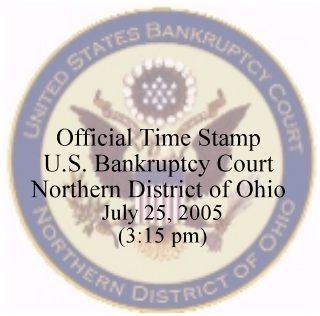
THIS OPINION NOT INTENDED FOR PUBLICATION

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 chapter 11 trustee, the official committee of unsecured creditors, and secured creditors Bank One, NA[1] and GE HFS Holdings, Inc. move for approval of a comprehensive settlement between and among them, as well as with GE Healthcare Financial Services and GE Medical Systems.[2] Administrative creditors Hahn Loeser & Parks and Klinc and Associates, LLC, who provided professional services to the debtors, oppose the motion.[3] For the reasons stated below, the motion is granted.

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)(A) and (O).

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[1] This creditor moves through its successor, JP Morgan Chase Bank N.A. For ease of reference, the court will continue to refer to the creditor as Bank One.

[2] Docket 925, 961, 962, 965.

[3] Docket 934, 950. Hahn Loeser's claim is for attorney fees incurred as counsel to the debtor and debtor-in-possession. Klinc has served as the accountant.

PROCEDURAL BACKGROUND

The debtors filed their chapter 11 cases on November 21, 2003. Shortly after that, the cases turned into liquidating chapter 11s. The debtors sold most of their assets in April 2004. The debtors and their creditors reached a stalemate in terms of resolving the major remaining issues with GE HFS and Bank One. This led to the committee, GE HFS, and Bank One bypassing the debtors and negotiating a settlement that would resolve the GE HFS and Bank One claims, supplement the carve-out previously in place for the committee's counsel fees, and create the possibility that other administrative claimants and priority and general unsecured creditors might receive a distribution. The debtors declined to participate in the agreement and the other parties moved for approval of the settlement notwithstanding the debtors' position. The court denied that motion on procedural grounds.[4]

The committee, Bank One, and GE HFS then moved to appoint a chapter 11 trustee, which the court granted for cause.[5] David Simon is the chapter 11 trustee. The committee, Bank One, and GE HFS (with certain affiliates) filed a new motion to approve a settlement, which Klinc and Hahn Loeser opposed. At the trustee's request, the court adjourned the hearing on that motion to permit him to assess the situation. The trustee retained counsel, reviewed the proceedings, negotiated settlement terms more favorable to the estates, and then joined in the motion to settle based on the new terms.[6]

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[4] Docket 859.

[5] Docket 909, 910.

[6] Docket 965.

On June 16, 2005, the court held a hearing on the motion and opposition to it. At that time, the United States trustee appeared in support of the chapter 11 trustee's position that the motion should be approved.

THE DEBTORS' DISPUTE WITH THE GE CREDITORS

GE HFS was the debtors' prepetition lender. On November 21, 2003, following a hearing, the debtors and GE HFS entered into an agreed order authorizing the debtor to use GE HFS's cash collateral.[7] On November 26, 2003, again following a hearing, GE HFS and the debtors entered into an emergency agreed order regarding interim postpetition financing.[8] GE HFS advanced funds under this agreement. The debtors soon stopped doing business, complaining that GE HFS failed to advance an additional $250,000.00 that the debtors said had been unconditionally promised as part of the agreed order. For its part, GE HFS denied making an unconditional promise to advance an additional $250,000.00 and asserted a position as an oversecured creditor.

The debtors filed an adversary proceeding against GE HFS seeking to equitably subordinate its claim based on the events described above.[9] They retained special counsel, Spangenberg, Shibley & Liber LLC, to represent them. The parties conducted extensive discovery at the end of which GE HFS moved for summary judgment. The debtors oppose that motion, which is pending.

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[7] Docket 15.

[8] Docket 32.

[9] Adversary proceeding 04-1319.

GE HFS asserts a secured claim as of October 1, 2004 of $4,298,548.42 plus charges including interest accrual, legal fees, and costs provided for in the financing documents. The debtors paid GE HFS $3.5 million on October 1, 2004 to stop the running of interest, with a reservation of all rights. GE Healthcare Financial Services and GE Medical Services, divisions of GE (collectively referred to by the movants and here as GE Med) assert an administrative claim of at least $77,489.54. The claim arises from the debtors' postpetition use of equipment leased from GE Med.

