

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF LOUISIANA
LAFAYETTE DIVISION**

In re:)	CASE NO. 14-50756
)	
NEW LOUISIANA HOLDINGS, LLC,)	(Chapter 11)
et al.)	
)	
Debtors)	(Jointly Administered)

**CREDITOR TORT CLAIMANTS' PRELIMINARY OBJECTION TO NOTICE OF
EXECUTORY CONTRACTS AND UNEXPIRED LEASES THAT MAY BE ASSUMED
AND ASSIGNED, IN CONNECTION WITH THE SALE OF SUBSTANTIALLY ALL OF
CERTAIN ESTATES' ASSETS, AND THE PROPOSED CURE AMOUNTS**

Parties in Interest, Creditor Tort Claimants¹ injured by the Florida nursing homes operated by the Palm Terrace Debtors (collectively "**Creditor Tort Claimants**"), file this Preliminary Objection to Palm Terrace Debtors' Notice of Executory Contracts and Unexpired Leases that May be Assumed and Assigned, in Connection with the Sale of Substantially all of Certain Estates' Assets, and the Proposed Cure Amounts (Doc. 677). In support thereof, the Creditor Tort Claimants state as follows:

BACKGROUND

On September 3, 2014, SA-Lakeland, LLC; SA-Clewiston, LLC; and SA-St. Petersburg, LLC (collectively, the "**Palm Terrace Debtors**"), each filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. The Debtors' respective cases are being jointly-

¹ Estate of James Acker, Estate of Olive Algeo, Estate of Richard Bartley, Estate of John Berry, David Deal, Estate of Virginia Bliven, Estate of Alphonse Bouchard, Estate of Ora Lee Bryant, Judith Buss, Leon Demps, Estate of Joyce Digrazia, Sheila Duerst, Estate of David Ferguson, Estate of Tillie Fuchs, Estate of Mildred Harpin, Estate of Patricia Harris, Estate of Juanita Henderson, Estate of Ruby Holley, Estate of Odell Jordan, Cloyce McGee-Southerland, Estate of Robert Metzger, Estate of Verl Miller, Dorothy Mitchell, Estate of Danuse Mohr, Calvin Monroe, Estate of Rosemary Mullen, Mary Nance, Estate of James Nobles, Estate of Tara Oquendo, Estate of Richard Pompei, Estate of Leo Poulin, Estate of Maria Rios-Lopez, Charlie Rutledge, Sr., Estate of David Santiago, Estate of Eldon Sipes, Estate of Bertha Smith, Estate of Ronald Trim, Estate of Dorothea Trump, Henry Virgo, Donald Ware, Estate of Robert Whitmire, James Williams, Estate of Helen Clarke, Donald Hochbaum, and Estate of Beulah Willis.

administered under the caption *In re New Louisiana Holdings, LLC*, Case No. 14-50756.

On January 23, 2015, the Palm Terrace Debtors filed a motion (the “**Sale Motion**”) seeking, among other things, authority to assume and assign certain agreements in connection with the sale of substantially all of the Palm Terrace Debtors’ assets. On March 20, 2015, the Court entered an amended order granting the Palm Terrace Debtors’ Sale Motion and establishing procedures for the assumption and assignment of executory contracts and unexpired leases.

With respect to the assumption and assignment of executory contracts and unexpired leases, the March 20, 2015 amended order provides that the Palm Terrace Debtors are to file with the Court and serve proper notice of each executory contract and unexpired lease that the Palm Terrace Debtors intend be assumed and assigned, along with what the Palm Terrace Debtors’ records show to be the applicable cure amounts.

On May 11, 2015, the Palm Terrace Debtors served upon the Creditor Tort Claimants a Notice of Executory Contracts and Unexpired Leases that May be Assumed and Assigned, in Connection with the Sale of Substantially all of Certain Estates’ Assets, and the Proposed Cure Amounts (the “**Cure Notice**”) (Doc. 677). Pursuant to the Cure Notice, the Palm Terrace Debtors indicate that they may seek to assume and assign certain agreements to a potential purchaser of their assets.

