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

IN RE: §
§
CHARTWELL HEALTHCARE, INC., § CASE NO. 98-38546-SAF-7
DEBTOR. §
§
IN RE: §
§
EAST TEXAS HEALTHCARE, INC., § CASE NO. 98-38547-SAF-7
et al., § (JOINTLY ADMINISTERED)
DEBTORS. §
§
DIANE G. REED and JOHN LITZLER, §
PLAINTIFFS, §
§
vs. § ADVERSARY NO. 99-3273
§
HELLER HEALTHCARE FINANCE, §
INC., et al. §
DEFENDANTS. §

MEMORANDUM OPINION AND ORDER

In three motions for partial summary judgment, Heller Healthcare Finance, Inc., seeks dismissal of counts one through ten of the third amended complaint filed by Diane G. Reed and John Litzler, Chapter 7 trustees of Chartwell Healthcare, Inc., and several of its subsidiaries. Complete Care Services, Inc., and its affiliated defendants, join in the motion concerning counts five, seven, eight and ten. The trustees oppose the motion. Trustee Reed moves for partial summary judgment against Heller and 22 Acquisition, Inc., concerning counts two, three, four and five, and a declaration regarding transfers of Medicare and Medicaid receivables. Trustee Litzler joins in that motion. Heller opposes the motion. The court conducted a hearing on the motions on August 14, 2002.

22 Acquisition filed its own bankruptcy case on November 28, 2001. In re 22 Acquisition Corp., case no. 01-36543 (Bankr. E.D. Pa.).

On October 2, 2002, Trustee Reed, Heller and 22 Acquisition filed a notice in this adversary proceeding of a stipulation they filed in the 22 Acquisition case. Trustee Litzler agrees to be bound by the stipulation. In the stipulation, 22 Acquisition agrees, upon court approval, to abandon its interests in accounts receivable generated by Chartwell nursing homes to Heller. The trustees may prosecute the claims asserted in the third amended complaint. The automatic stay will be modified to allow the trustees to pursue their avoidance action against 22 Acquisition but the trustees agree not to seek a money judgment or judgment for the return of property from 22 Acquisition and, if they obtain such a judgment, not to enforce it against 22 Acquisition. Heller may defend against the trustee’s claims as a real party in interest. Upon court approval, the stipulation is effective as of July 17, 2002.

Summary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, and other matters presented to the court show that there is no genuine issue of material fact and that the moving party is entitled to a judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby Inc., 477 U.S. 242, 250 (1986); Washington v. Armstrong World Indus., 839 F.2d 1121, 1122 (5th Cir. 1988). On a summary judgment motion the inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Anderson, 477 U.S. at 255. A factual dispute bars summary judgment only when the disputed fact is determinative under governing law. Id. at 250.

The movant bears the initial burden of articulating the basis for its motion and identifying evidence which shows that there is no genuine issue of material fact. Celotex, 477 U.S. at 322. The respondent may not rest on the mere allegations or denials in its pleadings but must set forth specific facts showing that there is a genuine issue for trial. Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). The court applies the same standards to the cross-motion for partial summary judgment.

Counts One to Four

As alleged in the third amended complaint, the trustees hold certain funds while other funds have been deposited by a state trustee in the registry of the court. The trustees seek, in count one, a declaration that neither Heller nor 22 Acquisition have an enforceable interest in the funds. In count two, the trustees seek a declaration that $6,333,295 of the Chartwell debt to Heller has been extinguished. The trustees invoke specific provisions of the Texas Business and Commerce Code in count three and seek a declaration that Heller does not have an enforceable interest in the registry funds. In count four, the trustees seek a declaration that Heller does not have an enforceable interest in the funds held by the trustees.

As a basis to declare the Chartwell debt to Heller extinguished, the trustees allege, in count two, that a transaction between 22 Acquisition and HCFP Funding II, Inc., amounts to an implied novation of $6,333,295 of the Chartwell debt. Heller requests a partial summary judgment dismissing the implied novation contention. The trustees seek a partial summary judgment establishing the novation.

On February 11, 1998, Chartwell and several of its subsidiaries and HCFP Funding, Inc., entered a $10,000,000 loan and security agreement. Chartwell pledged its accounts receivable as security for the loan. Also, on February 11, 1998 (the document actually says 1997), Chartwell and several of its subsidiaries executed a revolving credit note promising to pay $10,000,000 or as much of that sum as had actually been advanced, to HCFP Funding, Inc. Chartwell would pay the obligation from revenue derived from receivables generated from the operation of its nursing homes.

Pursuant to a letter agreement dated August 3, 1998, Chartwell transferred its leasehold interest in certain of its nursing homes and the corresponding outstanding receivables to 22 Acquisition, Inc. By a secured term note for $8,528,295 dated August 12, 1998, 22 Acquisition promised to pay HCFP Funding II, Inc., for a loan for the operation of the nursing homes acquired from Chartwell. In the note, 22 Acquisition agreed that it purchased the accounts from Chartwell and that it assumed Chartwell's obligations to HCFP Funding, Inc. The note recites that HCFP Funding, Inc., is an affiliate of HCFP Funding II, Inc. Heller advanced in excess of $17,000,000 to 22 Acquisition by November 2001.

