IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	: CHAPTER 11
	:
22 ACQUISITION CORP.	:
	:
DEBTOR(S)	: BANKRUPTCY NO. 01-36543 SR

OPINION

By: STEPHEN RASLAVICH, UNITED STATES BANKRUPTCY JUDGE.

Introduction.

There are before the Court three motions in this Chapter 11 case:1) the Application of the Debtor, 22 Acquisition Corp., for authority to employ Total Health Care Consultants of Texas, LLC, d/b/a ZA Consulting of Texas, Inc. ("Total Healthcare") as consultants; 2) the Debtor's Motion to expand the scope of services Total Healthcare is authorized to perform slightly beyond those described in the original retention application; and 3) the Debtor's Motion for an Order authorizing and approving the Amendment and Assumption of six lease agreements. These requests have been pending for several months for reasons which will be detailed herein. Approval of the Debtor's request is strongly supported by the Debtor's primary secured creditor, Heller Healthcare Finance, Inc. ("Heller") and the Official Committee of Unsecured Creditors (the "Creditors Committee"). A lone but vigorously pressed objection is interposed by the Office of the United States Trustee. For the reasons which follow, the Debtor's requests will be approved.

Background.

The Trustee's Objection to the Retention Application and the follow-up Motion related thereto, are premised generally on assertions that the proposed consultant, Total Healthcare, is ineligible for employment by the estate under 11 U.S.C. § 327(a), because it is not a disinterested person as that term is defined in 11 U.S.C. § 101 (14), and because it has a material adverse interest to the estate. The Trustee's contentions pertain specifically to alleged conflicts of interest that are said to be present by virtue of inter-relationships which exist between and among the Debtor, Total Healthcare, Heller, the Debtor's landlords, and certain individuals having ownership interests in the foregoing entities. Supporters of the pending requests acknowledge the presence of certain connections, but they characterize them as remote and attenuated. The Trustee's assertions of conflicts, they say, exaggerate the facts and represent a case of "horrible imaginings." The facts germane to these concerns have been aired at several evidentiary hearings in this Court and are detailed at length in various memoranda of law submitted to the Court by the parties in interest, and in the comprehensive May 31, 2002 report of an independent Examiner appointed by Order of this Court dated February 26, 2002. As discussed herein, the Court finds some merit to the parties' competing positions, but concludes that both sides to this controversy overstate their case. In the final analysis, the Court has determined that rather than establishing a disqualifying conflict of interest, the evidence presented demonstrates at most the potential for a future conflict. Based on this conclusion the Court, although it has the discretion to disqualify Total Healthcare under applicable principles of law, declines to do so. The relevant facts are, as follows:

The Debtor is a Delaware Corporation with a principal place of business in Philadelphia, Pennsylvania. The Debtor's business is the operation of seven long term care/nursing home facilities in the State of Texas. The actual nursing home facilities themselves are leased by the Debtor. Philtex Holding, Inc. ("Philtex") is landlord in five of the seven cases. A sixth facility is leased from an entity known as Silver Serenity, Inc. ("Silver Serenity"). The seventh nursing home is subleased by the Debtor from an entity called Blue Bonnet Healthcare, Inc.[1] Total Healthcare assumed basically all day to day operations for all of the nursing homes of the Debtor in February 2001; this pursuant to a series of pre-petition engagement letters described at paragraph 4 of the Debtor's application to employ Total Healthcare. Gregory Lentz is the individual who on behalf of Total Healthcare has principal responsibility for management of the Debtor's daily operations. In the ninety days prior to the bankruptcy filing, the Debtor paid Total Healthcare the sum of \$277,354.10 under the aforesaid engagement letters, and owed it on account a balance of \$223,205.00. The present retention application essentially represents a request by the parties to continue their pre-petition relationship.