Under the Cure Notice, the deadline to file objections to the Palm Terrace Debtors’ proposed assumption and assignment of certain executory contracts is May 26, 2015. The Creditor Tort Claimants timely submit this preliminary objection, along with a reservation of rights, and oppose the assumption and assignment of the Palm Terrace Debtors’ purportedly executory contracts, and in particular, the Halcyon Rehabilitation, LLC (“**Halcyon**”) contracts.

PRELIMINARY OBJECTIONS

I. Assumption and Assignment of the Contracts, and in Particular the Halcyon Contracts, Do Not Enhance the Palm Terrace Debtors' Estate

The Bankruptcy Code provides that a debtor-in-possession, “subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor.” 11 U.S.C. § 365(a). The standard typically governing approval of a debtor-in-possession’s decision to assume an executory contract is the “business judgment” test. *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1308-09 (5th Cir. 1985). The debtor-in-possession “bears the burden demonstrating that the assumption sought satisfies the business judgment test.” *In re 22 Acquisition Corp.*, No. 01-36543 SR, 2002 WL 34560879, at *10 (Bankr. E.D. Pa. Sept. 27, 2002). Although the test is not an onerous one, if the debtor’s request is manifestly unreasonable or made in bad faith, the Court should not grant approval. *Richmond*, 762 F.2d. at 1309. Approval should be granted only “[a]s long as [the proposed action] appears to enhance [the] debtor’s estate.” *Id.*; see also *In re Klein Sleep Prods., Inc.*, 78 F.3d 18, 25 (2d Cir. 1996) (stating assumption must be “in the best interests of the estate (and unsecured creditors).”).

While the business judgment standard is appropriate for most assumptions of executory contracts under Section 365, which typically involve a debtor and unrelated third-party, it is not appropriate in the context of insider transactions. When a proposed assumption of an executory contract involves insiders, “it [is] prudent of the Bankruptcy Court to look closely at the assumption.” *Westship, Inc. v. Trident Shipworks, Inc.*, 247 B.R. 856, 865 (M.D. Fla. 2000); see also *Pepper v. Litton*, 308 U.S. 295, 306 (1939) (holding insider transactions are subject to rigorous scrutiny). This is because a debtor-in-possession “must never give an insider a competitive advantage over others with regard to matters affecting the administration of bankruptcy estate”. *In re Simon Transp. Servs., Inc.*, 292 B.R. 207 (Bankr. D. Utah 2003). The

term insider under the Bankruptcy Code is a flexible term. *In re Chira*, 353 B.R. 693, 724 (Bankr. S.D. Fla. 2006); see also *In re Greenwood Point, LP*, 445 B.R. 885, 897 (Bankr. S.D. Ind. 2011) (finding statutory list of “insiders” not exhaustive). An insider may be any person or entity with a “sufficiently close relationship with the debtor” such that the insider’s “conduct is made subject to closer scrutiny”. *In re China*, 353 B.R. at 724.

Here, the Palm Terrace Debtors have failed to demonstrate that any of the assumptions sought satisfy the business judgment test. On that basis alone, this Court should disapprove of any proposed assumptions and assignments. Moreover, the very limited discovery produced thus far in this bankruptcy proceeding has revealed a complex ownership and management structure of the Palm Terrace Debtors consisting of over 200 related entities – all of which are owned or controlled by Harris Schwartzberg and his family, non-debtor insiders. (Exhibit A, Transcript of Hearing, Jan. 27, 2015, pp. 14-16; Dkt. 319, p. 3). While all the insider connections have yet to be investigated and determined, based upon the limited information available to the Creditor Tort Claimants, it is clear that one such non-debtor insider is Halcyon.