The movants refer to GE HFS and GE Med, collectively, as the GE Creditors and this court will do the same. The GE Creditors' claim totals more than $4.9 million.

THE DEBTORS' DISPUTE WITH BANK ONE

Bank One filed a secured claim for $3,043,134.99 as of the date the cases were filed and asserts that the amount has grown over time to $3,262,431.86. There is a dispute over the extent to which this debt is secured.

EXISTING CARVE-OUTS FOR ESTATE PROFESSIONALS

It is customary in chapter 11 cases for professionals to negotiate with secured creditors to reserve, or "carve-out", from those creditors' collateral, funds that will be set aside by the debtors to pay the professionals. This case followed the norm, resulting in a $650,000.00 total carve-out for the debtors' professionals, with $490,000.00 designated for Hahn Loeser and $160,000.00 for the committee. Klinc had not been appointed at the time the carve-out was negotiated. The professionals filed fee applications and the court heard and allowed the fees as appropriate. With court permission, the debtors paid allowed fees and expenses from the carve-outs to Hahn Loeser ($490,000.00, thus exhausting its carve-out) and the committee's counsel ($137,617.47, leaving

$22,382.53). Without objection, the court also allowed and authorized payment to Klinc of $53,359.00. Other fee applications have been heard and allowed but not paid because the debtors do not have unencumbered funds from which to make the payments and GE HFS will not consent to use its cash collateral for this purpose. ($200,000.00 to Hahn Loeser and $16,504.05 to Klinc). The committee's counsel has a pending fee application for $193,477.69.[10]

THE PROPOSED SETTLEMENT

The movants propose to settle their disputes under these general terms:[11]

1. The GE HFS secured claim will be allowed in the amount of $4,250,000.00. GE HFS will retain the $3.5 million already paid and will be paid an additional $350,000.00. After the GE Creditors receive payments totaling $3,850,000.00, they will covenant not to seek recovery from any other assets of the estate and will agree that $400,000.00 in assets that they would otherwise claim as collateral for their allowed claim will be used in this manner:

(A) The existing carve-out for the committee's allowed administrative expenses will be increased so that the total carve-out will be $60,000.00.

(B) Bank One will receive $340,000.00 on account of its secured claim.[12]

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[10] *See* amended memorandum of opinion and order entered April 21, 2005. (Docket 909, 910).

[11] There are other aspects to the proposal. This is just a summary of the major aspects, including those areas that are the specific subject of the objections.

[12] After the $400,000.00 is paid, funds may be available in the estates to pay allowed administrative claims and allowed priority claims. After those payments, if any, remaining funds will be divided with 50% available to Bank One on account of its secured claim (with certain limitations) and 50% available to general unsecured creditors.

2. The GE Med claim will be allowed as an administrative claim in the amount of $77,489.54. This claim will not be paid if all other amounts due to the GE Creditors under the settlement are paid.

3. GE will release the trustee, the committee, and Bank One.

4. Bank One will covenant not to seek further recovery from the estates on its claims.

5. The trustee will release the committee, Bank One, and the GE Creditors.

6. The trustee, Bank One, and the committee will release the GE Creditors from all claims and will dismiss with prejudice all litigation against the GE Creditors.

THE TRUSTEE'S EVALUATION

Chapter 11 trustee David Simon has served as a chapter 7 trustee in this district on a regular basis since 1975. He has also served as a chapter 11 trustee during that time on an "as needed" basis. He is approaching his 30th anniversary practicing law, primarily in bankruptcy-related areas. He routinely represents debtors, creditors, and committees.

Immediately after his appointment in this case, the trustee began an extensive review of the record. He read each filing in both the main case and the adversary proceeding.[13] He spoke, either in person or by telephone, with counsel for these parties: the debtors, the committee, Bank One, and GE HFS. He also spoke with the United States trustee and the debtors' representative. Additionally, he retained the Spangenberg firm, which already had considerable involvement

[13] As of the hearing date, there were 965 docket entries in the main case and 75 entries in the adversary proceeding.

with the equitable subordination case. The trustee read each deposition taken and reviewed each exhibit.

Based on this activity, he stated his conclusion at the hearing: it is more likely than not that the debtors will not prevail in the equitable subordination lawsuit. Specifically, he cannot find that GE HFS agreed to loan the debtors an additional $250,000.00 with "no strings attached," as the debtors allege. While some evidence suggests the commitment was made, substantially more evidence suggests the commitment was not made. The trustee states that if such a commitment existed, he would have expected to find it memorialized in the November 26, 2003 agreed financing order. Instead, that order just refers to an agreement to fund in accordance with the loan agreements. He considered the debtors' argument that the increase in collateral shows a commitment was made, but concludes the increase was not a commitment to fund but rather an indication of potential availability of funding.