The ownership structure of the entities in question breaks down, as follows: The Debtor corporation is owned by an entity called Feld, LLC. Feld, in turn, is co-owned by individuals named Steven Fishman and Frederick Ehmann. Total Healthcare is 70% owned by Z.A. Consulting, LLC ("ZA Consulting"). The remainder of Total Healthcare is owned by individuals named Don McKay (15%) and Roy Freeborn (15%). ZA Consulting, in turn, is owned by Steven Fishman (40%); Gregory Lentz (20%); Allan Morrison (20%); and Janet Himmelreich (20%). Philtex and Silver Serenity are owned by Fishman (20%), Ehmann (50%), Lentz (10%), Morrison (10%) and Himmelreich (10%).

The Debtor's liabilities far exceed its assets. Heller is the Debtor's primary creditor and the outstanding balance owed to it is approximately \$17,000,000. Heller holds a first lien against all of the Debtor's assets as security for its debt. Heller is also the primary secured creditor of Philtex

[1]There are no interrrelationships alleged between the parties in interest and Blue Bonnet Healthcare and that entity does not otherwise figure in these proceedings.

and Silver Serenity and holds a first mortgage on the realty leased by those entities to the Debtor. Rents paid by the Debtor thus "pass through" Philtex and Silver Serenity and go towards servicing the landlord's mortgage loans, which loans are cross-collateralized with Heller's loans to the Debtor. In addition to the foregoing, Heller is also 1) a substantial, but subordinated secured creditor of ZA Consulting and Total Healthcare, 2) a lender and equity participant with an affiliate of ZA Consulting known as Zack Investments, a Pennsylvania L.L.C., and 3) the financier of 54 nursing home operations in Florida owned in part by Fishman. The specific details of all of the Heller loans are delineated in the Examiner's Report and are incorporated herein by reference.

One primary source of revenue for the Debtor is reimbursement it receives from an agency of the United States Department of Health and Human Services ("HHS") known as the Center for Medicare and Medicaid Services. ("CMS") In November 2001, HHS notified the Debtor that it was initiating proceedings to recoup $3,000,000 in alleged over payments by CMS to the Debtor. This was apparently the precipitating event for this bankruptcy case, which was commenced on November 28, 2001.

On December 4, 2001, the Debtor filed the instant application to employ Total Healthcare and on December 13, 2001, the Office of the United States Trustee filed its Objection.[2] The Trustee's Objection asserted that by virtue of the above described interrelated ownership and lending relationships, Total Healthcare had an actual conflict of interest or a material adverse interest to the Debtor. The Trustee also stressed Total Healthcare's pre-petition claim against the Debtor, and argued that its status as a creditor of the Debtor barred its retention. An evidentiary hearing with

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[2] Objections were also filed by CMS and the Creditors Committee, however these have since been withdrawn.

respect to the Application was held on January 3, 2002. At the conclusion thereof the Court expressed the need to review the record in detail, however the Court stated that in view of the fact that a stopgap ruling was necessitated in order to avoid disruption or cessation of the Debtor's business, it would approve the request on an interim basis. A written order memorializing that decision was entered on January 18, 2002, and it authorized the Debtor to employ Total Healthcare through March 31, 2002 on the terms proposed, subject to Total Healthcare's waiver of its pre-petition claim for all purposes save for its assertion as a defense in any later action brought against Total Healthcare under the avoidance provisions of the Bankruptcy Code.

In the interim, (January 15, 2002) the Debtor filed the present Motion for an order authorizing and approving the amendment and assumption of the Philtex and Silver Serenity leases. Shortly thereafter, (January 23, 2002) the Trustee filed a Motion to Convert or Dismiss the Debtor's Bankruptcy case, then followed that with an Objection to the proposed lease assumption on February 7, 2002. The Trustee's conversion/dismissal motion and his objection to lease assumption tracked, more or less, the assertions of the earlier objection to the retention of Total Healthcare; to wit: that the interrelationships which existed essentially precluded the possibility that the Debtor could act as a fiduciary and exercise independent business judgment in the conduct of this case.

