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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 03-25461
	)	
DEACONESS HOSPITAL, LLC, *et al.*,	)	Chapter 11
	)	(jointly administered)
Debtors.	)	
	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**

The debtors filed this chapter 11 case on November 21, 2003. Since then, the debtors have been using cash collateral under a series of interim agreed orders. The last such order expired on July 2, 2004. The debtors filed an emergency motion for a further order authorizing the continued use of cash collateral which the court heard on July 8, 2004. (Docket 528).[1] GE HFS Holdings, Inc. opposes the motion in part. (Docket 556). GE consents to the use of cash collateral as agreed to in the past. GE objects, however, to the debtors' request to use the cash collateral to fund litigation against GE seeking to equitably subordinate GE's claim.[2]

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[1] The debtors also asked for permission to open accounts at Key Bank in which to deposit proceeds from the Health Partners of America, Inc. settlement and the sale of substantially all of its assets to MetroHealth System. The debtors did not pursue this issue at the hearing and the court deems it moot, without prejudice.

[2] The unsecured creditors committee filed a limited objection preserving its right to argue that pursuing the GE litigation is not in the best interest of the estates. (Docket 552). Bank One filed limited opposition asking for a litigation budget so that it can evaluate the request to retain special counsel. (Docket 554). Bank One also objected to the debtors' request to increase the carve-out for professional fees from $650,000.00 to $750,000.00 but the debtors withdrew that request at the hearing. The part of GE's objection relating to independent contractors was resolved on the record.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2).

BACKGROUND FACTS

Pre-petition, the debtors borrowed money from GE[3] and Bank One. As of the petition date, the debtors acknowledge owing GE at least $3,314,851.25.[4] To secure this obligation, debtor Deaconess "had granted to [GE] first priority security interests in substantially all of its assets . . . [Debtors] Pearlview and Indoga granted [GE] a second priority mortgage on certain real property in Cleveland, Ohio comprised of a hospital building and an indoor parking garage . . . ." Order Authorizing Debtors' Interim Use of Cash Collateral ¶ C. (Docket 15). As of that same date, the debtors owed Bank One $5,586,776.57, secured by "first priority mortgages on the [building and garage] and a security interest in substantially all of their other assets junior in priority to [GE]." *Id.* The amount now due to Bank One is approximately $3.043 million. *See* Objection. (Docket 554). The debtors entered into an order in which they agreed that to provide both lenders with adequate protection against the diminution in value of their collateral, their lien claims would continue and "attach to all Collateral that may be acquired or generated by the Debtors from and after the Petition Date with the same validity and priority as they had obtained

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[3] The lender was a predecessor to GE, but for ease of reading the court will refer to GE only.

[4] GE filed a proof of claim in the amount of $3,479,612.42.

prior to the Petition Date." *Id.* at ¶ 2. All parties reserved their rights concerning the validity, priority and extent of liens and claims. *Id.* at ¶ 6.

GE and the debtors also entered into an agreement on November 26, 2003 under which GE would provide post-petition financing secured by a first priority post-petition security interest in and to all assets and claims acquired by any of the debtors from and after November 21, 2003, excluding claims under 11 U.S.C. §§ 544, 547, 548 and 549. *See* Emergency Stipulation re Post-Petition Financing ¶ 7. (Docket 31, 32). Under circumstances that are not in the record, GE did not advance all of the funds the debtors anticipated receiving. On November 28, 2003, the debtors closed their doors to patients and the case has proceeded since then as a liquidating 11.

GE, Bank One, and the debtors continued to enter into a series of cash collateral orders. *See* Orders (Docket 52, 100, 227, 301, 373, 491). On June 4, 2004, the debtors filed an application to employ special counsel to prosecute claims against GE arising out of the post-petition financing events. (Docket 468). The relief sought is to equitably subordinate GE's debt. The debtors propose to use some of the cash collateral to pay special counsel, subject to fee application and court approval. The last agreed cash collateral order expired without a continuing order because the parties do not agree on this use of cash collateral.