He turned next to the amount of the GE HFS claim. As of the filing date, there is an undisputed principal balance of $3.4 million with interest continuing to accrue. There followed a period of high activity with a corresponding increase in the legal fee component of the claim.[14] After reviewing the claim and the objections to the claim, he concluded it is likely that GE HFS will have a secured claim of not less than $4.25 million.

[14] The financing agreements include a provision for the borrowers to pay the lender's attorney fees and costs.

THE POSITIONS OF THE PARTIES

The chapter 11 trustee, the committee, the GE Creditors, and Bank One argue the settlement is fair and reasonable and should be approved. The United States trustee supports this position. Klinc and Hahn Loeser object.

Some of the objectors' arguments were resolved by amendments to the proposed settlement filed shortly before the hearing. These are the remaining disputes. Klinc argues that increasing the reserve for the committee's counsel to $60,000.00 violates 11 U.S.C. § 503(b)(1). Hahn Loeser makes these arguments: (1) the proposed increase violates § 503(b)(1), as interpreted by the First Circuit in *Official Unsecured Creditors' Comm. v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305 (1st Cir. 1993); (2) the movants did not comply with bankruptcy rule 9019's notice provisions; (3) the settlement does not "strike the right balance," given the Spangenberg firm's earlier written statements that it believes the debtors will prevail in the adversary proceeding; (4) if closure is the goal, the settlement does not provide it because it leaves unresolved the question of what the Spangenberg fee should be; and (5) there is no benefit to the estates because the term sheet does not require GE HFS and Bank One to release the estates, thus leading to the virtual certainty that these creditors will take the money and then come back with new or additional claims.

DISCUSSION

Outside of the bankruptcy context, parties are generally free to settle their legal disputes under any terms they deem acceptable. The approach is different in a bankruptcy case that involves property of the bankruptcy estate. If a debtor wishes to compromise such a claim, it must obtain court approval to insure that the compromise is fair and equitable to all parties in

interest. *Reynolds v. Comm'r of Internal Revenue*, 861 F.2d 469 (6th Cir. 1988). The claims made by the debtors in this case are property of the estate. 11 U.S.C. § 541(a). The chapter 11 trustee stands in the debtors' shoes and is responsible for controlling this adversary proceeding. The trustee's decision to compromise is, therefore, subject to court approval. FED. R. BANKR. P. 9019(a).

"In considering a proposed compromise, the bankruptcy court is charged with an affirmative obligation to apprise itself of the underlying facts and to make an independent judgment as to whether the compromise is fair and equitable. The court is not permitted to act as a mere rubber stamp or to rely on the trustee's word that the compromise is reasonable'." *Reynolds*, 861 F.2d at 473 (citing *In re American Reserve Corp*., 841 F.2d 159, 162-63 (7th Cir. 1987)). "Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 425 (1968). A court must make a reasoned evaluation of the case, but stop short of trying the case on the merit. The court "is not to decide the numerous questions of law and fact raised . . . but rather to canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness'[.]" *Cosoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir. 1983) (quoting *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir. 1972)).

In evaluating a proposed compromise, courts consider "the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise." *Anderson*, 390 U.S. at 424 (1968). This standard is often reduced to

four factors: (1) the probability of success in the litigation; (2) the difficulty of collection; (3) the complexity of the litigation, including any attendant expense, inconvenience, and delay; and (4) the paramount interest of creditors. *Bard v. Sicherman (In re Bard),* 49 Fed. App. 528 (6th Cir. 2002); *Fishell v. Soltow (In re Fishell),* 47 F.3d 1168 (6th Cir. 1995).

1. The complexity of the litigation, including expense, inconvenience, and delay

The parties propose to compromise the equitable subordination suit and contested matters involving the amount of GE HFS's secured claim and GE Med's administrative claim and the amount of and extent to which Bank One's claim is secured. The equitable subordination lawsuit, and the defense of it, raise numerous lender liability issues in the bankruptcy context, including whether the parties entered into the agreement at issue and if so, the terms of the agreement, the impact of the alleged breach on the debtors, and the damages attributable to that breach. GE HFS has filed a motion for summary judgment that, if successful, will result in no recovery for the unsecured creditors. If the summary judgment motion is denied, the case will proceed to a trial estimated by the parties to last three days.[15] Under either scenario, the losing side is quite likely to appeal. An appeal will add at least one year to the time frame for resolving the matter due to the work load of the appellate courts.