The conversion/dismissal motion was heard on an expedited basis on January 29, 2002. The record with respect to the Motion consisted basically of the record made earlier in connection with the Total Healthcare retention application. At the conclusion of proceedings, the Court denied the request to convert or dismiss the case; however, the Court ruled that in light of an admittedly complex setting it would direct the appointment of an independent Examiner under 11 U.S.C. § 1104, and charge that individual to review the circumstances and prepare a report and evaluation of the Debtor's request to retain Total Healthcare and assume the Philtex and Silver Serenity leases, taking specifically into account the various challenges which had been raised as to conflicts of interest. After consultation with the parties and an extensive search, the U.S. Trustee recommended the appointment of John F. Gough, Esquire, an attorney experienced in the fields of healthcare and healthcare facilities law. By order dated February 26, 2002 this appointment was approved.

The Examiner, as previously noted, prepared a lengthy report dated May 31, 2002. Pending its receipt, the Court, in the months that had intervened since the January 2002 hearing on the Debtor's Motion to Employ Total Healthcare, had entered bridge orders which continued the interim authority on the same terms as originally stipulated, subject to the Court's final determination on the merits of the question. The lease assumption motion, which was originally scheduled for hearing on February 14, 2002, had also been continued pending the Court's receipt and consideration of the Examiner's report.

Both matters were re-listed for hearing on June 11, 2002. At that time the parties were given the opportunity to supplement the record with additional evidence in light of the Examiner's report and/or the passage of time. Both the Debtor and the Trustee elected to do so; the Debtor offering brief additional testimony from Gregory Lentz, and the president of the Debtor corporation, Robert W. Scott, and the Trustee offering excerpts from prior deposition testimony of Lentz, Scott and Fishman. Following this supplementation, the parties all submitted memoranda of law. The last of these having been received, the pending matters are, in short, ripe for disposition.

<u>Discussion</u>.

A. **<u>Employment of Total Healthcare.</u>**

The opposing parties do not, for the most part, disagree over the principles of law applicable to their dispute; rather, they differ over the application of that law to the facts *sub judice*.

Bankruptcy Code § 327(a) provides that "the Trustee may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons that do not hold or represent an interest adverse to the estate, and that are disinterested persons." 11 U.S.C. § 327(a). A "disinterested person" is, in relevant part, a person who: "(A) is not a creditor, an equity security holder, or an insider, . . . and (E) does not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor. . . " 11 U.S.C. § 101(14)(A) and (E). It has been observed that these two tests, i.e., the twin requirements of disinterestedness and lack of adversity, telescope into what amounts to a single hallmark. *See In re Martin*, 817 F.2d 175, 180 (1st Cir. 1987).

An insider of a corporate debtor is deemed to be an officer, director, or person in control of the Debtor, "or an affiliate, or insider of an affiliate, as if such affiliate were the debtor." 11 U.S.C. § 101(31)(B)(iii) and (E). An "affiliate," in turn, is defined in Bankruptcy Code § 101(2) to mean, *inter alia,* "a corporation, 20% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote, by the Debtor, or by an entity that directly or indirectly owns, controls or holds with the power to vote 20% or more of the outstanding voting securities of the debtor. . ." 11 U.S.C. § 101(2)(B).

Perhaps not unsurprisingly, what might appear at first blush to be straightforward statutory language has nevertheless generated considerable controversy and resultant interpretive case law. The term "adverse interest," for example, is itself not defined in the Bankruptcy Code. It has been construed, however, that to hold an adverse interest to the estate means to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate, or that would create either an actual or potential dispute in which the estate is a rival claimant. *TWI International v. Vanguard Oil and Service Co.*, 162 B.R. 672, 675 (Bankr. S.D. N.Y. 1994). The concept of adverse interest has also been viewed in terms of motivation, that is to say that a professional will be considered to have an adverse interest where the professional possesses a meaningful incentive to act contrary to the best interest of the estate and its creditors. *In re Martin* 817 F.2d 175, 180 (1st Cir. 1987), or where the professional possesses an interest or relationship that would color the professional's independence and impartial attitude. *In re BH&P Inc.,* 949 F.2d 1300, 1308 (3rd Cir. 1991). Most courts agree that an adverse interest must rise to a level of materiality to create a conflict of interest that is disabling, and that the inquiry is therefore fact specific. *See e.g., In re Martin, supra*, 181 - 182 (adverse interest must be sufficiently material to create an unacceptable risk of conflicting loyalty) Indeed, most courts reject any invitation towards a mechanical or *per se* approach to the question, endorsing instead a case by case analysis. *See, e.g.*, *In re Creative Restaurant Management Inc.*, 139 B.R. 902, 912-913 (Bankr. W.D. Mo. 1992) and *In re Howard Smith, Inc.*, 207 B.R. 236 (Bankr. W.D. OK 1997)

