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UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

In re:	)	
	)	Case No. 10-42241-JDP
GABLES MANAGEMENT, LLC.,	)	
	)	Chapter 11
Debtor.	)	
	)	

TRUSTEE'S REPORT UNDER 11 U.S.C. §1106(a)(4)

Wayne Klein, Chapter 11 Trustee for Gables Management, LLC ("Trustee"), through his undersigned counsel, hereby submits this report ("Report") that summarizes the Trustee's findings with regard to the operations, activities, and financial condition of Gables Management, LLC ("Gables"). This report also summarizes the results of the Trustee's investigation into potential dishonesty, mismanagement, and misconduct of the prior owners and managers of Gables.

The conduct of an investigation and issuance of this Report is required by 11 U.S.C. §§1106(a)(3) and (4), which provides that a trustee shall:

(3) . . . investigate the acts, conduct, assets, liabilities, and financial condition of the

> debtor, the operations of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
>
> (4) as soon as practicable – (A) file a statement of any investigation conducted under paragraph (3) of this subsection, including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate . . . .

I. BACKGROUND

On August 12, 2011, the Court issued an order directing the United States Trustee to appoint a Chapter 11 trustee for Gables. The Trustee was appointed by the Court on August 23, 2011 [Doc. #184] on the motion of the United States Trustee [Doc. #183]. The Trustee's appointment followed allegations that Keith Rasmussen, the debtor in possession, had improperly diverted funds from Gables to the personal uses. (For simplicity, I will refer to Keith Rasmussen hereafter as "Rasmussen.")

Rasmussen has also filed a personal bankruptcy petition. Rasmussen's bankruptcy was initially filed as a Chapter 11 proceeding, but has been converted to a Chapter 7 proceeding.[1] One of the Rasmussen's assets was his ownership interest in Gables Management. This interest was auctioned by the Chapter 7 bankruptcy trustee on August 31. The winning bid of $6,000.00 came from a joint venture of Continental Bank and Reed Dame. They are now the equity owners of Gables.[2] However, because Gables is still under the control of the Trustee in this chapter 11 proceeding, the Trustee asserts that Continental Bank and Reed Dame have no control over the activities of Gables and will only realize value from their investment if all other creditor claims have been satisfied.

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[1] This is a joint bankruptcy of Keith and Renee Rasmussen. The personal bankruptcy was filed April 18, 2011 as a Chapter 11 proceeding and converted to Chapter 7 on July 21, 2011 [Case No. 11-4057 –JDP].

[2] This sale was approved by the Court on September 21, 2011 [Doc. #99 in Case No. 11-40571-JDP].

The three facilities are licensed with the Idaho Department of Health and Welfare. The licenses must be renewed annually. The renewal applications were filed by the due date of October 14, 2011. Gables is in the process of responding to additional information required by the state.[3] The facilities are inspected periodically by state inspectors. Prior inspections have identified "non-core" issues relating to the operations of the facilities. These issues were promptly corrected.

II. INITIAL ACTIONS TAKEN BY THE TRUSTEE

Following his appointment, the Trustee visited the Gables facilities on August 25, 2011. This visit included:

1. Facility Inspections The Trustee inspected each facility and found each in very good condition. Each property is relatively new. They have been maintained well, although in some instances maintenance problems had been deferred during the period between the removal of Rasmussen and appointment of the Trustee.[4]
2. Meetings with Facility Administrators The Trustee met with the administrator of each facility in an effort to learn the status of the operations of each facility, problems needing to be addressed, and morale. The Trustee found that all three administrators are exceptional employees that take pride in their facilities and demonstrate genuine care for their

[3] As part of the renewal, Gables must notify the state of new owners. Because the equity interests in Gables were sold to Continental Bank and Reed Dame, Gables must furnish the state with information about these new owners. The Trustee has requested information from Continental Bank about those holding significant ownership interests in the bank, so this information can be provided to the state.