THE POSITIONS OF THE PARTIES

The debtors ask for an order authorizing them to use cash collateral that includes this provision:

> Notwithstanding any other provision of this Order or any prior order, absent the consent of GE HFS or a further order of the Court, so long as Debtors maintain cash on hand in excess of

> $3,500,000, Debtors may expend cash collateral to pay fees and expenses when, if, as and to the extent permitted by the Court, to counsel in relation to any Challenge against GE HFS.

(Motion ¶ 9). They argue that they hold funds that are not subject to GE's security interest and that in any event GE is adequately protected.

GE does not object to the use of cash collateral to fund an investigation by the debtors or the committee of the events surrounding GE's decision not to advance funds in November and does not oppose the budget in general. GE does object to the use of cash collateral to pay special counsel to pursue claims against GE for two reasons: (1) the agreed-to orders specifically provide that the cash collateral may not be used for that purpose, and GE is entitled to enforcement of those orders; and (2) if the orders do not bar the use, then the debtors still may not use the funds for that purpose because GE's interest in the cash collateral is not adequately protected by the debtor's proposal.

11 U.S.C. §§ 361 and 363

Bankruptcy code § 363(a) defines "cash collateral" to include "cash . . . or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds . . . of property[.]" 11 U.S.C. § 363(a). A debtor may not use cash collateral unless each entity with an interest in the collateral consents or the court authorizes such use, after notice and a hearing. 11 U.S.C. § 363(c)(2). On request of a party with an interest in the collateral, the court "shall prohibit or condition such use . . . as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e). There are three ways in which a debtor may provide protection: by a cash payment; by an additional or replacement lien; or by such other relief "as will result in the realization by such entity of the indubitable equivalent of

such entity's interest in the property." 11 U.S.C. § 361. The existence of an equity cushion (i.e. "the value in the property, above the amount owed to the creditor with a secured claim, that will shield that interest from loss due to any decrease in the value of the property[.]") may provide adequate protection in some cases. *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396, 1400 n.2 (9th Cir. 1984)(citation omitted). Whether an equity cushion provides adequate protection is determined by the facts of the particular case rather than by the application of a formula. *See In re Gallegos Research Group Corp.*, 193 B.R. 577 (Bankr. D. Colo. 1995); *Kost v. First Interstate Bank of Greybull (In re Kost)*, 102 B.R. 829, 831 (D. Wyo. 1989). The debtor has the burden of proving that the creditor is adequately protected. 11 U.S.C. § 363(o)(1).

FACTS FROM THE EVIDENTIARY HEARING[5] AND DISCUSSION

I.

To see if GE's interest is adequately protected, the preliminary issue is the amount of GE's claim. At trial, GE asserted that as of June 30, 2004 its claim totals $3,564,213.50, which includes contractual interest and costs. GE has also incurred $155,000.00 in attorney fees to date. GE anticipates that its claim will increase by $30,000.00 a month in interest (because the debtors stopped paying post-petition interest) and $50,000.00 a month in attorney fees, for a total over the next six months of $180,000.00 interest and $300,000.00 in fees. Without agreeing that all of these elements are properly calculated or appropriately included in the claim, the debtors essentially assumed in final argument that GE's number is correct for purposes of this hearing

[5] The debtors presented their case through the testimony of George Saad, M.D. GE and the committee presented their cases through cross-examination. GE and the debtors also offered exhibits that were accepted into evidence.

only, and the court will do likewise. This means that within six months, GE's claim will be about $4.2 million.

The debtors claim that GE will be adequately protected if the debtors maintain at least $3.5 million in cash. This will not provide GE with the indubitable equivalent of its interest because its claim is more than that now and will exceed it by more than $700,000.00 within six months.

The debtors also argue that they have sufficient assets when balanced against liabilities and expenses to leave a large equity cushion to protect GE's interest. The parties agree that as of June 30, 2004, the debtors hold $5,013,393.39 in cash. The debtors project a net cash balance as of July 31, 2004 of $5,054,783.39 based on a July budget deficit of $12,750.00. (Debtors exhs. 1, 2). The dispute is over how to value the debtors' remaining assets; specifically, the accounts receivable and the projected recovery from HCAP (2002-03). The parties also dispute which assets are unencumbered by GE's security interest.