As guidance for Bankruptcy Courts locally, the Third Circuit Court of Appeals has emphasized the distinction between various levels of conflict, holding in *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, 476 (3rd Cir. 1998) that Bankruptcy Code Section 327(a) requires the disqualification of professionals who have an <u>actual</u> conflict of interest, permits the Court in its discretion to order the disqualification of a professional having a <u>potential</u> conflict of interest, but restricts the Court from disqualifying a professional based on the <u>appearance</u> of a conflict alone.

The parties themselves have directed the Court's attention to the above decisions. They disagree, as noted, on their application herein. The Trustee's initial argument is that Total Healthcare cannot meet the test of disinterestedness because it is an "affiliate"of the Debtor and hence a prohibited "insider." In this respect the Trustee stresses that Fishman owns 40% of ZA Consulting, which in turn owns 70% of Total Healthcare, and that Fishman also owns a 50% share of the Debtor's parent corporation, Feld LLC. This confluence, says the Trustee, makes Total Healthcare an affiliate of the Debtor. In support, the Trustee cites *In re Holly Hill Medical Center Inc.*, 53 B.R. 412 (Bankr. M.D. Fla 1985). In *Holly Hill*, a single individual owned 95% of the shares of one corporation and 42½% of the shares of the Debtor corporation, with neither corporation owning shares of the other. 53 B.R. at 413 The Court held that the non-debtor corporation was an affiliate and hence an insider of the Debtor by virtue of the common shareholder interest. *Id.*

The facts of *Holly Hill*, however, do not mirror those herein. In *Holly Hill*, the debtor and non-debtor corporations were each controlled by a single individual. Such is not the case here. The Debtor corporation and Total Healthcare are each the subsidiary of a separate parent corporation. The respective parent corporations, i.e., Feld and ZA Consulting, have a common <u>minority</u> shareholder in the person of Fishman. It cannot be said therefore, nor did the evidence of record establish, that Fishman alone controls either the Debtor or Total Healthcare. On the contrary, the testimony tended to establish that Fishman, if anything, is more or less a passive stockholder of both Feld and ZA Consulting, with day to day business operations of the Debtor being run for the Debtor by Total Healthcare in the person of Gregory Lentz, subject to review and approval, albeit for the most part perfunctory, of the Debtor's president, Robert W. Scott.

In sum, the ownership structure at issue does not fit the technical definition of an affiliate relationship and the Court therefore rejects the argument that Total Healthcare is an affiliate of the Debtor. The Court notes in passing that the Examiner reached a similar conclusion, opining at page 22 of his report that "the fact that the Debtor's 100% parent corporation Feld and Total Healthcare's 70% parent company (ZA Consulting, LLC) share a common minority shareholder, Steven Fishman (who owns 50% of Feld and 40% of ZA Consulting) does not, in the Examiner's opinion, make the subsidiarys (the Debtor and Total Healthcare) affiliates of each other and therefore insiders with respect to each other within the meaning of § 101(31) (E) of the Bankruptcy Code.

Beyond the argument that Total Healthcare is a prohibited insider of the Debtor by reason of being its affiliate, the Trustee argues that there are other independent grounds upon which the Court should adjudge Total Healthcare to be an insider of the Debtor. On this point the Trustee observes that the statutory definition of the term "insider" does not exhaust the list of persons whom the Court may find to be insiders. Rather, because the statutory definition uses the term"includes," a wide variety of relationships not listed in the statute may be sufficient to confer insider status on a person under 11 U.S.C. § 102 (31) (B).