Before the trustee's appointment, the debtors had also moved to determine the exact amount of GE HFS's claim. The challenge centered on interest charges and attorney fees. Hahn Loeser joined in this objection. This contested matter, which has been put on hold pending a decision on this motion, will also increase the attorney fees if it must go forward. And the same appeal time considerations apply here as discussed above.

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[15] *See* adv. proc. 04-1319, docket 30.

Additionally, the debtors have a dispute with Bank One over the nature and extent of its secured claim and GE HFS and Bank One have disputes with each other, such as over whether the debtors' assets should be marshaled.

All in all, the parties have treated the disputes as complex and the court agrees with that assessment.

On the expense consideration, Hahn Loeser points out that continuing the adversary proceeding will not increase the debtors' fees because the Spangenberg firm is retained on a contingency fee basis. GE HFS's claim, however, includes a colorable right to be reimbursed for its legal fees and expenses and they will continue to accrue through the life of the litigation. Also, the debtors will continue to incur expenses relating to experts and the like.

On balance, this factor weighs in favor of the proposed compromise.

2. The probability of the debtors' success on the merits

The parties have quite different views of the debtors' probability of success on the merits. Interestingly, the debtors through their trustee representative believe they will lose on the merits while the objectors (counsel and accountant to the former debtors-in-possession) believe the debtors will win. The objectors contend that the settlement does not "strike the right balance" because it does not give appropriate weight to the opinion of the Spangenberg firm concerning the merits of the adversary proceeding. Spangenberg made the statements before the trustee was appointed and while Hahn Loeser was representing the debtors. The statements are to the effect that the debtors would prevail.[16]

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[16] *See* amended memorandum of opinion granting motion to appoint a chapter 11 trustee. (Docket 909).

The trustee is now represented by that same firm and he does not agree with that earlier evaluation.[17] He spoke at length with all parties in interest and reviewed extensive dockets, all with an eye to carrying out his fiduciary responsibilities. After a detailed and nuanced review, he concluded that it is more likely than not that the debtors will lose on the merits. The same is true with respect to the debtors' challenge to the amount of GE HFS's claim.

The earlier Spangenberg statements show that there are at least two sides to every story and it is possible that any party could win on the merits. This court has, however, presided over this case since it was filed, including ruling on numerous vigorously contested motions, holding status conferences in the adversary proceeding, and reviewing the pending motion for summary judgment. Based on that review, including familiarity with the arguments made by all counsel throughout the case, the court agrees with the trustee's reasoning and his evaluation and concludes that it is unlikely that the debtors will win on the merits of any of the claims against the GE Creditors.

This factor weighs in favor of the settlement.

3. The difficulty of collection

There is no evidence that the secured creditors are not collectible and they have not made that argument.

This factor weighs against the settlement.

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[17] Rightly, the law firm itself did not take a position on this at the hearing. It is entirely possible that the firm's evaluation has changed. In any event, it is up to the client (in this case the trustee) to solicit and consider his counsel's advice. There is no evidence that the trustee failed to do so.

4. The interest of the creditors

There are several creditor constituencies who have been heard on this issue. The committee of unsecured creditors, secured creditors GE HFS and Bank One, and administrative creditor GE Med support the compromise, while administrative creditors Klinc and Hahn Loeser object. The interest of the two objecting administrative creditors must be addressed under this factor.

If the compromise is approved, one administrative creditor will have additional funds set aside to pay some of its allowed fees, secured creditors will consent to receive less than they claim to be owed, one administrative creditor (GE Med) will agree to forego payment of its claim if all agreed-to actions are taken, and the unsecured creditors have the possibility of receiving some payment. Other administrative creditors who have unpaid claims will have the opportunity to be paid as the debtors liquidate their remaining assets, such as outstanding receivables and the HCAP claim. These remaining assets will also be the source of any payments to unsecured creditors.

The objecting creditors argue that the interest of creditors are not served because the only carve-out being increased is the committee's, which will cause the committee to receive a greater percentage of its administrative priority claim than others similarly situated.[18] This raises both a factual issue and a legal issue.