The trustees contend that the advance of funds by HCFP Funding II, Inc., pursuant to the note executed by 22 Acquisition, amounted to an implied novation of the obligation of Chartwell to pay $6,333,295 of the outstanding amount on Chartwell’s note with HCFP Funding, Inc.

In Texas:

> [n]ovation is the substitution by mutual agreement of one debtor or one creditor for another, whereby the old debt is extinguished, or the substitution of a new debt or obligation for an existing one, which is thereby extinguished. It is the mode of extinguishing one obligation for another – the substitution, not of a new paper or note, but of a new obligation in lieu of an old one – the effect of which is to pay, dissolve, or otherwise discharge it. . . . To constitute a novation by substitution of a new obligation between the parties, there must be the consent of both contracting parties. The intention of the obligor that the existing debt should be discharged by the new obligation he enters into does not suffice. The creditor must concur in this. To constitute a novation by substitution of creditors and debtors, there must be a mutual agreement among three or more parties. . . .

Pierce Fordyce Oil Ass'n v. Woods, 180 S.W. 1181, 1183 (Tex. Civ. App.-–Ft Worth 1915, writ ref'd). "Novation is effected by the substitution of a new obligation, between the same parties, with the intention to extinguish the old one; or by the substitution of a new debtor with the intention to release the old one..." Meador v. Rudolph, 218 S.W. 520, 526 (Tex. Civ. App.–-Amarillo 1919, writ dism'd w.o.j.).

"If the agreement does not, or was not intended to, operate as a release of the original debt, it is not a novation." Woods, 180 S.W. at 1183. A novation may be by express agreement or by acts of the parties showing an intent to work a novation. Cooper Grocery Co. v. Strange, 18 S.W.2d 609, 612-13 (Tex. Comm'n App. 1929, judgm't adopted). A novation can be demonstrated by inference from the acts and conduct of the parties and other facts and circumstances. FDIC v. Waggoner, 999 F.2d 826, 829 (5th Cir. 1993); Meador, 218 S.W. at 526.

The trustees concede that the August 12, 1998, note does not contain an express novation. Rather, the trustees maintain that the transaction amounts to an implied novation.

22 Acquisition obtained Chartwell's interest in the specified nursing home leases and the outstanding receivables generated from operating the nursing homes. Chartwell thereafter lacked the income source to satisfy its outstanding indebtedness to HCFP Funding, Inc. 22 Acquisition acquired the outstanding receivables from the specified homes and the Chartwell revenue stream from those properties from which to pay the obligation. 22 Acquisition assumed Chartwell's obligations. HCFP Funding II, Inc, an affiliate of HCFP Funding, Inc., advanced money to 22 Acquisition pursuant to the very note by which 22 Acquisition assumed Chartwell's obligations.

When a lender's affiliate loans new money to a debtor who has assumed the debts of a different debtor to the lender, following and in conjunction with a transfer of the revenue stream from the first debtor to the second debtor, the lender must be deemed to have consented to the arrangement. No other inference would be reasonable. A contrary inference would be illogical. 22 Acquisition assumed Chartwell's obligations to Heller regarding the subject properties. Chartwell assigned the outstanding receivables and the income stream to service that debt. The Heller affiliates consented to the arrangement, including the transfer, and upon consent loaned new money to 22 Acquisition. Chartwell had no source of income to pay the debt to Heller, as the outstanding receivables and the ongoing income stream had been transferred to 22 Acquisition with Heller's consent. It is inconsistent that the same debt would be payable by two parties, one of whom had the assets to generate income to service the debt but transferred those assets to the other party who then had the capacity to service the debt. 22 Acquisition's assumption of the debt with the transfer and the subsequent Heller loan to 22 Acquisition must amount to an extinguishment of the debt. Otherwise, a prudent affiliated lender would never have allowed its collateral to be transferred.

Heller contends that it did not extinguish the debt. In his affidavit, Michael Gardullo, a Heller vice president, refers the court to a document titled "financing assumption agreement." In that document, HCFP Funding, Inc., consents to the assignment of the Chartwell interests to 22 Acquisition, but the document further states that the agreement shall not be deemed a release of Chartwell’s obligations to HCFP Funding, Inc. That document was not executed by HCFP Funding, Inc., and it was not executed by any of the Chartwell entities.

A document not signed by all the parties may constitute a binding contract if the parties intended. However, courts impose a strong presumption against finding a binding agreement when the document has not been executed. Courts do not impute an intent to be bound when the complexity of the transaction suggests that the parties would require the execution of a final contract. Winston v. Mediafone Entm't Corp., 777 F.2d 78, 80 (2nd Cir. 1985); Ogden Martin Sys. v. Tri-Cont'l Leasing, 734 F.Supp. 1057, 1069 (S.D.N.Y. 1990). See, also, Knight v. Sharif, 875 F.2d 516, 524 (5th Cir. 1989)(weighing factors to determine if parties have manifested an intention to be bound by a writing). A transfer of leasehold interests to operate nursing homes in two states coupled with a transfer of existing accounts receivable and the assumption of outstanding debt constitutes the type of complex transaction which would require that the parties execute a final contract. Furthermore, there is no summary judgment evidence that Chartwell agreed to the provision or acquiesced in the provision. Heller also did not execute the document. Consequently, the document amounts to only a party's draft of a proposed agreement; not an agreement.