[4] Company-wide administrative and bookkeeping functions are conducted from a separate office located in Blackfoot. This office is rented from the parents of Mike Robbins, who is the office manager and bookkeeper for Gables. The lease was signed on April 26, 2011, after the filing of the bankruptcy petition. This property was rented as a replacement for other office space costing three times as much. The Trustee has examined the lease agreement for this office and determined that the rates are fair and reasonable. There are no reasons to suspect insider dealing with this lease.

residents.[5] Each administrator expressed a commitment to do the best she could despite the limitations and disruptions occasioned by the bankruptcy. The Trustee compiled a list of needs for each facility and subsequently made arrangements to have the maintenance needs resolved.[6]

3. Gables Office Manager/Bookkeeper The Trustee also met with the office manager for Gables, who also maintains its financial records. During his initial meeting with the manager, the Trustee learned of the manager's role in exposing the diversion of funds by Mr. Rasmussen and was persuaded that the manager's loyalty was to Gables, not to Mr. Rasmussen. The manager has proven to be very competent in maintaining the financial records for Gables, preparing the monthly operating reports that are filed with the Court, and handling system-wide administrative matters for Gables.[7] In addition, the manager's background in construction is proving to be a big help to the company. The manager has used that expertise to handle most of the maintenance issues that arise, including a leaking roof and refinishing dining room tables.

4. Taking Possession of Bank Documents and Debit Card Most of the funds diverted by Rasmussen were paid by check or charges on a Gables debit card from the Bank of America. The checkbooks and debit card had previously been impounded by Robert Maynes (who had been serving as bankruptcy counsel for Gables). During this visit, the

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[5] This finding is consistent with the reports of state health care inspectors. Prior to the site visits, the Trustee read inspection reports by the state regulatory agency that oversees these facilities. Those reports found high levels of compliance for each of the facilities. The reports of the Court-Appointed Ombudsman also attest to the high degrees of competence and empathy of the administrators.

[6] During the interim period between the removal of Mr. Rasmussen and the Trustee's appointment, some of the lawn care work was performed by relatives of employees. After review of the payments for this work, the Trustee believes the rates paid were fair and reasonable.

[7] Most of the administrative matters for each facility are handled by the facility administrators. For some tasks, the administrators assist in preparing reports relating to other facilities or the company as a whole. The administrators are quick to assist each other and share ideas for improving the experiences of the residents.

Trustee took possession of the debit card. The check books were left with the manager. *Note: the Trustee is the only one with signatory authority on the account. The manager prepares checks that are then signed by the Trustee.*

5. Change Bank Account Signature Authority The Trustee changed the signature authority on all bank accounts used by Gables. Keith Rasmussen was removed as an authorized signatory on all the accounts. This includes six bank accounts at Key Bank and one bank account at Bank of America.[8] The Trustee made arrangements with Key Bank for weekly withdrawals of funds to be used for food purchases by the facility administrators.

6. Payroll, Vendor Payments The Trustee signed payroll checks that were due to employees that week. He also reviewed invoices from trade creditors and other vendors and signed checks to pay those bills.

7. Payments to and for Rasmussen The Trustee determined not to sign payroll checks for Keith or Renee Rasmussen in light of amounts they owe to the bankruptcy estate. The Trustee did sign checks for several Rasmussen children for lawn care work they had performed previously. The Trustee canceled cell phone service for Rasmussen that was being paid by Gables. None of the Rasmussens are still providing services to Gables.

III. PROPERTIES OWNED BY GABLES

Gables owns four real estate properties.[9] These are discussed below. The Trustee believes, based on his investigation to date, including examination of some written appraisals, that

[8] The Bank of America account is a non-bankruptcy account. Its sole purpose was to receive electronic Medicaid payments. The Trustee signed Medicaid forms to have these deposits sent directly to the Key Bank accounts instead of Bank of America. When these electronic deposits are all transferred to Key Bank, the Bank of America account will be closed.