Dr. Saad testified that the debtors anticipate collecting $3 million in accounts receivable at a cost of $1.2 million, netting $1.8 million plus $24,000.00 to be collected in July 2004. There was no testimony to support the debtors' projection about the July collections and the court will discount that. The testimony to support the anticipated $3 million collection was sketchy. The youngest batch of receivables is about 200 days old and if the parties agree on one thing it is that receivables do not improve with age. Some of the receivables are potentially covered by insurance while others are not; some have already been referred unsuccessfully to collection. The debtors will undoubtedly collect some of the receivables, but the court cannot say that the debtors are likely to net $1.8 million based solely on the testimony given by Dr. Saad.

Dr. Saad also testified that the debtors anticipate receiving $1.2 million from HCAP (2002-03). Dr. Saad adequately explained his factual basis for this projection and the court accepts it.

The testimony, therefore, established this value for the debtors' assets:[6]

Cash as of July 31, 2004	$5,054,783.39
Projected HCAP recovery	$1,200,000.00
TOTAL	$6,254,783.30

This must be compared to the debtors' expenses. The debtors currently have $160,000.00 in unpaid administrative expenses, excluding attorney fees, and they are incurring additional expenses each month of about $205,810.00. If the numbers stay the same, then the debtors will incur $1.2 million in expenses over the next six months. Debtors' counsel has a pending fee application for $499,702.88 (fees and expenses) through April 30, 2004. *See* (Docket 469). In sum, the computation for the next six months shows this:

Assets	$6,254,783.30
Unpaid administrative expenses	($160,000.00)
Monthly expenses	($1,200,000.00)
Fees	($499,702.88)
	$4,395,080.50

As the evidence shows that in the next six months GE's claim will total approximately $4.2 million and the value of the debtors' assets will total $4.39 million, the debtors did not prove that GE is adequately protected through an equity cushion. This is particularly so because it is likely

[6] As noted above, the debtors did not establish the value of the receivables.

that the professional fees will go up due to increased litigation, and it seems that the litigation will go beyond six months. Also, the committee has incurred attorney fees as well, though no application has been filed.

The debtors' remaining argument is that they have unencumbered funds that can be used to pay special counsel without GE's approval. They point to two items. The first is the $500,000.00 that the debtors received as a settlement from HPA when HPA refused to go through with its agreement to purchase substantially all of the debtors' assets. Although the debtors intend to argue that GE's claim should be equitably subordinated, the fact remains that GE has filed a secured claim, no objection has been filed to it, and the cash collateral and post-petition financing orders give GE a first security interest in the debtors' assets. This money is property of the estate subject to GE's security interest under 11 U.S.C. § 541(a). The second asset is listed on the budget as "medical records $200,000.00." This is the debtors' theory for why this amount is unencumbered: the debtors entered into a purchase agreement with MetroHealth Systems under which MetroHealth purchased substantially all of the debtors' assets. The proposed purchase price was indexed down by $200,000.00 to account for the fact that MetroHealth did not purchase medical records and those records would have to be stored off-site. After that, the debtors negotiated a contract that only requires them to pay $70,000.00 for storage. The debtors believe that because they struck a good bargain, those funds are unencumbered. The court is not familiar with any law that supports this conclusion and the debtors did not offer any. The debtors did not prove that these funds (whether they be $200,000.00 or as seems more likely $130,000.00) are unencumbered.

CONCLUSION

The debtors did not meet their burden of proving that GE will be adequately protected through their proposed order authorizing the use of cash collateral. The motion to use cash collateral, as filed, is therefore denied.

Date: 12 July 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center on:

Daniel DeMarco, Esq.
Andrew Vara, Esq.
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	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**ORDER**

For the reasons stated in the memorandum of opinion filed this same date, GE's objection to the debtors' motion to use cash collateral is sustained (Docket 556) and the motion is denied. (Docket 528).

IT IS SO ORDERED.

Date: 12 July 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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