The trustees offer two internal Heller memoranda reporting that Chartwell's debt to Heller following the transfer to 22

Acquisition had been reduced to $779,873. That remaining debt was derived from the Missouri nursing homes, which were not part of the 22 Acquisition transaction. Heller objects to the evidentiary use of its internal memoranda. However, Heller cannot have it both ways. Heller cannot, on the one hand, produce an unexecuted document to show that it did not release Chartwell from the debt, while at the same time oppose the evidentiary use of Heller's internal communication which suggests the very opposite. Further, the unexecuted document would only be binding if the parties intended. The court may look to evidence of actions by Heller that would inform the question of intent. The internal memoranda reflect that Heller reduced the Chartwell debt, which supports both an inference that the document did not constitute the agreement of the parties and an inference of novation.

Additionally, the unexecuted document is undated. The specific day for the agreement in August 1998 is blank. The letter agreement for the transfer of assets is dated August 3, 1998. The Heller internal memoranda reflecting the reduced loan balance for Chartwell are dated August 3, 1998, and August 10, 1998. The 22 Acquisition note is dated August 12, 1998. This sequence supports the inference of a novation. Chartwell did not agree to the unexecuted document. Heller never signed the document, yet reduced the debt in its internal memoranda and, thereafter, funded the note executed by 22 Acquisition, after 22

Acquisition obtained the leasehold interests and receivables of Chartwell.

The two notes coupled with the transfers, the subsequent funding evidence and the sole reasonable inference to be drawn therefrom, establish all the elements of a novation. Following the transfer of assets, 22 Acquisition, in a note to Heller, assumed Chartwell’s obligation to Heller concerning the subject nursing homes. Heller, thereupon, financed 22 Acquisition with respect to the subject nursing homes. By permitting the transfer of its collateral to 22 Acquisition, by consenting to the assumption of Chartwell’s debt by 22 Acquisition, by consenting to the removal of any ability of Chartwell to pay its obligation, and then by financing the new arrangement, Heller’s agreement to a new debtor, 22 Acquisition, releases the old debtor, Chartwell. The trustees are entitled to a partial summary judgment declaring that $6,333,295 of the debt to Heller had been extinguished.

On August 2, 1998, Chartwell owed Heller $7,125,188.67. After crediting the novated $6,333,295, that leaves $791,893.67 owing.

With the partial summary judgment for the trustees on the implied novation issue, there is no genuine issue of material fact that any remaining obligation has been more than paid for by the proceeds received by Heller from the Missouri receiver and the State of Florida. In his affidavit, Michael Gardullo, Heller’s vice president, includes a claim statement. The claim statement reports that Heller received $555,458.03 from the Missouri nursing homes and $869,265.54 from the Florida nursing homes. That totals $1,447,535.20. Applying the $1,447,535.20 received to the $791,893.67 owed, leaves a net amount held by Heller of $655,641.60.

The court next addresses the claims pertaining to the funds held by the trustees and the court. As alleged in paragraphs 78 through 81 of the third amended complaint, Trustee Reed obtained $462,385.67 of Medicare payments for the Texas Chartwell subsidiaries and $916,263.34 of Medicaid payments for the Texas Chartwell subsidiaries. Trustee Reed also obtained $7,100.39, held in money market accounts, and $67,181.10 from Chartwell subsidiaries’ bank accounts. Trustee Litzler also holds funds in two accounts. Funds totaling $165,218.73 have been placed in the registry of the court. Heller claims a lien on the funds. The trustees contend that no lien can be enforced against the bankruptcy estates because the underlying claim has been extinguished.

Heller presents summary judgment evidence that the funds held by the trustees derived from Chartwell receivables that had been transferred to 22 Acquisition. Consequently, the trustees have no claim to the funds. The trustees assert, however, that the receivables derive from Medicare and Medicaid reimbursement payments, which cannot be transferred.

Chartwell, as a provider, could not assign the receivables for Medicare and Medicaid services to 22 Acquisition. 42 U.S.C. §§ 1395g(c) and 1396a(a)(32). Further, none of the statutory exceptions apply.

Relying on In re Missionary Baptist Found. of Am., Inc., 796 F.2d 752, 754-59 (5th Cir. 1986), Heller contends that the federal statutes do not prohibit the transfer of the Medicare and Medicaid receivables as part of a sale of a provider's assets. In Missionary Baptist, the Fifth Circuit held that a lender took a valid security interest in the debtor's accounts receivable. The bank in Missionary Baptist financed the debtor/provider's operations and took a security interest in the Medicare and Medicaid receivables. The bank, by agreement, received direct payments of the receivables and applied the proceeds received to the debt. The Fifth Circuit held that this arrangement did not violate the federal anti-assignment statutes.

Heller cites a footnote and a provision in the Court's reasoning that discusses the legislative history of the statute. The passages discuss Congressional concern with factoring Medicare and Medicaid receivables. The discussion cites a committee report suggesting that the statute would not preclude a transfer of the accounts receivable as part of a sale of the assets of the debtor/provider. On its face, the comment from the committee report appears to address the instant case. However, the issue was not before the Fifth Circuit. The Fifth Circuit did not address a sale of the debtor’s assets, and therefore, did not confront whether it would deviate from the language of the statute.

In this case, the accounts receivable were transferred to 22 Acquisition, rather than to Heller to pay the debt. Missionary Baptist establishes that Medicare and Medicaid accounts receivable may be pledged to secure operating loans for the debtor/provider and may be paid to the lender on account of the financing debt. The case does not address the sale of the receivables to a third person.