Halcyon was organized as a Delaware corporation in 2009 to provide therapy services for nursing facilities owned or operated by Schwartzberg. (Exhibit B). Halcyon’s principal office address, 4 West Red Oak Lane, White Plains, New York 10604, is the same as that of its managing members, Health Care Navigator, LLC (“**HC Navigator**”) and Asset Navigator, LLC, both Schwartzberg entities. (Exhibit C). Halcyon is also designated on the Palm Terrace Debtors’ Florida Medicaid Cost Reports as a related entity providing therapy services. (See e.g. Exhibit D, p. 80-81). In addition, Halcyon has appeared on the Palm Terrace Debtors’ Monthly Operating Reports as it is still providing therapy services and receiving payment to the present date. (See Exhibit E, p. 12, 16-18, 62). The close connections do not stop there. James “Trey” Blalock, III

(“**Mr. Blalock**”), the Designated Officer of the Palm Terrace Debtors, is general counsel to HC Navigator, which as previously stated, is one of the managing members of Halcyon. (See Exhibit C). Based upon the foregoing, Halcyon should be considered an insider of the Palm Terrace Debtors under the Bankruptcy Code and any transactions involving Halcyon should be subject to rigorous scrutiny.

The proposed assumption and assignment of the Halcyon contracts appear, on their face, to benefit the interests of Halcyon, an insider of the Palm Terrace Debtors, to the detriment of the Palm Terrace Debtors’ unsecured creditors, such as the Creditor Tort Claimants. Allowing the Palm Terrace Debtors to assume and assign the Halcyon contracts would allow an insider to the Schwartzberg group to obtain a post-petition administrative claim and priority over other unsecured creditors. “Rejection or assumption of an executory contract determines the status of the contracting creditor's claim, namely whether ‘it is merely a pre-petition obligation of the debtor or is entitled to priority as an expense of administration of the estate.’” *In re National Steel Corp.*, 316 B.R. 287, 304 (Bankr. N.D. Ill. 2004) (quoting *In re Univ. Med. Ctr.*, 973 F.2d 1065, 1078 (3d Cir.1992).

As to the Halcyon contracts, the Palm Terrace Debtors propose to cure the exact amounts listed in the Schedules filed with each Petition, for a total of \$575,275.01. (See Exhibits F, p. 7; Exhibit G, p. 10; and Exhibit H, p. 8 - Schedule F to Palm Terrace Debtors’ Petitions). Based upon Halcyon’s insider status, this sum is a debt Schwartzberg essentially owes to himself. Notably, the Palm Terrace Debtors have also failed to provide any records to substantiate the accuracy of this debt and proposed cure amount. Of further concern, however, is the fact that the Creditor Tort Claimants do not know the identity of the ultimate purchaser of the Palm Terrace facilities. A new insider entity could purchase the Palm Terrace facilities, taking them free and

clear of any encumbrance, along with recouping an administrative priority cure for the “assigned” Halcyon contracts. Rather than enhance the Estate, allowing the Palm Terrace Debtors to assume the Halcyon contracts would burden the Estate with insider debt to the detriment of the Estate’s unsecured creditors. As such, this Court’s approval should be withheld.

The Court should also deny assumption and assignment of the proposed contracts because assumption may release parties from avoidable transfer liability, which would not enhance the Palm Terrace Debtors’ Estate. Pre-petition transfers made pursuant to a contract that has been assumed may not be avoided as preferential under § 547 of the Bankruptcy Code. *See, e.g., In re Kiwi Int’l Air Lines, Inc.*, 344 F.3d 311, 317-21 (3d Cir. 2003); *Matter of Superior Toy & Mfg. Co., Inc.*, 78 F.3d 1169, 1173-74 (7th Cir. 1996); *In re LCO Enterprises*, 12 F.3d 938, 943-44 (9th Cir. 1993); *In re Network Access Solutions Corp.*, 330 B.R. 67, 75 (Bankr. D. Del. 2005) (finding assumption of contract barred creditors action to recover transfers); *In re Vision Metals, Inc.*, 327 B.R. 719, 722 (Bankr. D. Del. 2005) (holding debtor's assumption of a contract barred constructive fraud claims with respect to transfers made pursuant to that contract).