[9] Gables also owned a fifth group of properties. These are vacant lots that are adjacent to the Shelley facility. These were subject to liens by the Bank of Commerce. The Bank of Commerce is in the process of foreclosing on these lots.

each of the four parcels is subject to liens in aggregate amounts greater than the value of the property. At the current time, the Trustee believes that none of the properties has positive equity. This means that the Trustee is unlikely to sell any of the properties for more than the amounts owed to secured lenders. As a result, it is not expected that sale of the properties will provide any proceeds available to help pay administrative expenses, priority claims, or the claims of unsecured creditors. The Trustee is concerned that many of the secured creditors may assert that a portion of their claims are unsecured – thereby increasing the size of the pool of unsecured claims.

In other bankruptcy situations, a Trustee would be expected to abandon properties that had negative equity. However, the situation with Gables merits different treatment because: i) these are operating businesses where the properties have greater value as operating businesses than as vacant properties and ii) these properties serve an important role for residents of the facilities, their families, employees, and the communities in which they are located. As a result, the Trustee feels an ongoing obligation to keep the facilities operating, even though there appears to be no equity in the properties. The decision to keep operating the properties, while a long-term solution is sought, is supported by the fact that the facilities are currently operating at a profit. The financial condition of the facilities and the long-term plans being considered by the Trustee are described in more detail in Sections IV, X, and XI of this Report.

1. <u>Pocatello Facility</u> This facility has not been appraised. Reed Dame and the Small Business Association have asserted secured claims in the property totaling $1,350,000.00. This property is the subject of a cash collateral order issued by the Court on May 9, 2011 [Doc. #'s 124, 130]. Under the cash collateral order, 40% of the room charge collected by the Pocatello

facility is deemed "rent" and is treated as cash collateral.[10] Gables pays $6,000.00 monthly to Reed Dame as "adequate protection" payments. Dame was granted an adequate protection lien in the post-petition revenue generated by the Pocatello facility.

2. Blackfoot Facility This facility was appraised at $1,360,000.00 on February 4, 2011. The Bank of Idaho has asserted a secured claim in the property totaling $1,400,000.00. This property is the subject of a cash collateral order issued by the Court on March 21, 2011 [Doc. #101]. Under the cash collateral order, Gables pays $9,550.47 monthly to the Bank of Idaho. The Bank of Idaho was granted an adequate protection lien in the post-petition revenue of this facility.

3. Shelley Facility This facility was appraised at $1,350,000.00 on February 22, 2011. Continental Bank has asserted a secured claim in the property totaling $1,350,000.00. This property is the subject of a cash collateral order issued by the Court on May 9, 2011 [Doc. #125]. Under the cash collateral order, Gables pays $9,400.00 monthly to Continental Bank. Continental Bank was also granted an adequate protection lien on revenue generated by this facility subsequent to the bankruptcy filing.

IV. FINANCIAL CONDITION OF GABLES

Under the circumstances, the financial condition of Gables is good. The occupancy rate is higher than existed at the time Gables first proposed its reorganization plan. In addition, Gables has increased the rates for some levels of care it provides. As a result, each facility is earning more revenue than was anticipated. In addition, as a result of the bankruptcy, the expenses associated with operation of Gables are substantially lower. Gables is no longer making interest

[10] For residents who are being funded by Medicaid, 50% of the total amount received is deemed rent and is cash collateral. The cash collateral is deposited into a separate debtor-in-possession bank account. Other monies received by Gables are deposited into Gables' general operating account.

payments on the large amounts that Rasmussen and Gables borrowed from investors and private lenders. Moreover, the expenses attributable to each facility have been reduced further as the facilities are no longer being charged for a share of the salaries and expenses of Keith and Renee Rasmussen.[11]

As a result of these factors, each facility is currently profitable. While all three facilities have the same occupancy rate, the profitability of the facilities differs. Pocatello is the most profitable facility, while Shelley is the least profitable. This is primarily a result of Shelley having two [*several?*] residents whose rent and care is paid by Medicaid, while all of Pocatello's residents are paid from private sources.