Thus, in the absence of a controlling Fifth Circuit decision and based on the language of the statute, it appears that the transfer of the outstanding receivables to 22 Acquisition violated federal law. Nevertheless, the trustees may not obtain relief based on the apparent prohibition on the transfers. The trustees cannot obtain novation relief while retaining all of the proceeds of the receivables held by the trustees. The implied novation included a transfer of the accounts receivable derived from the subject nursing homes. For the trustees to be able to invoke the benefit of the implied novation, Heller must receive the benefit of the transfer of the accounts receivable to 22 Acquisition. Without prejudice to the trustees' avoidance claims and for purposes of counts one through four, the trustees must be precluded from attacking the transfer based on the federal statutes.

There is no genuine issue of material fact that Heller or an affiliated entity holds perfected liens against the accounts receivable held by the trustees. To assure that Heller receives the benefit of the bargain that resulted in the novation, the trustees must, without prejudice to their avoidance claims, recognize the transfer. Based on the summary judgment evidence, the funds held by the trustees appear to derive from properties transferred to 22 Acquisition. However, the trustees may set off the $655,641.60 owed the estates and, after the setoff, transfer the remaining funds to Heller, without prejudice to the trustees' avoidance claims. The trustees shall have a partial summary judgment in accordance with this determination.

If a reviewing court determines that the court erred in granting the trustees a partial summary judgment on the implied novation issue, then the court would address the Medicare and

Medicaid receivables after a trial on the merits. The transfer appears to violate federal law. However, if the parties did not intend a transfer in violation of federal law, then an underpinning of the 22 Acquisition transaction would fail. The court would have to determine what the parties intended after a trial.

In count three, the trustees allege that Heller does not hold enforceable security interests in the funds in the registry. Both Heller and the trustees request partial summary judgment on count three.

A Texas state court appointed David Crowson as a trustee to oversee the operations of eight nursing homes. Crowson opened a trusteeship bank account. He received funds from the Texas Department of Human Services. He also received Medicare payments. Crowson deposited those funds into the trusteeship account. The account also contained funds from the State of Texas Nursing Home and Convalescent Home Trust Fund and the Emergency Assistance Fund.

Heller has a perfected lien on proceeds of receivables generated from the operation of the subject nursing homes. However, under Texas law, in the event of insolvency proceedings instituted by or against a debtor, Heller would have a perfected security interest in the proceeds only if Heller meets specific Texas statutory requirements. Tex. Bus. & Com. Code § 9.306(d)(1998). That section provides:

> In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(1) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds;

(2) in identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(3) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings;

(4) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this Subdivision (4) is

(A) subject to any right of set-off; and

(B) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under Subdivisions (1) through (3) of this Subsection (d); and

(5) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, if the perfected security interest under this Subdivision (5) is provided by Section 9.319 of this code.

The summary judgment evidence establishes that there is no genuine issue of material fact that Crowson did not keep Heller’s cash proceeds in a separate account. There is also no genuine issue of material fact that Crowson commingled the proceeds with other funds. In addition, Crowson received the proceeds more than 10 days before the Chartwell orders for relief under the Bankruptcy Code.

Consequently, under Texas law, Heller does not have a perfected security interest in the funds Crowson received and deposited in the registry of the court.

Heller asserts, however, that the state court trusteeship constituted an insolvency proceeding and that prior to that proceeding, the proceeds had not been commingled. Heller argues that § 9.306(d) does not apply to proceeds received after the commencement of an insolvency proceeding. The summary judgment evidence does not establish that the state court trustee had been appointed pursuant to an insolvency proceeding. To the contrary, the summary judgment evidence establishes that Crowson was appointed in an action commenced by the Texas Department of Human Services pursuant to the Texas Health & Safety Code § 242.094 to protect the residents of the nursing homes. These bankruptcy cases, however, constitute insolvency proceedings. Prior to these cases, the state court trustee had commingled the funds.

In Aycock v. Texas Commerce Bank, 133 B.R. 190 (S.D.Tex. 1991), the district court held that § 9.306(d) applies "only to funds that have been commingled by the debtor, not to funds that may have been unsegregated by another creditor or a third party." Heller argues that under Aycock, § 9.306(d) does not apply because the state trustee, not Chartwell, commingled the funds. The trustees respond that Aycock misreads or rewrites the statute. In Aycock, the district court found that funds in a bank account were never commingled with any funds of the debtor. The court enunciated its rule of law premised on that fact. Here, the state trustee obtained funds of the debtor. Indeed, he commingled funds of the debtor, which may have been subject to Heller's security interest, with other funds that were also funds of the debtor, or at least, transferred to the trustee for or on account of the debtor. Thus, the Aycock premise of no funds of the debtor does not apply. Consequently, the court's holding would not necessarily follow. Furthermore, to the extent Aycock modifies the statute, it is not binding on this court, and this court respectfully declines to follow it.

The trustees are, therefore, entitled to summary judgment on count three.

In count four, the trustees allege that Heller holds no enforceable security interest in the funds held by the trustees. The count, however, appears to be limited to funds held by Trustee Litzler in his account II. Third amended complaint, par. 109. Heller moves for partial summary judgment on this count. Heller claims that all the funds derive from Chartwell operations or sources and, hence, are subject to Heller's security interest. The trustees concede that substantially all of the funds derive from receivables subject to Heller's claim, including the Medicare and Medicaid payments on the Texas nursing homes. But the trustees assert that the funds have been commingled.