The very limited discovery in this bankruptcy proceeding has already revealed numerous pre and post-petition transfers that must be investigated and analyzed as fraudulent insider transfers, such as the DIP financing which is the product of an insider transaction, a complex ownership and management structure of the Debtors consisting of over 200 related entities – all of which are owned or controlled by non-debtor insiders Harris Schwartzberg and his family, and the DIP representative’s significant conflicts of interest given his active role as the agent of numerous non-debtor insiders under the Schwartzberg empire. At this stage of the bankruptcy proceedings, more information is needed to determine if the Palm Terrace Debtors have

wrongfully transferred assets to any of the entities and individuals listed in the Palm Terrace Debtors' Cure Notice including, without limitation, Halcyon.

If the Court were to approve the assumption and assignment of the contracts and unexpired leases listed in the Palm Terrace Debtors' Cure Notice, transfers made under such contracts would likely be insulated from future avoidance actions. This would result in a reduction of potential recoveries to the Palm Terrace Debtors' Estate and its creditors, which is not in the best interest of the Estate. At this time, there is a lack of material information that is critical to a proper investigation of all potential avoidance actions to be brought in this bankruptcy proceeding. The Palm Terrace Debtors should not be allowed to insulate interested parties, especially insiders, from avoidable transfer liability by prematurely assuming contracts with them. Therefore, approving of the Palm Terrace Debtors' assumption and assignment of such contracts at this time would be improper. Accordingly, this Court's approval should be withheld.

II. The Palm Terrace Debtors Fail to Provide Sufficient Information to Determine Whether the Contracts are Executory

The Palm Terrace Debtors' assumption and assignment of contracts must also be denied at this time because the Palm Terrace Debtors have failed to provide sufficient information to determine whether the contracts are in fact executory. Before a debtor can assume a contract pursuant to Section 365, it must first be established that an executory contract existed at the time of the bankruptcy filing. *In re Liljeberg Enterprises, Inc.*, 304 F.3d 410, 436 (5th Cir. 2002).

While the Bankruptcy Code does not define the term "executory contract", the United States Court of Appeal for the Fifth Circuit has stated that for the purpose of assumption, courts look to "whether performance remains due to some extent on both sides," such "that an agreement is executory if at the time of the bankruptcy filing, the failure of either party to

complete performance would constitute a material breach of the contract, thereby excusing the performance of the other party.”” *Id.* at 436.

As of the time of this objection, the Palm Terrace Debtors have failed to provide all interested parties with sufficient facts and documentation regarding the executory nature of the contracts. Without this information, the Creditor Tort Claimants and this Court are unable to verify that the contracts are executory.

The Creditor Tort Claimants therefore request that the Court require the Palm Terrace Debtors to produce the contracts at issue and set an evidentiary hearing to determine whether the contracts are executory. *See, e.g., In re Louisville Motor Exch., Inc.*, 26 B.R. 490, 490 (Bankr. W.D. Ky. 1983) (scheduling evidentiary hearing to determine alleged existence of executory contract); *In re Snowcrest Dev. Grp., Inc.*, 200 B.R. 473, 478 (Bankr. D. Mass. 1996) (finding unsecured creditors’ committee entitled to evidentiary hearing to determine whether agreement was executory). Absent this crucial information, this Court must disapprove of the Palm Terrace Debtors’ proposed assumption and assignment of certain contracts.