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[18] Hahn Loeser's objection states that the proposal violates the absolute priority rule which is applied in determining whether a chapter 11 plan is fair and equitable and generally requires that no party in a class junior in priority may receive a distribution unless all classes senior to such party are paid in full. *See* 11 U.S.C.A. § 1129(b)(2)(B). The objector has not explained why that rule would apply in this context and so the court will not address it further.

The factual issue is whether the settlement will indeed result in such a maldistribution. At the hearing, counsel to GE HFS stated that with the increased reserve, Hahn Loeser's distribution is about 70%, Klinc's distribution is about 80%, and the committee's distribution is in the low 60%. The objectors did not take issue with this calculation. The proposed increase will not, therefore, result in the committee receiving more than its fair share.

Alternatively and additionally, however, the settlement term does not violate the bankruptcy code. The legal disagreement here mirrors a difference in the case law. *See for example, In re SPM Mfg. Corp.,* 984 F.2d 1305, 1313 (1st Cir. 1993) (noting that "creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors."); *In re Hotel Syracuse, Inc.*, 275 B.R. 679 (Bankr. N.D .N.Y. 2002) (permitting an undersecured creditor to carve out counsel fees for debtor's counsel from its collateral). *But see, In re Ben Franklin Retail Store, Inc.*, 210 B.R. 315 (Bankr. N.D. Ill. 1997) (rejecting an agreement by the secured lender that would allow debtor's counsel to be paid from its collateral).

The carve-out provision is permissible under the circumstances of this case for several reasons. GE HFS asserts a claim of more than $4.9 million, secured by essentially all of the debtors' assets. The compromise provides for payment to GE HFS in an amount less than that claimed. The supplemental committee carve-out is created from monies that would otherwise be paid to GE under the settlement. Additionally, GE has agreed not to seek further recovery from the debtors' estates. Under these facts, it is clear that the carve-out is being created from the

proceeds of GE HFS's collateral, rather than property of the debtor's estates.[19] This does not violate the bankruptcy code's distributive priorities.

5. Other issues raised by the objectors

The objectors make three other arguments that do not fall squarely within the above factors. The first argument is that the movants did not give appropriate notice of the motion. Federal rule of bankruptcy procedure 9019 states that notice of a proposed compromise shall be given to creditors, the United States trustee, the debtor, indenture trustees, and any other entity as directed by the court. FED. R. BANKR. P. 9019. The movants served the initial motion to approve the compromise on all creditors, the United States trustee, and each entity requesting notice in the main case. The amended settlement term sheet, which provides more favorable terms to the estates, was only served on objectors to the first motion, entities requesting notice, and the United States trustee. A creditor who did not object to the first proposed settlement is unlikely to have an interest in objecting to a settlement that enhances the estates' recovery. The notice given was adequate under the circumstances.

The second argument relates to the Spangenberg firm's compensation, an issue that is not addressed in the proposed settlement. The objectors are concerned that the Spangenberg firm will not be adequately compensated, a concern that has not been raised by the firm itself. There is an order appointing the firm that states the basis for its compensation. All professional compensation is subject to application and notice. The firm has not filed an application and the

[19] This conclusion is buttressed by the moving parties' statements at the hearing that if need be they would restate the agreement to provide that all of the challenged funds would go to GE HFS and that entity would then distribute them as the fees are allowed.

compensation question is not before the court. The court will address that issue when an application is filed. This is not a reason to disapprove the settlement.

The third argument is the objectors' claim that the GE Creditors and Bank One will just take the settlement money and come back to demand more. It is hard to understand the factual basis for this concern. The settlement requires the GE Creditors to covenant that they will not seek any recovery from estate assets after the settlement terms are met and requires Bank One to release the estates after it receives its funds under the settlement. Counsel for both creditors and the trustee reiterated at the hearing that this is a full resolution of all claims against the estates and documents so providing will be executed. This is not, therefore, a realistic concern.

6. Balancing all factors

When balancing all relevant factors, they clearly favor approving the proposed settlement.

CONCLUSION

For the reasons stated, the motion to approve settlement is granted. A separate order will be entered reflecting this decision.

Date: 25 July 2005

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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

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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
	)	
	)	**ORDER**

For the reasons stated in the memorandum of opinion filed this same date,

IT IS, THEREFORE, ORDERED that the joint motion to approve settlement is granted and the objections filed by Hahn Loeser & Parks and Klinc and Associates LLC are overruled. (Docket 925, 934, 950, 965).

Date: 25 July 2005

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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