The operating results of the facilities are described in the monthly operating reports that are filed with the Court. The monthly operating report for September shows the following:[12]

1. Monthly gross revenue: $129,447.00
2. Monthly operating expenses: $106,869.00
3. Net operating income: $22,578.00
4. Cash in the bank: $158,524.00
5. Assets (primarily facilities) $3,322,509
6. Post-petition liabilities $48,356.00[13]
7. Pre-petition liabilities $8,536,597.00

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[11] While Gables is no longer paying the salaries and expenses of the Rasmussens, Gables is incurring higher expenses relating to the costs of the Trustee and his counsel. These expenses are expected to be higher than the amount originally allocated in the reorganization plan for professional fees. It is hoped that the fees for the Trustee and his counsel, along with fees to be paid to prior counsel for Gables, will not exceed the combined amounts allocated for professional fees and for salaries for the Rasmussens.

[12] This information reflects results as of September 30, 2011.

[13] These post-petition fees include $37,426.00 in accrued professional fees and $10,930 in taxes payable. $27,353.35 of the professional fees were paid earlier in October, 2011. The taxes payable reflect a lag between accrual of the tax liabilities and the due date for their payment. All post-petition taxes are being paid on a timely basis.

V. OPERATIONAL CONDITION

Early in the bankruptcy, the Court appointed a "Patient Care Ombudsman" to ensure that the quality of care for residents was not diminished as a result of the bankruptcy. The ombudsman visits each facility bi-monthly and files reports with the Court. In the most recent report, dated October 8, 2011, the ombudsman reports that:

- Patient care has not been compromised as a result of the bankruptcy;
- Procedures are in place to ensure patient care is provided in a compassionate and efficient manner;
- The facilities are clean and have inviting environments;
- The facility administrators are experienced and competent, take great pride in their facilities, and are conscientious in ensuring high standards of patient care.

In the ordinary business of the facilities, some problems have arisen, such as a resident eloping (wandering) from the facility. However, these problems are resolved and procedures have been implemented to improve operation of the facility. Some expenditures have been required for upkeep of the facilities such as treating a lawn insect infestation, painting a fence, repairing a sprinkler system, purchasing a new computer, repairing appliances at the Pocatello facility, and purchasing replacement components to the electronic monitoring systems for residents.[14] Gables is in the process of improving its Internet websites to provide better information to families of residents and to improve its marketing efforts.

Each of the facilities has filled 14 of the 15 available rooms.[15] The administrators are

[14] Additional landscaping in the rear of the Pocatello facility is warranted, but the Trustee has determined to wait on this improvement until the spring.

[15] The facilities are licensed to be able to house 16 residents in the 15 rooms.

actively seeking to keep the facilities full. This includes marketing the facilities by visiting physician offices, home health agencies, and hospitals, giving tours to prospective residents, and advertising services offered by the facilities. Moreover, the administrators are undertaking innovative steps to increase the occupancy rate and revenue. These include providing senior day-care services at one of the facilities and exploring creation of an Alzheimer's support group at another facility.

The company may have to expend funds to pay for a used piano located at one of its facilities. In the personal bankruptcy petition of Rasmussen and his wife, Renee, they listed a piano at one of the facilities as his personal asset. The bankruptcy trustee for Rasmussen's Chapter 7 bankruptcy requested that the piano be delivered to the trustee for sale at auction. Gables has questioned whether the piano that Rasmussen claimed is at one of the facilities. If it is determined that one of the pianos was personal property of Rasmussen, Gables will pay the Chapter 7 trustee the estimated value of the used piano. There had been a concern that Rasmussen would attempt to pick up patio furniture and other furnishings at the various facilities, claiming that those were personal property that belong to his personal bankruptcy. The bookkeeper could find no record of Rasmussen using his personal funds to pay for furniture, so the Trustee communicated to Rasmussen that it would not release any furniture and instructed the facility administrators to refuse to permit Rasmussen to enter the facilities.