III. The Palm Terrace Debtors Fail to Provide Sufficient Information to Determine Whether All Existing Defaults will be Cured and Whether the Palm Terrace Debtors Have Provided Adequate Assurance of Future Performance

Assuming that the contracts at issue are executory, this Court should still disallow assumption and assignment of the executory contracts because the Palm Terrace Debtors have failed to provide sufficient information to determine: (1) whether the Palm Terrace Debtors could cure all defaults; and (2) whether any future purchaser could assurance future performance of such contracts. Pursuant to Section 365(b)(1)(A), a debtor-in-possession must cure, or provide adequate assurance that it will promptly cure, all monetary and nonmonetary defaults under a contract prior to assuming assigning the contract. 11 U.S.C. § 365(b)(1)(A); *In re Texas Health Enterprises Inc.*, 72 F. App'x 122, 126 (5th Cir. 2003).

In addition, a debtor-in-possession must provide adequate assurance of future performance by the assignee of a contract, regardless of whether there has been a default under the contract. 11 U.S.C. § 365(b)(1)(C), (f)(2)(B). In determining whether the debtor-in-possession has provided adequate assurance of future performance, courts look to “ ‘factual conditions,’ ” including “consider[ation of] whether the debtor’s financial data indicated its ability to generate an income stream sufficient to meet its obligations, the general economic outlook in the debtor’s industry, and the presence of a guarantee.” *In re Liljeberg*, 304 F.3d at 438-39; *In re Texas Health*, 72 F. App’x at 126.

Based upon the very general descriptions in the Palm Terrace Debtors’ Cure Notice and the lack of discovery in this bankruptcy proceeding, the Creditor Tort Claimants and this Court cannot determine whether the Palm Terrace Debtors will be able to cure existing defaults. In fact, the Palm Terrace Debtors have failed to provide any records to substantiate the accuracy of the proposed cure amounts. Furthermore, the Palm Terrace Debtors have failed to identify any prospective assignees/purchasers, much less been able to provide adequate assurance of future performance by any assignee/purchaser with respect to the contracts at issue.

Because the Palm Terrace Debtors have failed to comply with Section 365, this Court must disapprove of the Palm Terrace Debtors’ proposed assumption and assignment of certain contracts.

RESERVATION OF RIGHTS

As of the filing of this preliminary objection, the identity of the successful bidder has not been determined or disclosed to the Creditor Tort Claimants. Additionally, the Palm Terrace Debtors have not yet established a definitive, binding list of executory contracts to be assumed and assigned. Before a creditor’s interests may be adversely affected by judicial action, the due

process clause of the Fifth Amendment to the United States Constitution requires “notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and to afford them an opportunity to present their objections.” *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S. Ct. 652, 657, 94 L. Ed. 865 (1950). See also *United States v. Sec. Indus. Bank*, 459 U.S. 70, 75, 103 S. Ct. 407, 410, 74 L. Ed. 2d 235 (1982) (stating bankruptcy proceedings are subject to the Fifth Amendment).

The Palm Terrace Debtors seek to assume and assign certain contracts, but without further discovery of fundamental information, the Creditor Tort Claimants cannot determine all of the grounds barring assumption of such contracts or otherwise governing its rights in this matter, or whether the Palm Terrace Debtors have complied with the mandates governing assumption and assignment of executory contracts as set forth in the Bankruptcy Code.

Accordingly, the Creditor Tort Claimants reserve the right to file a supplemental objection on any basis, including, without limitation, objections based on the identity of the successful bidder. The Creditor Tort Claimants reserve the right to be heard and to present evidence at any hearing on the proposed assumption and assignment.

CONCLUSION

WHEREFORE, the Creditor Tort Claimants respectfully request that the Court deny assumption and assignment of the Palm Terrace Debtors’ allegedly executory contracts, to schedule an evidentiary hearing to determine the propriety of the Palm Terrace Debtors’ assumption of such contracts, and grant such other and further relief as the Court deems just and proper.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been duly served upon those parties receiving electronic notification via the Court's CM/ECF System on this 22nd day of May, 2015.

/s/ James L. Wilkes II, Esq.
James L. Wilkes, II, Esq.