The Trustee is correct that insider status may be based on a professional or business relationship with the Debtor beyond the *per se* classifications found in the statute. Thus, whenever allegations are made that any person has such a close relationship with the Debtor that unfair advantage is being gained by that person, close scrutiny is of course in order. Close scrutiny, however, has been paid to the circumstances of this case, and the evidence points to nothing beyond a circumstantial case at most.

The Trustee argues that Fishman and Lentz are insiders of the Debtor by virtue of their insider interests in Feld LLC, ZA Consulting, Philtex and Silver Serenity. He asks the Court to collapse any separateness between these legal entities and the Debtor for purposes of the present inquiry, and then to impute disqualifying insider status to Total Healthcare as the final result. The supporters of the retention application stress, conversely, that the applicant, Total Healthcare, does not fit within any of the specifically listed classifications of an insider found in 11 U.S.C. § 101 (31)(E), and emphasize the dire consequences which would inevitably follow should the retention application be denied. In the latter respect, a persuasive case was made out.

Supporters of the application stress that Total Healthcare has been intimately involved with the Debtor's business since well before the Bankruptcy filing, and that at no time has there ever been a complaint going to the quality or cost of its services. Indeed, Total Healthcare was apparently employed by the Debtor only after it had suffered bad experiences with two other service providers. On this score, the Examiner noted, in particular, that the fees charged to the Debtor by Total Healthcare are significantly (approximately 20% or more) lower than the percentage of revenue rate typically charged in the marketplace, and that there is no evidence in the record warranting a change of management, or indicating that equivalent management services are even available in the marketplace. (Examiner's Report at page 23). The Examiner posits that replacement of Total Healthcare would likely cause serious disruption in the Debtor's operations and patient care. The Debtor, the Creditors Committee and Heller go further, and bluntly state that without the services of Total Healthcare the Debtor will be forced to close its doors.

The Trustee offers nothing to rebut these points, instead arguing simply that the affinities which exist between Fishman and Lentz on the one hand, and Total Healthcare on the other, standing alone, are sufficient to confer prohibited insider status on the latter entity. In this argument the Court sees an invitation for it to eschew objectivity and adopt a mechanistic, reflexive approach to the question presented. The Court respectfully declines to do so. There is no evidence of record that Fishman, Lentz, or anyone else associated with this case has at any time acted in anything other than a proper and above board manner, nor has any party with an economic stake in the outcome of this proceeding even suggested differently.

To expand the statutory definition, and extend insider status to Total Healthcare on the facts presented would ignore the realities of this case and make no practical sense. The Heller claims so vastly exceed the value of the Debtor's assets that, despite the network of interrelationships discussed herein, this Chapter 11 case is, at least in some respects, fairly straightforward. As the Examiner noted in his report, a successful outcome in this case is most likely to occur, if at all, through a sale of the Debtor's assets under Section 363 of the Bankruptcy Code to a purchaser financed by Heller in furtherance of a consensual liquidating Chapter 11 plan or, in the less likely alternative, via an income based reorganization plan, but in either event with administrative expenses and any dividend for unsecured creditors to come from funds "carved out" through an agreement with Heller. (Examiner's report at 6 - 7) It is in no doubt in recognition of these facts that the Creditors Committee so staunchly supports approval of the retention application.

In a final argument for the disqualification of Total Healthcare, the Trustee invokes the material adverse interest standard contained in the statutory definition of disinterestedness found at 11 U.S.C. § 101 (14)(E). As previously noted, the term adverse interest is not defined in the Bankruptcy Code. The Trustee's position in this regard is premised on the same body of facts and circumstances detailed throughout this opinion. Stressing in particular, however, the scope of the services which Total Healthcare performs for the Debtor, the Trustee argues that it is inherently improper for a professional who performs a wide variety of tasks that largely shape the Debtor's financial and operational structure to be closely associated with that Debtor's major secured creditor. Rather, says the Trustee, as a general principle professional persons employed by the estate should be free from any conflicting interests which might affect the performance of their services or might impair a high degree of impartiality during the administration of the case. *See generally* 3 COLLIER ON BANKRUPTCY ¶ 327.03 page 327-22. (Matthew Bender 15th Ed. Revised 2000)

