Docket #232 Date Filed: 3/22/2023

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	
TEHUM CARE SERVICES, INC.	§	CASE NO. 4:23-BK-90086 (CML)
	§	
	§	CHAPTER 11
Debtor.	§	
	§	

ARIZONA DEPARTMENT OF CORRECTIONS, REHABILITATION, AND REENTRY'S OBJECTION TO THE DEBTOR'S EMERGENCY DIP MOTION AND JOINDER IN THE COMMITTEE'S OBJECTION TO THE DIP MOTION

The Arizona Department of Corrections, Rehabilitation, and Reentry ("ADCRR"), by and through undersigned counsel, submits this Objection to the Debtor's Emergency Motion for Entry of Interim and Final Orders Authorizing DIP Financing, Use of Cash Collateral, Granting Liens and Providing Claims with Superpriority Administrative Claims Status, Modifying the Automatic Stay, and Granting Related Relief (the "DIP Motion"). Dkt # 185. In addition, ADCRR joins in the Committee's objection, including the Committee's reservation of rights, filed at Dkt # 224. Due to the emergency nature of the Debtor's requested relief, ADCRR reserves the right to supplement this Objection prior to any final hearing on the DIP Motion.

ADCRR is the state of Arizona's department of corrections. Pursuant to pre-petition contracts with the Debtor's predecessors, ADCRR is owed for certain indemnity obligations arising from litigation between prisoners and the Debtor (or its predecessors). ADCRR estimates that it is currently owed between $1 million and $2 million for expenses that the state incurred defending lawsuits that should have been defended by the Debtor or its predecessors.

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I. Introduction.

To evaluate the Debtor's DIP Motion, the Court should bear in mind what the case is about. The Debtor is (or perhaps was) the entity divested by the Debtor's predecessors and left to be the target for litigation claims brought by numerous individuals and entities across the United States. At the time of division, the Debtor's assets allegedly consisted of $1 million in cash and a $15 million funding agreement (the "Funding Agreement") with M2LoanCo, LLC ("M2LoanCo"). Indeed, FTI provided its opinion that the division merger was fair based on the idea that the Funding Agreement would "earmark" $11 million for the Debtor's unsecured creditors. *See* Dkt #7, p. 6, ¶ 16 (motion), and p. 24, ¶ 7 (Perry Declaration).[1] It is unclear if this money was ever provided to the Debtor – and because the Debtor has not yet filed schedules or statements, neither the creditors nor the Court know the true scope of the Debtor's assets.

What is clear is that the Debtor does not have a business other than to provide a pool of assets and mechanisms for distribution to deal with the Debtor's predecessors' numerous creditors. In other words, it does not operate in a traditional sense. The emergency in this instance arises from: (a) the apparent pre-petition drain of $15 million from the Debtor that was supposedly designed to fund the liquidation mechanism and pay creditors; and (b) the need to pay administrative professionals to continue the liquidation scheme envisioned by the division merger.

Problems arise when the owners' desire for control of the distribution process runs afoul of the bankruptcy process. Here, the Court is being asked to approve a post-petition DIP loan made by M2LoanCo, an entity owned or controlled by the Debtor's owners and predecessors-in-interest, that contains the following terms in tension (or outright conflict) with the Bankruptcy Code:

[1] Unless otherwise specified, all page references are to the court-stamped electronic page number.

1. The DIP Motion provides releases for the Lender and its officers, shareholders, directors, etc., from all claims including those involving the divisional merger and the pre-petition Funding Agreement. Dkt #185, pp. 15-16. These third-party releases provide a result that the Lender(s) (who share common ownership with the Debtor and the Debtor's predecessors) likely could not obtain through the plan process.[2] At a minimum, the estate's claims should not be released until the Court and the creditors have had an opportunity to investigate the worth of these claims.[3]
2. The DIP Motion authorizes a lien on the Debtor's avoidance actions. Dkt #185, p. 14. Given the apparent "disappearance" of the money from the Funding Agreement and the controversies surrounding the divisional merger, this appears to be inappropriate prior to an opportunity to investigate those claims.
3. The DIP Motion authorizes a superpriority administrative expense claim. Dkt #185, p. 5, ¶ 13 and Dkt #185-1, p. 19, ¶ 6. This all-too-common provision virtually guarantees that the Debtor and its creditors will be at the mercy of M2LoanCo until the Debtor has funding in excess of the amount needed to repay the lender. And, since the Debtor does not operate and has provided no additional evidence to support payment of the loan, it is unclear when that would occur (if ever).
4. The DIP Motion requires the waiver of the right to surcharge under Section 506(c) or obtain equitable remedies under Section 552(b). It is unclear why

[2] The practical effect of the release provisions is that the debtor-in-possession has released the lender (a non-debtor) from claims that the DIP holds on behalf of all creditors. This likely could not be achieved in a Chapter 11 plan. *See, e.g., In re Pacific Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009); *In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995).

[3] The proposed order does provide a challenge period and below ADCRR addresses why that challenge period is not enough protection for the creditors.

such relief is necessary and it only deepens the problems related to giving the Debtor's owners a clean exit if they choose to default the Debtor under the loan.

