** ("Q. If you couldn't prevent Comerica from exercising its remedies against the property, would you need to get this loan? A. I don't believe so. Q. And is the loan an integral part of this plan that you have here? A. Yes."); **T2:119, L16-19** ("Q. I'm trying to figure out where the changes are. The patient room conversion is a $150,000. That's where money is actually going into the property? A. That's right."); **T2:122, L20-23** ("Q. So of all -- the total of $1.6 million that you're borrowing, 150,000 of it is going to go directly into the property? A. Into the -- into the buildings.").

[17]*See* **T1:120, L15-19** ("Q. Okay. And your plan is to maximize the high return and do away with some of the low return; is that correct? A. Our plan is to convert the York facility west wing and primarily convert it to Medicare rehab and some private pay skilled nursing."); **T2:102, L22 through T2:103, L13** ("Q. Mr. Sibley, if it was so easy to fill up these homes with Medicare, rehab and high-dollar Medicare patients, wouldn't you have done it already? A. I think we just had to respond within the working capital cash flow scenario that we've had to deal with. And I think that we have chosen -- I don't think it is that unusual for a start-up health care facility to grow its population with Medicaid, if it can get Medicaid and then attrition back once it's built up. Q. Uh-huh. Now, you're talking about working capital. You're talking about York conversions, right? A. We're talking about working capital and cash flow. Q. You're talking about mainly to convert the York facility, right? A. That – Q. That's what you're driving at there? A. That's part of it."); **T4:75, L6-18** ("But just so it's clear for the judge, in

occupancy stabilizing is essential to the Debtors being able to achieve the New Projections.[18] In turn, achievement of the New Projections is essential to any hope that the Debtors can obtain a

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your appraisal, you have really two sets of valuations, right, for the 242 bed and then, also, for the 261 bed? A. That's correct. Q. And is your understanding that to get to the 261 bed facility that that's going to be achieved by taking a number of the units in Williamsburg and converting them into three bed units? A. That's assuming this payer mix at 261 beds. Q. Well, Ms. Butler, let me rephrase that. The as-fully converted and stabilized scenario calls for 261 actual beds, right? A. Yes.").

[18]*See* **T2:100, L17-25** ("Q. So the reason you're telling the Court that you can get this additional revenue is that you're going to change your patient mix, right? A. That's correct. Q. In other words, by this time, you're hoping to be rid of all the assisted living patients, right? A. Right. Q. By January? A. Yes."); **T4:79, L15-24** ("Q. Well, Ms. Butler, let me be clear here so we're clear for the record. What I'm saying is that the figure of $9,686 of debt operating income per bed is derived from a patient mix, not a total number of beds, a patient mix or payer mix that did not actually exist last August, correct? A. Correct. Q. Again, that was a projection of patient or payer mix that you obtained from the Williamsburg management, correct? A. Based on the trends that they saw in the market and that were more verified by us, yes."); **T4:148, L4 through 4:149, L7** ("Q. And that [Debtors' Exhibit 39] shows the net operating income has increased from a loss of 94,000 to a quarterly net operating income of more than 186,000; is that accurate? A. Yes. Q. And my mathematics are not good at all, but that's an increase of hundreds of percents, isn't it? A. Yes . . . Q. And do you attribute that as the chief financial officer of Williamsburg to conversion; is that correct? A. Yes, conversion and growth . . . Q. But it's -- suffice it to say, the impact of this conversion which we talked about on both the patient growth, the revenues and most importantly the net operating income has been highly beneficial; is that accurate? A. Yes."); **T4:221, L16 through T4:223, L4** ("Q. What was the liquidation value of the facilities, in your mind? A. We still feel like that would be close to Ms. Butler's replacement value. Q. $16 million? A. Yes. Q. So if this Court were to order this property sold in a reasonable marketing period, there would be enough money to pay Comerica -- A. I believe – Q. Let me finish my question, sir. There would be enough money to pay Comerica, pay the unsecured creditors and even return some to the original investors, wouldn't there? Now you can answer. A. Okay. If we were to liquidate at this moment, at this time, is that what you're asking me? Q. No. In six months. A. Liquidate at the time of the end of our loan? Q. No, sir. You -- you adopted Ms. Butler's liquidation value of $16 million, right? . . . A. I correct myself. No. I feel like that the value should be worth close to $19 to $20 million at the end of the 12-month period, if that's what you're asking me. Q. So if the judge had to liquidate -- if the Bankruptcy Court ordered this property sold in the next six months, do you think you could generate $16 million? A. No, sir. I think that we have to reach stabilization in order to be able to do that. Q. So something far less than $16 million, if it had to be sold in six month's time? A. Yes.") (colloquy omitted).