Each of the facilities would be benefitted by having a vehicle that could be used to transport residents to doctors' offices. The Trustee has decided not to authorize this improvement at the present time. During the bankruptcy, the facilities will continue the current practice of reimbursing employees for the use of their personal vehicles when transporting residents.

Gables is highly dependent on its administrators. They ensure that the facilities are run in compliance with regulatory requirements. They engage in marketing to fill empty rooms at the facilities. They plan the menus and activities for the residents. They purchase the food and other supplies needed for the facilities. They hire and train employees.[16] Most importantly, they ensure a positive experience for each resident of the facilities. Not surprisingly, the bankruptcy of Gables has created confusion and uncertainty among employees and residents. The administrators have successfully reassured residents and employees that operations will continue. It is not an exaggeration to say that the long term success of Gables is dependent on these administrators.

VI. EFFORTS TO INCREASE THE AMOUNT AVAILABLE TO PAY CLAIMS

There are two primary means of increasing the amounts of likely recoveries for creditors: challenging the validity or amount of suspect claims and increasing the amount of funds in the bankruptcy estate that will be available for distribution to creditors. The Trustee is pursuing efforts on both fronts.

VII. EVALUATION OF CLAIMS

Creditors have two primary means of asserting claims for recovery against Gables. One is to rely on the creditors identified in the bankruptcy schedules which the Gables scheduled as undisputed, liquidated, and non-contingent. The other is to file a proof of claim. Based on the review of claims conducted to date by the Trustee, it appears that the bankruptcy schedules list a number of claims that are not debts owed by Gables. Further, it appears that a large number of claims filed by creditors are not debts owed by Gables. Finally, many claims appear to be

[16] The Trustee authorized limited additional funds for the administrators to resolve salary inequities among some long-time employees.

classified improperly.

1. Debts Owed by Rasmussen, Not Gables. Many of the claims that have been filed in this proceeding are based on assertions that the claimants made loans to fund the operations of Gables.

a. In many instances, however, the claimants made their loans to Rasmussen, not to Gables. To the extent that debts are the obligation of Rasmussen, rather than Gables, the Trustee expects to challenge those claims.

b. In other instances, the claims are not easily classified. In many instances, particular loans have some documents in the name of Rasmussen and other documents suggesting that Gables had liability on the loan. Sometimes, the Gables documents are dated contemporaneously with the loans; other times Gables appears to have assumed responsibility for funds borrowed by Rasmussen at an earlier date. The Trustee will have to analyze each of these claims in detail, to decide which claims to challenge. The Trustee has begun requesting additional documentation from some of these claimants and asking claimants to withdraw their claims. In response, some claimants have agreed to withdraw their claims.[17]

2. Claims Are Based on Funds Not Paid to Gables. In the case of the claim by Niguel Sante, the claimant asserts that $270,000.00 was paid to Gables as a down payment on a contractual agreement to purchase the Idaho Falls properties. The contract also required Niguel Sante to make other payments to Gables. To date, the Trustee has not been able to verify that the $270,000.00 was paid to Gables or that the other payments were made, as required by the contract. The Trustee and his counsel have discussed these issues with the attorney for Niguel Sante and

[17] These are difficult and sad situations. Many of these creditors loaned large amounts to Rasmussen and are understandably upset at being told that the Trustee will oppose their claims. The tragedy is compounded by the likelihood that few payments will be made to creditors from Rasmussen's personal bankruptcy.

hope to obtain clarification of many issues that appear on the face of the Niguel Sante claim. The Niguel Sante claim is discussed in more detail in Section VIII.