The third amended complaint alleges that in November 1998, Irving Boyes, Chartwell's president and sole director, closed several Chartwell group bank accounts at Eagle National Bank in Dallas. Boyes transferred the funds in those accounts to Trustee Litzler who deposited them in an account at Dallas National Bank, account II. Invoking § 9.306(d), the trustees contend that the funds had been commingled. The court lacks summary judgment evidence to determine the source of the funds now in account II. As a result, Heller has not established that it is entitled to a partial summary judgment on this count.

From the hearing on the summary judgment motions, the court cannot determine whether the trustees actually intend to apply this count to all funds held by both trustees. Assuming the trustees do allege that count four applies to all funds held by the trustees and that they could prevail on this count, if pursued, the trustees must be precluded from obtaining relief as with the transfer of Medicare and Medicaid receivables. Substantially all the proceeds held by Trustee Reed derive from the Texas nursing homes' Medicare and Medicaid receivables. The trustees cannot obtain novation relief while retaining the proceeds from the Texas receivables. The implied novation included a transfer of the accounts receivable derived from the subject nursing homes. For the trustees to be able to invoke the benefit of the implied novation, Heller must receive the benefit from the transfer of the accounts receivable to 22 Acquisition. Without prejudice to the trustees' avoidance claims, for purposes of counts one, two and four, the court must recognize and effectuate Heller's claim on the funds held by the trustees, the count four issue notwithstanding.

Counts five, seven and nine

In count five, the trustees seek to avoid the transfer to 22 Acquisition pursuant to 11 U.S.C. § 544(a)(1) and Texas law. In count six, the trustees seek a setoff against 22 Acquisition. In count seven, the trustees assert a fraudulent conveyance claim against 22 Acquisition and Heller pursuant to 11 U.S.C. §§ 548 and 550. Irrespective of the implied novation issue, the court must address these counts. Unless voluntarily dismissed by the trustees, the court must rule on all issues presented. Blockton Cahaba Coal Co. v. United States, 24 F.2d 180, 181 (5th Cir. 1928)(explaining "it was the duty of the trial court to make complete findings of fact upon all the issues.") In addition, regarding the implied novation and related rulings above, the trustees must pay net funds to

Heller, without prejudice to the trustees’ avoidance claims. Lastly, if the novation issue should have gone to trial and if Heller prevailed at trial, the trustees would seek to avoid the transfers to 22 Acquisition and thereupon, recover from Heller. If the trustees can avoid the transfers, then, under the Bankruptcy Code, Heller could accordingly assert a claim. In count nine, the trustees seek to subordinate any such Heller claim.

Heller contends that the trustees may not prosecute fraudulent conveyance avoidance actions because the trustees cannot obtain a recovery for unsecured creditors. Heller asserts that if the trustees avoid the transfer to 22 Acquisition, the property recovered would be subject to Heller's perfected security interest. Heller cites a series of cases that hold that a Chapter 7 trustee may not prosecute a fraudulent conveyance avoidance action unless a recovery would benefit unsecured creditors.

The trustees reply that the transferred property itself cannot be recovered. Consequently, the trustees request a money judgment for the value of the property. 11 U.S.C. § 550(a). The trustees suggest that the Heller lien would not attach to the proceeds of the money judgment.

Contrary to the trustees' position, the court views as axiomatic that Heller may assert a claim if the trustees recover from Heller under § 550(a). Heller has asserted a secured claim and has evidence of perfected security interests at the time of the transfer. The trustees seek to equitably subordinate Heller's secured claim. If successful, recovery from an avoidance action would be available for unsecured creditors.

The court does not read one cause of action in the third amended complaint in isolation from other causes of action. More fundamentally, a court should not condition a trustee's standing to pursue an avoidance action on the court's view of the ultimate distributions in the underlying bankruptcy case. Therein lies the defect in Heller's reliance on cases limiting the statutory authority of a trustee to prosecute an avoidance action. Sections 544(b) and 548 of the Bankruptcy Code provide that "the trustee may avoid" certain transfers if the trustee meets his burden of proof. The Code does not provide that if the trustee is a Chapter 7 trustee, then he may only pursue his cause of action under certain conditions. Or, similarly, if the trustee is a Chapter 11 trustee, then he may pursue his cause of action under different conditions.

If the trustee prevails in this litigation and recovers a money judgment from Heller, Heller's claim shall be disallowed if Heller does not pay the money judgment. 11 U.S.C. § 502(d). Disallowance of the claim under § 502(d) would void the liens. 11 U.S.C. § 506(d); In re Davis, 889 F.2d 658, 662 (5th Cir. 1989)(explaining that § 502(d) is triggered only after a creditor has been afforded a reasonable amount of time to turn over a money judgment belonging to a bankruptcy estate). Thus, successful litigation by the trustee under 11 U.S.C. § 544(b) or § 548 resulting in a money judgment under 11 U.S.C. § 550 may have a significant effect on the ultimate distributions in the underlying bankruptcy cases even if the trustee does not collect on the judgment.

In addition, if Heller pays the judgment and invokes its secured claim, the trustee may still benefit the unsecured creditors by successfully litigating the equitable subordination claim. Thus, the trustees could conceivably recover a money judgment from Heller and then subordinate Heller's secured claim below that of unsecured creditors.