The Court will not belabor the entire backdrop of relevant facts and circumstances yet again. Suffice it to say furthermore, that there is little reason to quarrel with the Trustee's referral to the general principles articulated in *Collier.* The Trustee again, however, demonstrates a certain lack of perspective in arguing the existence of an inherent conflict based on the relationships shown. There is no doubt that there is the potential for conflict inherent here. However, as explained by the Circuit Court in *Marvel Entertainment*, *supra,* the existence of an actual conflict alone mandates disqualification. There is simply no evidence of such a conflict on this record. On the contrary, the dynamics of this case being as they are, there is every reason to conclude that the various parties in interest, including the applicant, Total Healthcare, have economic incentives which are more or less aligned. As a consequence, subject to one caveat, the Court will therefore not disqualify Total Healthcare from employment on any of the bases urged by the United States Trustee.[3]

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[3] The Court observes in passing that the historic financial operations of the subject nursing homes have been indeed checkered to say the least. The Debtor acquired the homes in August 1998 from Chartwell Healthcare, Inc. when that entity was unable to meet its expenses and was forced to cease operations. Chartwell at present is in a Chapter 7 Bankruptcy proceeding in Texas. Its prior ownership of the nursing homes was apparently financed, just as the present Debtor's, by Heller, an additional factor the Trustee makes note of in respect of the parties' interrelationships. The Court acknowledges that this "history" adds all the more reason to ensure that the conduct of all of the parties in this case receives appropriate scrutiny. The Court reiterates, however, that a great deal of light has been focused on the entire situation, but no evidence of untoward conduct and/or an actual conflict of interest has emerged.

(continued...)

The single caveat which must be added goes to the pre-petition claim of Total Healthcare, and its receipt of monies from the Debtor during the ninety day pre-petition preference period. The issue of a pre-petition claim has actually already been dealt with, as the interim orders approving Total Healthcare's employment to date have all been conditioned on its waiver of that claim. The issue of a preference payment is less straightforward.

The Trustee correctly notes that the Third Circuit Court of Appeals in *In re First Jersey Securities*, 180 F.3d 504, 514 (3rd Cir. 1991) has held that a law firm's receipt of a preference payment from a Debtor disqualifies its from representing that Debtor. The evidence of record in this case has established only that Total Healthcare was paid money by the Debtor during the preference period. There is no evidence which would tend to clarify whether the payment in question was or was not preferential, and whether if it was, affirmative defenses, such as the exchange of new value, might exist. The interim employment orders entered in this case, in fact, preserved Total Healthcare's pre-petition claim for the limited purpose of permitting Total Healthcare to rely on the services rendered in connection with that claim as potential defenses to a preference action.

The Trustee argues that prior to sanctioning its employment, the Court must first establish to a certainty whether or not Total Healthcare has received an avoidable preference payment, and further, that anything short of an unconditional waiver of its pre-petition claim will fail to insulate Total Healthcare from disqualification, given the Third Circuit's decision in *In re BH&P Inc.*, 949 F.2d 1300 (3rd Cir. 1991). The Debtor, in response, argues that the Trustee misreads *First Jersey* to require a formal and final adjudication where there exists only the potential that a proposed

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[3](...continued)

professional has received an avoidable preference payment. The Court agrees that the Trustee's reading of *First Jersey* is an overbroad interpretation of that case. Under the circumstances, however, it seems perfectly clear that neither the Debtor, Heller, nor the Creditors Committee have any interest in joining the question of an avoidable preference through the institution of litigation, which leaves the matter in a somewhat awkward posture. Perhaps in recognition of this, the Examiner, who addresses this issue in his report, recommends that the parties agree in writing to a reciprocal waiver of their respective claims, and that they seek Court approval of such agreement. The Debtor in its post-hearing submission has indicated the parties' willingness to file an appropriate motion to implement the Examiner's recommendation. The Court views this as a practical and appropriate means of resolving this issue, and will direct the same in its accompanying Order.