3. Lenders Are Overpaid. In several instances, claimants have asserted large claims against Gables based on loans they allege were made to Gables. Investigation conducted by the Trustee has revealed that some of these lenders have been repaid the full amount of their principal plus interest. Their large claims, notwithstanding the payments made to them, are based on high interest rates promised to them and large late fees that accumulated over time. In one case, the lender provided $28,000.00 in loans and received more than $44,000.00 in payments – an excess of $16,837.00 over the amount loaned to Gables – but still claims to be owed $42,000.00 by Gables. In another case, the claimant loaned $160,000.00 to Rasmussen and was paid more than $221,000.00 in interest and late fees – by Gables. Nevertheless, this claimant asserts that Gables still owes more than $217,000.00 to the claimant. The Trustee has made a demand on these claimants to withdraw the claims and repay the excess funds to the bankruptcy estate. In these cases and others, the Trustee may have to file adversary complaints against the recipients of these funds.

4. Claimants Have Equity, Not Debt. Multiple creditors have asserted claims in situations where the funds provided by the creditors were intended as some type of ownership interest instead of a pure loan. As with the loans described above, there are many variations in these transactions. In some instances, the creditors believed they would have ownership in individual facilities, not in Gables itself. In others, the creditors had hybrid transactions where they were purchasing equity but had the ability to convert that equity to debt. The Trustee will need to conduct further analysis to determine the extent to which these claims should be disputed

as being equity, not debt.

5. Claims Are Classified Improperly. Some claims improperly assert secured creditor status. The Trustee has begun asking some of these claimants to demonstrate the basis of their secured claims and whether the Uniform Commercial Code filings that were necessary to perfect their claims were filed. One claimant has already agreed to reclassify its claim as unsecured.[18] In another instance, the claimant has asserted a secured claim based on payments made by the creditor. The Trustee is investigating whether such payments properly constitute secured claims.

6. Excessive Claims. Some lenders have filed claims asserting that Gables owes amounts many times the amount loaned to Rasmussen or Gables. For example, Kim and Troy Hansen loaned $100,000.00 to Rasmussen. They received at least $13,000.00 in interest payments from Gables. Nevertheless, their claim is for $610,272.40. This is based on extremely high interest rates on the loans and large late fee penalties that kept compounding.

VIII. POTENTIAL RECOVERIES

The Trustee has identified a number of transactions by Gables that might result in recoveries of additional funds for the bankruptcy estate. These include:

1. Recovering Fraudulent Transfers. As noted earlier, some claimants have already been paid substantially more than the amount of loans they made to Rasmussen or Gables. The Trustee's current view is that he will seek to recover these overpayments. Other lenders, who have not filed claims, were paid the amounts of their loans plus high interest payments and fees, significantly in excess of the principal amounts of their loans. The Trustee is attempting to

[18] In the case of this particular claim, the Trustee is asserting that the work performed by this vendor was for Rasmussen, not for Gables. Consequently, the Trustee has asked the claimant to withdraw the claim entirely.

determine how many individual lenders have been overpaid and the extent to which it will be cost effective to pursue recoveries against them. It appears that Gables has been insolvent for several years, giving the Trustee a legal basis for recovering excess payments.

2. Niguel Sante. Gables owns two properties in Idaho Falls that are being used as specialized assisted living facilities. In March of 2007, Gables entered into a contract to lease these facilities to Niguel Sante, a company owned by Rasmussen's nephew, Ryan Rasmussen. At the time of the 2007 lease, the two buildings were operating facilities and had residents. The 2007 lease included an option for Niguel Sante to purchase the properties at a set price, with credit towards the agreed-upon purchase price from a portion of the lease payments it was to make under the lease. The lease and purchase options also included a number of other conditions. The 2007 lease and purchase option was set to expire in March 2010, with a possibility of being extended to October 31, 2010 if Niguel Sante were to be unable to finalize financing by March 2010.