Heller argues, nevertheless, that, as a matter of law, the trustees cannot maintain their avoidance causes of action without summary judgment evidence of a benefit to the unsecured creditors in the underlying bankruptcy cases. The Code contains no such prohibition. This court declines to graft such a prohibition onto § 544 or § 548.

In count five, the trustees seek to avoid 22 Acquisition's claim of ownership in the transferred accounts receivable. The trustees allege that 22 Acquisition did not perfect its ownership interest in the receivables by filing a UCC-1 financing statement. As a result, the trustees contend the ownership interest may be avoided under 11 U.S.C. § 544(a)(1). Heller moves for summary judgment dismissing the count, while the trustees move for summary judgment voiding 22 Acquisition's ownership interest in the accounts receivable.

Article 9 of the then applicable Texas Uniform Commercial Code “applies to any sale of accounts or chattel paper.” Tex. Bus. & Com. Code § 9.102(a)(2)(1998). To perfect a security interest in accounts, a financing statement must be filed. Tex. Bus. & Com. Code § 9.302(a)(1998). The trustees contend that similarly to perfect an ownership interest in accounts, a financing statement must be filed. S. Rock, Inc. v. B & B Auto Supply, 710 F.2d 683, 685 (5th Cir. 1983); In re Charge Trucking, 236 B.R. 620, 623 (Bankr. E.D. Tex. 1999).

22 Acquisition did not file a UCC-1 financing statement. Consequently, unless a perfection exception exists, the trustees may avoid the 22 Acquisition ownership interest pursuant to § 544(a)(1).

Both the trustees and Heller agree that certain types of transactions are excluded from the perfection provisions of Article 9. Specifically, the provisions do not apply “to a sale of accounts or chattel paper as part of a sale of the business out of which they arose.” Tex. Bus. & Com. Code § 9.104(6)(1998). The trustees assert that 22 Acquisition did not purchase the business out of which the receivables arose. Heller contends to the contrary.

Chartwell had been in the business of operating nursing homes. Chartwell transferred certain leasehold interests for the operation of nursing homes in Texas and Florida. Chartwell also transferred the outstanding accounts receivable generated from the operation of those nursing homes. Consequently, Heller asserts that Chartwell sold the accounts to 22 Acquisition as part of the sale of the business out of which they arose.

The trustees observe, however, that the August 3 letter agreement, containing the terms of the transaction, does not state that 22 Acquisition was acquiring Chartwell's business. The agreement states that 22 Acquisition "is acquiring" from Chartwell and its subsidiaries "the following assets." The agreement then identifies the assets as certain leasehold interests and accounts. The agreement further states that the parties will use reasonable efforts to conclude a similar agreement "to assume 10 leasehold interests in Missouri." The agreement thus refers to the acquisition of assets. The agreement does not state or refer to the purchase of the business of Chartwell.

In their second amended complaint, however, the trustees alleged that 22 Acquisition had successor liability to Chartwell as a result of the purchase of Chartwell's business. 22 Acquisition denied that allegation in its answer. The trustees contend the denial means that 22 Acquisition does not believe it purchased Chartwell's business. Heller observes that the mere denial may only mean that 22 Acquisition denies it has successor liability. Of course, if 22 Acquisition purchased the business, it may have successor liability for the subject nursing homes.

If, on the other hand, it did not purchase the business, then the perfection exception would not apply.

Based on this summary judgment evidence and the competing inferences which the court may draw therefrom, there is a genuine issue of material fact concerning whether 22 Acquisition purchased the Chartwell business, thereby precluding summary judgment on this count for either party.

In count seven of the third amended complaint, the trustees seek to avoid the transfers to 22 Acquisition under 11 U.S.C. § 548, and, thereupon, seek to recover a money judgment from Heller and Complete Care under § 550. Heller moves for summary judgment dismissing count seven. Complete Care joins in that motion.

Heller contends that the summary judgment evidence establishes that Chartwell received reasonably equivalent value for the transfer to 22 Acquisition. 11 U.S.C. § 548(a)(1)(B)(i). Pursuant to the agreement dated August 3, 1998, the Chartwell entities transferred leasehold interests in 12 Florida and Texas nursing homes to 22 Acquisition as well as outstanding accounts receivable related to services provided at those nursing homes. In exchange, 22 Acquisition paid Chartwell $1,010,000 to fund a delinquent payroll at the subject nursing homes and made several promises to pay. 22

Acquisition promised to pay Chartwell's outstanding obligation of $6,333,295 to Heller with respect to the transferred properties. 22 Acquisition also promised to pay Chartwell two subordinated notes with a principal amount of $2,000,000 each.

22 Acquisition agreed that Complete Care Services would manage the nursing homes for a fee based on five percent of gross revenues.

The determination of value must be made as of the time of the transfer. There is summary judgment evidence that Heller valued the leasehold interests at $7,100,000. There is also summary judgment evidence from Heller's records that suggests the transferred outstanding accounts receivable totaled $4,500,000, although there is conflicting evidence from Chartwell's accounting records suggesting $3,100,000.