A final point the Court will address before moving on is the question of the timeliness of the various disclosures made in connection with the Debtor's application to employ Total Healthcare. Federal Rule of Bankruptcy Procedure 2014(a) requires a professional to submit to the Court a verified statement setting forth all of that person's connections with the Debtor, creditors, or any other party in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the Office of the United States Trustee. The failure to be forthcoming with disclosures provides the Bankruptcy Court with an independent ground for disqualification or fee reduction. *See In re Filene's Basement Inc.* 239 B.R. 850, 856 (Bankr. D. Mass. 1999).

The retention application in question was filed on December 4, 2001. Attached to it was the verified affidavit of Gregory Lentz. The affidavit disclosed Total Healthcare's pre-petition claim and its receipt of payments within ninety days of the Debtor's bankruptcy filing. It also disclosed Fishman's ownership interest in Feld, LLC and ZA Consulting, and Fishman and Lentz's ownership interests in Philtex and Silver Serenity. It closed by stating that Fishman did not participate in the day to day business affairs of either Total Healthcare or Feld. This affidavit, while containing significant required disclosures, was nevertheless clearly deficient in many respects. Many additional details relevant to the present inquiries quickly surfaced in objections to the proposed retention, and these were explored at the hearings on January 3, 2002 and June 11, 2002. A supplemental affidavit was filed by Lentz on March 22, 2002.

The Trustee argues that the Debtor and Total Healthcare have not been forthright and forthcoming to the Court concerning the relationships which exist among the various parties in interest and, in particular, those which exist among Total Healthcare, its principals, and Heller. The Trustee urges the Court accordingly to disqualify Total Healthcare on this basis.

The Debtor has acknowledged deficiencies in the original Lentz affidavit but, by way of explanation, has stated that the original Lentz affidavit was based on Lentz's mistaken belief, as a layman, that only matters of major significance were required to be disclosed. The Court finds this explanation to be less than wholly satisfactory, and agrees that under the circumstances a penalty is in order. It is not persuaded, however, that the draconian remedy of disqualification is warranted.

On this score the Court is unconvinced that Total Healthcare ever possessed an intention to mislead or conceal the true facts. The very significant disclosures which were made in connection with the original application fairly assured that the full spectrum of interrelationships would receive careful scrutiny. The supplemental affidavit, moreover, was filed well before the Court considered final approval of the application. It would appear, finally, that Total Healthcare and all other parties were completely candid in responding to the Examiner as he went about the performance of his duties. It remains to be said, however, that the initially deficient application affidavit made unnecessarily difficult the resolution of an already complex matter. The disclosure requirements of Federal Rule of Bankruptcy Procedure 2014(a) are so basic and so clear that the Court simply cannot accept the somewhat lame excuse proffered as a complete and sufficient response in this setting. Accordingly, the Court, in its accompanying Order, will direct the disgorgement by Total Healthcare of the sum of $10,000 from the fees paid to it herein for its violation of Federal Rule of Bankruptcy Procedure 2014(a).

B. Motion to Expand Scope of Total Healthcare Services

This matter can be dealt with in short order. On May 15, 2002, the Debtor requested that Total Healthcare be authorized to perform a discrete set of additional services. These consisted of the preparation of a set of costs reports for fiscal year 1998 for submission to CMS. These reports apparently pertained to a time period prior to the date on which the Debtor actually assumed operation of its nursing homes, making the reports, in the Debtor's view, the responsibility of its predecessor to prepare and submit. CMS disagreed with the Debtor on this point, and this dispute between the Debtor and CMS has represented one major hurdle in this case. The Debtor has sought authority by way of this Motion to have Total Healthcare prepare the reports for a flat fee of $10,000. The Trustee objected to the Debtor's request, incorporating all of his objections to the original retention application.

By bench ruling, the Court has previously authorized Total Healthcare to undertake the additional services in question for the agreed fee, subject, of course, to a final ruling on the issue of disqualification. It is the Court's understanding that the reports in question have already been completed and that they have been signed and submitted to CMS. Indeed, it is the Court's understanding that this fact has in large measure paved the way toward a global resolution of all outstanding issues between the Debtor and CMS. As the objections to disqualification have been over-ruled, the Court will enter final approval of the Motion for Authority to have Total Healthcare prepare the aforesaid costs reports.