On October 28th, 2010, Gables signed a new lease and purchase option with Niguel Sante. This 2010 lease agreement contained a number of terms that appear unusually favorable to Niguel Sante. For example, the purchase price was reduced and the 2010 lease lists $392,442.51 in credits that Niguel Sante supposedly had earned towards the purchase price. The 2010 lease also purports to grant Niguel Sante a secured claim in those properties based on the payments Niguel Sante reportedly has made.

Gables filed for bankruptcy on December 17th, 2010. This was less than 90 days after the 2010 lease with Niguel Sante. Based on this timing, therefore, the Trustee is examining whether this 2010 agreement may be avoided as a preferential transfer under the Bankruptcy Code. In the proposed Reorganization Plan created by Rasmussen, Gables proposed to assume the terms of the

2010 lease with Niguel Sante. The Trustee has requested information from Niguel Sante and some of the requested information has been provided. Niguel Sante is urging the Trustee to assume the terms of the 2010 lease and permit Niguel Sante to purchase these properties. In his review of information surrounding the Niguel Sante leases, the Trustee is investigating questions in the following areas:

a. The 2010 lease states that Niguel Sante had paid $270,000.00 to Gables as down payments toward the purchase of the properties. The Trustee has been unable to find evidence that these payments were received by Gables. It is possible that these payments were made to Rasmussen, rather than Gables. The Trustee has asked Niguel Sante for evidence that these payments were made to Gables and has not yet received documents showing that these payments were made.

b. The 2007 lease required Niguel Sante to make monthly mortgage payments to the Bank of Commerce and the Small Business Administration. These payments appear to have been made. In addition, the lease required Niguel Sante to pay $5,000.00 each month in additional lease payments to Gables. From these payments, $1,250.00 per month would be allowed as credits toward the purchase price of the properties. The Trustee has not been able to verify that these monthly payments were made to Gables.[19] The Trustee has asked Niguel Sante for verification that these payments were made, but Niguel Sante has not yet provided this information.

c. The 2010 lease recites that $392,442.51 in payments from Niguel Sante are treated as credits towards the purchase price of the properties. The Trustee is attempting to

[19] Again, it is possible that these payments were made to Rasmussen.

determine whether these credits are properly calculated and whether they derive from payments actually made to Gables. The amount claimed as credits in the 2010 lease appears to be greater than the amount contemplated by the terms of the 2007 lease and the 2010 option purchase price was lowered in the 2010 agreement.

d. The 2007 lease required that Niguel Sante make certain payments in connection with its operation of the properties, including property taxes. The 2010 lease also requires that Niguel Sante make certain tax payments. The Trustee is evaluating whether Niguel Sante has complied with these contract terms.

e. The 2010 lease terms provide that the amount supposedly paid by Niguel Sante pursuant to the 2007 lease represented a secured interest in the properties. The Trustee is analyzing whether these payments properly represent a secured interest and, if so, whether a secured interest was properly perfected.

3. Rupert Property In October 2010, Gables executed a quit claim deed to transfer property it owned in Rupert to Robert and Richard Silcock. There was no consideration paid by the Silcocks to Gables for the transfer of this property. Investigation by the Trustee into this transaction revealed that the property had originally been owned by the Silcocks. Rasmussen had persuaded them to transfer the property to Gables via quit claim deed in December 2009. Gables paid nothing to the Silcocks for the property when Gables acquired title. Rasmussen told the Silcocks that Gables planned to build an assisted care facility in Rupert, but needed the land to be free of liens in order to secure bank financing for the construction of the facility. He had pledged to pay $180,000.00 to the Silcocks when the facility was completed. In October 2010, Rasmussen realized that he would not be able to proceed with plans to build a facility in Rupert, so

he had Gables transfer title back to the Silcocks. The transfer to the Silcocks, however, was within the 90-day period prior to the bankruptcy filing, which may implicate a cause of action for avoidance as either a preference or as a fraudulent transfer. The Trustee is analyzing the circumstances surrounding this transaction to determine whether to avoid the transfer and seek to recover this property for the benefit of creditors of Gables.