"Value" under § 548 means property or the satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unfulfilled promise to furnish support to the debtor. 11 U.S.C. § 548(d)(2). With the implied novation, the value given in exchange for the transfer would include the $6,333,295 extinguished debt. Assuming no novation, the promise to pay does not factor into the value determination, unless Chartwell received an actual debt reduction or the promise was marketable and included on Chartwell's balance sheet. In re Consol. Capital Equities Corp., 143 B.R. 80, 87 (Bankr. N.D. Tex. 1992). According to the note executed by 22 Acquisition, collections on the transferred accounts were to be applied against the outstanding Chartwell debt to Heller, which was assumed by 22 Acquisition. If that occurred, the debt reduction would be considered value. If the debt was not actually reduced, then the assumption agreement, unless included on the balance sheet and marketable, is merely a promise to pay in the future. Likewise, the promise to pay notes in the future adds no "value" to the transfer, if it is not on the balance sheet and marketable.

Thus, there is summary judgment evidence that 22 Acquisition provided as little as $1,010,000 in value for assets with a value over $10,000,000. On the other hand, there is summary judgment evidence that the value given in exchange for the transfers may have been in the range of $7,300,000, without considering whether the notes were on the balance sheet and marketable. Therefore, a genuine issue of material fact exists concerning reasonably equivalent value given for the transfer.

Heller contends that the transferred assets had been subject to its security interest. Indeed, had the assets not been transferred, they would be available to pay on the secured debt. But if Chartwell transferred the assets without obtaining satisfaction of the debt, a genuine issue of material fact exists concerning reasonably equivalent value given for the transfer.

Heller also argues that the trustees cannot obtain a judgment against Heller under § 550. Under § 550, the trustee may recover, for the benefit of the estate, property transferred, or, if the court so orders, the value of the property, from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a).

Chartwell transferred the property to 22 Acquisition, making 22 Acquisition the initial transferee. But the trustees allege that Chartwell made the transfer to benefit Heller. Heller has presented summary judgment that suggests that Chartwell could not operate the Florida and Texas nursing homes in August 1998 when it made the transfer. Heller's evidence suggests that 22 Acquisition had the financial and operational ability to operate the transferred nursing homes. That, in turn, facilitated payment of Medicare and Medicaid funds for the nursing homes, especially by the State of Florida and the Texas trustee. And that allowed 22 Acquisition to make payments to Heller. 22 Acquisition, with Heller's consent, assumed Chartwell's obligation to Heller concerning the subject nursing homes. 22 Acquisition collected Chartwell-transferred receivables and paid the proceeds to Heller. Heller thereupon reduced the Chartwell debt, irrespective of the novation issue. This evidence suggests, and indeed Heller appears to concede, that the transfer facilitated payment on the Heller debt. (Interestingly, the un-executed financing assumption agreement, cited by Heller for its contention that the Chartwell debt had not been extinguished by novation, acknowledges that the Chartwell transfer to 22 Acquisition confers a benefit on the affiliated Heller entities.)

Drawing inferences in favor of the trustees, as the parties opposing the motion, there is a genuine issue of material fact of whether Chartwell transferred the property to facilitate debt payment to Heller, making Heller a beneficiary of the transfer. While these facts may not fit the "paradigm" of § 550(a), see In re Consol. Capital Equities Corp.(CCEC), 175 B.R. 629, 636-37 (Bankr. N.D.Tex. 1994), the court cannot determine without a trial whether Heller would fit the benefit standards of § 550(a)(1).

In CCEC, this court held that "a subsequent transferee cannot be the entity for whose benefit the initial transfer was made, even if the subsequent transferee actually receives a benefit from the initial transfer." 175 B.R. at 636. Heller contends that this holding precludes recovery by the trustees under § 550(a)(1), regardless of whether it benefitted by the transfer. Heller may indeed be correct on that point, although the court cannot make that determination until the trial. The court notes, however, that in CCEC, the court considered precedent from the Ninth Circuit.

However, in In re Food Catering & Hous., Inc., 971 F.2d 396, 398 (9th Cir. 1992), the Ninth Circuit has determined that a lender receiving a benefit of a transfer under 11 U.S.C. § 547 would be subject to a judgment under § 550(a)(1). The Ninth Circuit's decision arguably makes "for the benefit of a creditor" under § 547(b)(1) synonymous with "for whose benefit" under § 550(a)(1). Although § 548 does not contain a "benefit" proviso, the court may, nevertheless, need to revisit its reasoning in light of Food Catering. Furthermore, even if Heller is correct, the court would still have to address recovery by the trustees under § 550(a)(2) and (b), which cannot be done until a trial. Heller has, therefore, not established that it is entitled to summary judgment on the issue.

If the trustees avoid the transfer of the accounts receivable to 22 Acquisition, the trustees may be able to setoff funds held against any 22 Acquisition claim. This count cannot be resolved until the avoidance counts have been determined after trial.

Based on the foregoing analysis, Heller's motions for summary judgment concerning counts five, six and seven must be denied. The trustees' motion concerning count five must also be denied.

Heller also seeks summary judgment dismissing the trustees' count nine for equitable subordination. Heller maintains that the trustees cannot assert a claim for equitable subordination.

The Bankruptcy Code provides that "the court may – (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another claim." 11 U.S.C. § 510(c)(1). To equitably subordinate a claim under § 510(c)(1), the trustees must establish: (1) that the claimant engaged in inequitable conduct; (2) that the conduct resulted in harm to the creditors and conferred an unfair advantage on the claimant; and (3) that the subordination would not be inconsistent with the Bankruptcy Code. In re Fabricators, Inc., 926 F.2d 1458, 1464-65 (5th Cir. 1991); In re Mobile Steel Co., 563 F.2d 692, 699-702 (5th Cir. 1977).