HUD loan.[19] Finally, qualifying for a HUD loan is essential to confirmation and consummation of the New Plan (and the "take out" of JDI and Comerica).[20]

On this record, and even assuming the Loan Motion was granted, the Court finds that the Debtors' ability to obtain a HUD loan is speculative, at best. Without a HUD loan, there is no reasonable prospect for a successful reorganization of the Debtors.

Given the turmoil in the nursing home industry, the lack of available credit, and the inability of the Debtors to successfully reorganize within a reasonable period of time, the Court

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[19]*See* **T4:110, L3-22** ("Q. I think you testified earlier today that your opinion was that they [the Debtors] could qualify for a HUD loan? A. Yes. Q. I want to make sure we're clear on what your opinion is. Is it your opinion that today's -- speaking today with conditions the way they are that the Williamsburg facility would qualify for a HUD loan? A. It would be considered for one, yes. Q. Well, but let's be specific here, Ms. Butler. Is it your testimony, is it your opinion that today the Williamsburg facility qualifies for a HUD loan? A. No. Q. When do you think -- do you have -- well, let me rephrase it. Do you have an opinion as to when it will be that the Williamsburg facility would qualify for a HUD loan? A. When it reaches stabilization. Q. And do you have any opinion as to when that will be? A. It should occur within the next year.").

[20]*See* **T1:101, L20 through T1:102, L8** ("Q. How are you going to repay the JDI loan? A. Either through a sale or through refinancing. Q. It can't be paid out of cash flow, can it? A. No. Q. Not enough money? A. No, it could not. Q. And you've mentioned the problems in the finance industry. Right now your only real hope of getting financing is we've talked about this HUD loan, right? A. It certainly appears to be the most viable source at this time. Q. Well, there isn't any other source right now, is there? A. Not that I'm aware of."); **T1:107, L2-9** ("Q. If you don't get that financing by next December, or whenever you're supposed to pay Comerica and JDI, Comerica has a problem on its hands, doesn't it? A. If we haven't received financing or if we haven't sold the property. And if for some reason we weren't allowed to extend for an additional six months, which JDI is agreeing to do is my understanding, then we would have to -- we would have a -- that would be a concern."); **T1:152, L1-12** ("[D]oes it [the Plan] provide to pay all the creditors -- all the live claims in full? A. Yes, sir. Q. Okay. Do you believe you'll be able to do that? A. Yes, sir. Q. Okay. Do you believe you'll be able to do that with the HUD 232 loan? A. Yes. Q. Okay. Are you aware of any other financing that's available out there for health care facilities such as Scotland and York, other than the HUD 232 loans? A. No, sir, not at this time."); **T1:155, L15-17** ("Q. Now, the reorganization depends on getting the HUD loan? A. Yes, sir.").

concludes that cause to modify the automatic stay under § 362(d)(1) exists.[21] An Order modifying the automatic stay will be entered separately.

Signed: April 11, 2001.

Barbara J. Houser
United States Bankruptcy Judge

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[21]The Stay Motions also seek relief under §362(d)(2). While the Court has concluded that there is no prospect for a successful reorganization of the Debtors within a reasonable period of time, relief under subsection (d)(2) cannot be granted because there is equity in the Facilities at this time.

The Debtors also asserted an "unclean hands" defense to the Stay Motions. Specifically, the Debtors contend that Comerica should be held liable to them for damages under the common law doctrines of fraud, conspiracy, and/or tortious interference in connection with the Debtors' efforts to sell the Facilities to a third party purchaser, Cathedral Rock Corporation ("Cathedral Rock"). The Debtors also assert these claims against Comerica and Cathedral Rock in Adversary Proceeding No. 00-3595. As relevant to the Stay Motion, the Debtors contend that Comerica's conduct should prevent it from obtaining equitable relief from this Court – *i.e.*, relief from the automatic stay. The Court disagrees. In *D-1 Enterprises, Inc. v. Commercial State Bank*, 864 F.2d 36, 38-39 (5th Cir. 1989), the court noted that "[t]he legislative history of §362(e) makes clear that counterclaims against a creditor seeking to lift the stay on largely unrelated matters are not to be handled in the summary fashion required by the expedited nature of the proceeding. Instead, they will be the subject of more complete proceedings . . . . Consistent with the legislative history, the courts have held that 'indirect defenses,' such as breach of contract, fraud and the like, would be severed from the expedited stay litigation if raised in an effort to defeat the creditor's motion." (Citations omitted). Thus, the Debtors' claims against Comerica and Cathedral Rock will be adjudicated in the adversary proceeding already on file.

Finally, the Court does not need to decide the Dismissal Motions in light of the denial of the Loan Motion and the granting of the Stay Motions.