5. The DIP Motion requires that parties give up their ability to challenge the or recharacterize the financing proceeds. Dkt #185, pp. 9-10. This term ordinarily would be (relatively) noncontroversial but raises problems when the Lender is in the Debtor's ownership structure and the case is largely being run to benefit those individuals.
6. That the Debtor must file a plan acceptable to M2LoanCo and obtain a confirmation order acceptable to the lender by September 1, 2023. In other words, any plan must be acceptable to the DIP lender or the Debtor will be in default.

Taken together the above-referenced provisions provide the lenders, i.e., the owners of the Debtor, with releases and the ability to default the Debtor in such a way that the creditors would be worse off than if the case were immediately converted to a Chapter 7. It would be folly to permit the Debtor's owners and predecessors-in-interest to obtain releases that they could not obtain in a Chapter 11 through the mechanism of a DIP loan. Further it is wrong to put those same owners and predecessors-in-interest in position to "tank" the bankruptcy case and put the creditors in a position worse than they would be if the case were converted to a Chapter 7.

II. Relevant Factual and Procedural Background.

1. The Debtor filed for bankruptcy on February 13, 2023. Dkt #1.

2. The Debtor has not yet filed its schedules and statements. They are due on March 30, 2023. Dkt # 113.

3. The actions against many non-debtors, likely including the potential lenders, were temporarily stayed by this Court through May 18, 2023. *See* Dkt #7 and Dkt # 118.

4. The Debtor filed the emergency DIP Motion on March 15, 2023. *See* Dkt #185 (DIP Motion) and 185-1 (proposed order and loan agreement).

5. The Debtor has represented to the Court that its pre-petition assets consisted mainly of $1 million in cash and a $15 million Funding Agreement from M2LoanCo. *See* Dkt #7, p. 25, ¶ 10.

6. FTI Consulting purportedly "confirmed" the fairness of the divisional merger to Corizon's unsecured creditors in part because of the "availability of $15,000,000 from M2LoanCo, pursuant to a funding agreement (the "Funding Agreement")." Dkt #186, p. 4, ¶ 8.

7. "[A]s part of the Divisional Merger, the Debtor was allocated $1 million in cash, as well as the right to draw on the $15 million Funding Agreement, $11 million of which was earmarked for the Debtor's creditors." Dkt #186, p. 5, ¶ 11.

8. The declaration in support of the Debtor's DIP Motion states: "As of the Petition Date, the Debtor had no cash on hand to fund its ongoing efforts to wind down its assets and liabilities or pay professionals to negotiate and propose a plan of liquidation. The Debtor was not allocated any tangible real property under the Divisional Merger, and, as of the Petition Date, though the Debtor was the beneficiary under the Funding Agreement, it does not appear that any additional amounts were available thereunder as of the Petition Date. . . ." Dkt #186, p. 6, ¶ 14. This statement is obliquely contradicted by a footnote which provides: "Along with counsel, Aukara is investigating and analyzing the Funding Agreement transactions to determine how much, if any, funding remains available thereunder." *Id.* at n. 2.

9. "The Debtor is actively winding down its business as it is no longer an operating entity with any active contracts or medical service providers." Dkt #186, p. 6, ¶ 13.

10. The budget attached to the DIP Motion (a) does not have a beginning balance (although it appears to be zero); and (b) does not show the Debtor receiving any revenue over the next thirteen weeks. Dkt #185-1, p. 98.

11. M2LoanCo is an affiliate of the Debtor by common ownership. *See* Dkt #186, p. 8, ¶ 18. M2LoanCo, however, is only the administrative agent for the proposed DIP financing. The actual lender (or lenders) are not identified (even in the proposed order). The credit agreement provides, "each of the lenders from time to time a party hereto (each a "Lender")." Dkt #185-1, p. 46. In other words, an affiliate of the Debtor, or predecessor-in-interest to the Debtor, can buy a release by becoming a "lender" under the credit agreement.

III. Objection.

The Debtor's DIP Motion should be denied, even on interim basis, for two reasons. First, without schedules or the identity of the lenders, the Court and the creditors cannot meaningfully evaluate the terms of the proposed DIP financing. For example, the Court does not know what, if anything, is available to repay the loan. The Debtor has indicated that it no longer operates. Further the Debtor is releasing its avoidance claims and potential causes of action against its owners (and likely its predecessors-in-interest). Without bankruptcy schedules it is unclear what assets remain. The Debtor's CRO has suggested that there may be tax refunds "and similar receivables," but there is currently no way to gauge whether these assets constitute enough value to pay a $10 million loan at 12% interest.

Similarly, without schedules and statements, the creditors have no idea what the universe of potential liabilities might be. Nor do they have any idea of the value of potentially avoidable transfers. Without such information the creditors do not have sufficient information to meaningfully evaluate the proposed DIP lending transaction.