Inequitable conduct usually involves: (1) fraud, illegality or breach of fiduciary duties; (2) undercapitalization; or (3) a claimant's use of the debtor as a mere instrumentality or alter ego. In re Herby's Foods, Inc., 2 F.3d 128, 131 (5th Cir. 1993); In re Clark Pipe & Supply Co., Inc., 893 F.2d 693, 699 (5th Cir. 1990).

Heller presents summary judgment evidence that it merely took actions to enforce its contractual rights. See Clark Pipe, 893 F.2d at 702. Furthermore, a lender has no fiduciary obligation to either its borrower or other creditors of its borrower in the collection of its claim. Id.

But the trustees present summary judgment evidence that demonstrates genuine issues of material fact concerning Heller's conduct. While the Fifth Circuit has articulated the factors usually considered for inequitable conduct, the Bankruptcy Code vests the court with discretion to determine equitable subordination based on the facts of the case. Like the common law, the standards for equitable subordination evolve based experience and a practical assessment of community mores and practices. The trustees have presented an analysis that Heller participated in a transaction that transferred Medicare and Medicaid receivables in violation of federal law. That, in and of itself, may constitute the type of illegal conduct contemplated by the Fifth Circuit.

Without reorganization, Chartwell could not continue to operate the Florida and Texas homes. The affidavit of Michael Rochelle suggests that Chartwell may have been able to reorganize. However, the summary judgment evidence supports an inference that Heller participated in the scheme that caused Chartwell to transfer its leasehold interests in the Florida and Texas nursing homes to 22 Acquisition, with 22 Acquisition operating the homes.

If the court erred regarding the novation, then there is further summary judgment evidence that Heller provided little debt reduction for the transfer. Heller argues that it did not extinguish the Chartwell debt. Heller knew and consented to the transfer. Heller anticipated that the transfer would facilitate debt collection. Heller’s internal memoranda reflect debt reduction, but Heller demands full payment. Heller’s internal memoranda reflect a value of the transferred assets considerably greater than the actual payment for the assets by 22 Acquisition, unless Heller extinguished the debt. With the transfer, Heller obtained proceeds released by the state of Florida. The trustees contend that Heller did not provide notice to Chartwell of any resolution or collection from the state of Florida. There is also summary judgment evidence that Heller did not account for collections of receivables by not providing notice of collections to Chartwell. Thus, there is summary judgment evidence that Heller participated in a scheme to transfer assets to 22 Acquisition, that the transfer may have violated federal law, that Heller benefitted by the transfer, that Heller left Chartwell unable to pay the debt, that Heller did not extinguish the debt, and that Heller still demands payment as a secured creditor. In other words, Chartwell was left with the Heller debt and no ability to pay the debt and/or reorganize its affairs. Meanwhile, there is summary judgment evidence that Heller, internally, reduced the debt by $6,333,295. Heller may have thereby reduced the debt on its books while demanding full debt payment before recovery by unsecured creditors.

In addition, if the trustees prevail on their claim under § 548 but cannot obtain a money judgment from Heller under § 550, Heller will have obtained a benefit from a fraudulent conveyance to the harm of other creditors.

There are genuine issues of material fact concerning whether Heller engaged in conduct beyond mere contractual debt collection to the extent of inequitable conduct which harmed Chartwell’s creditors. Until facts are established at trial, this court cannot hold, as a matter of law, that subordination would be inconsistent with the provisions of the Bankruptcy Code.

Other counts

At the hearing on the summary judgment motions, the trustees announced that they were not pursuing counts eight and ten. Those counts shall be dismissed.

Count 11 seeks an accounting and disgorgement. The summary judgment motions do not address count 11. However, the parties agree that Heller is not subject to a disgorgement order.

Lastly, Heller seeks a summary judgment dismissing count 14, which seeks attorney’s fees. Because the trustees have prevailed, in part, on summary judgment, Heller’s summary judgment motion addressing count 14 must be dismissed.

Order

Based on the foregoing,

IT IS ORDERED that Heller's motions for summary judgment are **GRANTED IN PART** and **DENIED IN PART.**

IT IS FURTHER ORDERED that the trustees' motion for summary judgment is **GRANTED IN PART** and **DENIED IN PART**.

IT IS FURTHER ORDERED that regarding counts one and two, $6,333,295 of Heller's claim is extinguished. The remainder of the claim has been paid in full by proceeds collected by Heller. Heller owes the trustees $655,641.60. That amount shall be setoff from the receivables held by the trustees. The balance of the receivables shall be paid to Heller, subject to the adjudication of the remaining counts in the third amended complaint.

IT IS FURTHER ORDERED that regarding counts three and four, Heller's motion for summary judgment is **DENIED** and the trustees' motion is **GRANTED** as to count three and **DENIED** as to count four.

IT IS FURTHER ORDERED that the motions for summary judgment regarding counts five, six, seven, nine and fourteen are **DENIED**.

IT IS FURTHER ORDERED that counts eight and ten are **DISMISSED.**

Signed this ______ day of October, 2002.

____

Steven A. Felsenthal
United States Bankruptcy
Judge