C. Motion for Authority to Amend and Assume Lease Agreements

Under Section 365 (a) of the Bankruptcy Code, the Debtor may assume an unexpired lease in existence at the commencement of the Bankruptcy case. The Bankruptcy Code does not provide a specific test for Courts to employ in evaluating a Debtor's decision to assume an unexpired lease, however the majority of courts apply the "business judgment" test. *In re Bildisco*, 682 F.2d 72, 79 (3rd Cir. 1982) (noting that the usual test for rejection of an executory contract is simply whether rejection would benefit the estate, the business judgment test). The Debtor bears the burden of demonstrating that the assumption sought satisfies the business judgment test, however objecting parties are typically required to produce some evidence in support of objections. *See In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 155 (Bankr.D. Del 1999).

In this instance, the Debtor has asserted several specific bases in support of its request to assume the Philtex and Silver Serenity leases; to wit: 1) that assumption of the leases is a condition to Debtor-in-Possession financing provided by Heller, which DIP financing was previously approved by the Court; 2) that the lease agreements, as amended, reflect a reduction in the Debtor's annual rental obligation of more than $300,000 per year; 3) that continuation of the leases in question is necessary for the continued operation of the Debtor's nursing facilities; and 4) that rejection of the lease agreements will expose the Bankruptcy Estate to significant claims for rejection damages.

The lease assumption motion is once again supported by Heller and the Creditors Committee, but opposed by the United States Trustee. In objecting to the proposed assumption, the Trustee argues that the Debtor has insufficiently demonstrated that the leases reflect fair rental value, and that the interrelationships previously discussed herein make suspect the independence of the Debtor's business decision to assume the leases. Having considered these arguments, the Court will overrule the objection and approve the Motion to Assume the Leases.

The Court notes that, here again, there is no objective evidence which confirms the Trustee's suspicions and speculations. Alternatively, there is direct evidence which tends to justify the request, not the least of which, of course, is the reduction in annual rent by $300,000. The Court notes also that the Examiner spent a considerable amount of time reviewing this issue, and emphatically concluded that the assumption of the leases is a proper exercise of the Debtor's business judgment. His reasoning, expressed at pages 18-19 of his report, stated, as follows:

> **First,** the Debtor cannot continue to operate its business without post-petition financing. Indeed, assumption of the leases is required by the post-petition financing arrangement.
>
> **Second,** the Debtor remits its monthly rent payment directly to Heller Finance. There is a pass-through relationship with the landlords. As such, there is no concern that the principals of the Debtor will derive personal gain if the leases are assumed.
>
> **Third,** the Trustee has not come forth with any evidence indicating fraud, collusion or bad faith on the part of the Debtor or the landlords. Put differently, although there may be an appearance of impropriety as perceived by the Trustee, the Examiner sees no evidence of an improper-insider aspect to the Debtor's exercise of its assumption rights. *See, Montgomery Ward*, 242 B.R. at 155 (noting that "objectant is required to produce some evidence supporting its objections.")

> **Fourth**, there is no merit to the Trustee's argument that the Debtor has not presented any evidence that the lease arrangements are fair. A fair market value analysis is irrelevant because the rent payments are dictated by the terms of the loan agreements between Heller Finance and the landlords. Instead, the Trustee would have to attack the loan agreements as unfair loans, which it has not done.
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> **Fifth,** the landlords will have a significant claim against the estate arising from rejection of the lease agreements. [Citations omitted.)]
>
> **Sixth**, practical considerations mandate that the Debtor assume the leases, it would not be prudent to require the Debtor to put the health and welfare of the elderly patients at risk by subjecting them to a relocation of the Debtor's facilities.
>
> In conclusion, the Debtor has sustained its burden of demonstrating that assumption of the leases is a proper exercise of its business judgment. . . .

The Court can find no flaw with the above analysis of the Examiner and will therefore, as indicated, overrule the Trustee's objection and approve the lease assumption motion.

An appropriate Order follows.

By the Court:

Stephen Raslavich
United States Bankruptcy Judge

Dated: September 27, 2002