Finally, the credit agreement does not identify the lenders. M2LoanCo appears to be a lender (in addition to being the administrative agent), but it is not clear. The credit

agreement, however, makes clear that M2LoanCo controls the authority exercised by the lenders under the credit agreement. In other words, insiders of the Debtor appear to have the authority to declare a default or demand compliance with the terms of the credit agreement. As a practical matter – and given the aforementioned problematic terms of the DIP Financing facility – it appears that the Debtor's "independent" CRO will be significantly constrained by the terms of the DIP Motion.

The second problem with the DIP Motion is that the "proposed terms would prejudice the powers and rights that the Code confers for the benefit of all creditors and leverage the Chapter 11 process by granting the lender excessive control over the debtor or its assets as to unduly prejudice the rights of other parties in interest." *In re Mid-State Raceway*, 323 B.R. 40, 59 (Bankr. N.D.N.Y. 2005). To begin, the DIP Motion tips the balance of plan negotiations in favor of the lender, i.e., the Debtor's insiders. This includes the economic pressure of a large, secured claim; but also incorporates "collars" such as limiting the scope of the Committee's investigation by prohibiting the use of DIP financing money to investigate any claims and causes of action related to the lender, its affiliates, and YesCare, Inc. (the entity that bought the NewCo (CHS) that received the assets of Corizon in the Divisional Merger). *See* Dkt #185, pp. 9-10. Thus, while there is a challenge period to investigate such claims, any such investigation cannot be funded by DIP financing proceeds.[4]

Further, M2LoanCo has the sole and absolute discretion to determine what constitutes an "acceptable" plan of reorganization and an acceptable confirmation order. *See* Dkt #185, pp. 14-15. This provides M2LoanCo with the ability to block any plan of reorganization and, through its ability to declare a default, the ability to force the case to convert to a Chapter 7 for lack of funding. Taken together with the releases of claims

[4] The DIP Motion does allow the Committee to utilize $500,000 to investigate the Divisional Merger, but there appear to be many other potential avoidance actions – including what happened to the $15 million Funding Agreement.

against lenders, releases of avoidance actions, a lien on all the Debtor's assets, a superpriority administrative expense claim, and no ability to surcharge the lender's collateral or seek equitable relief under Section 552, the DIP Motion surrenders all of the debtor-in-possession's Bankruptcy Code-based weaponry to the lender. The approval of such terms will improperly leverage the bankruptcy process in favor of the lender and against the creditors. As one court put it:

> Under the guise of financing a reorganization, the Bank would disarm the Debtor of all weapons usable against it for the bankruptcy estate's benefit, place the Debtor in bondage working for the Bank, seize control of the reins of reorganization, and steal a march on other creditors in numerous ways. The Financing Agreement would pervert the reorganizational process from one designed to accommodate all classes of creditors and equity interests to one specially crafted for the benefit of the Bank and the Debtor's principals who guaranteed its debt. It runs roughshod over numerous sections of the Bankruptcy Code. Under its rights of approval and supervision, the Bank would in effect operate the Debtor's business . . . . And the Bank would have the ultimate say over the very goal of this Chapter 11 case.

In re Tenney Village Company, Inc., 104 B.R. 562, 568 (Bankr. D. N.H. 1989). Here the situation is even slightly more pernicious because the lender is an insider – and one potentially subject to claims for pre-petition misconduct.[5] In *Tenney Village Co.*, the Court concluded that the debtor-in-possession's giveaway of so many of the fiduciary responsibilities (such as pursuing avoidance actions and proposing an independent plan) violated the debtor's fiduciary obligations to the estate. *Id.* at 569. The Debtor's similar failures here warrant a denial of the DIP Motion.

IV. Notice of Reservation of Rights.

Please take further notice that neither this Notice, any subsequent appearance (by pleading or otherwise), nor any participation in or in connection with this case is intended

[5] The same court observed: "It is said that a Chapter 11 lender should not be required to finance the prosecution of claims and defenses against it. That is true. If the lender believes that this will occur, it can elect not to make the loan. It cannot expect, however, to change the rules of a Chapter 11 case." *Tenney Village Co.*, 104 B.R. at 569.

to waive (i) the right to have final orders in non-core matters entered only after de novo review by a District Court Judge, (ii) the right to trial by jury in any case, controversy, or proceeding, (iii) the right to have the reference withdrawn by the District Court in any matter subject to mandatory or discretionary withdrawal, and (iv) any other rights, claims, actions, defenses, setoffs or recoupments to which the ADCRR is, or may be entitled, under agreements, in law or in equity, are expressly reserved.

V. Conclusion.

For the reasons set forth above, and those set forth in the Committee's Objection to the DIP Motion, Dkt #224, the Court should deny the Debtor's emergency DIP Motion. ADCRR requests any further relief that the Court deems appropriate.

DATED this 22nd day of March, 2023.

OSBORN MALEDON, PA

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Certificate of Service

I hereby certify that on March 22, 2023 I caused a copy of the foregoing document to be served by the Electronic Case Filing System for the United States Bankruptcy Court for the Southern District of Texas.

/s/ Peggy Nieto