4. Amounts Due from Keith Rasmussen and Family. As described below, substantial funds were improperly diverted from Gables to Keith Rasmussen and members of his family. The Trustee is determining whether and how to seek recovery of these improper payments.

IX. DIVERSION OF FUNDS BY KEITH RASMUSSEN

Background

The Trustee understands that the Court removed Keith Rasmussen as debtor in possession based on concerns raised that Rasmussen had used funds from Gables for personal benefit, after the bankruptcy had been filed. In April 2011, the bookkeeper noted checks written on the Gables checking account and expenditures on the Gables debit card that appeared to be for work on a personal residence of Rasmussen. Robert Maynes, the bankruptcy attorney for Gables, became aware of the expenditures and instructed Rasmussen to cease those expenditures. Subsequently, Maynes took possession of the debit card and the company's check books, to prevent further diversions of funds. A preliminary investigation was conducted to determine the extent of diversion.

Results of Investigation

As a result of the preliminary investigation and further analysis since appointment of the

Trustee, it appears that the following amounts have been diverted by Rasmussen:[20]

1. Debit Card Expenditures: $6,316.01 in expenses were charged to the Gables debit card between April 18, 2011 and June 14, 2011. Most of these payments were to Home Depot, Lowe's, and other construction suppliers.

2. Check Expenditures: Checks totaling $1,168.65 were paid to construction suppliers such as Rocky Mountain Supply and Quality Door and Millwork.

3. Diversion of Rental Payments from Residents: During this time period, four new residents came to Gables. Rasmussen instructed these residents make the checks for their first month's rent payable directly to Rasmussen. In one case, the resident also paid Rasmussen for the second month's rent. The checks were made payable to "Keith Rasmussen Properties" or "Rasmussen Properties" and were deposited into the Gables bank account. Rasmussen then wrote a check to him for the same amount from the Gables bankruptcy expense account.[21] These payments totaled $12,749.37.

4. Petty Cash: Rasmussen used $445.94 in petty cash for remodeling work on his personal residence or for other unaccounted uses. This included $200.00 expended by May 31, 2011 and $245.94 that was in his possession when he was removed as debtor in possession.

5. Reimbursement for Vehicle Use: Rasmussen used his personal vehicle as part of the work he did for Gables. However, it appears that instead of tracking the number of miles he drove his truck, Rasmussen had Gables pay all of his vehicle expenses. As a result, Gables paid the loan payments on Rasmussen's truck, his gas, and all maintenance on his vehicle – despite the

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[20] The amounts diverted by Rasmussen discussed in this section do not include payments made to Rasmussen as salary. Between the bankruptcy filing on December 17th, 2010 and the appointment of the Trustee on August 23, 2011, Gables paid $36,458.38 to Rasmussen in salary.

[21] The deposits of these checks into the Gables account and Rasmussen writing a check to himself for the amount of these checks is what alerted the bookkeeper to Rasmussen's misuse of funds.

vehicle also being used for personal purposes.[22] In addition, it is believed that Rasmussen had Gables pay for the gas for multiple other vehicles used by his family members.

6. Payment of Other Expenses: Even after the filing of the bankruptcy, Gables has been paying the telephone bills for the cellular telephone plan for Rasmussen and his family. On August 25, the Trustee terminated its payments of these expenses. Some of the other expenses charged to the debit card, besides construction expenses, were payments to a day spa and mortgage payments.

7. Salary Payments for Renee Rasmussen: Shortly after the Gables bankruptcy filing, Keith Rasmussen's wife, Renee, was added as an employee of Gables. She had not been an employee of Gables prior to the bankruptcy filing. Since the bankruptcy filing, Gables has paid $18,124.95 to Renee Rasmussen. Employees of Gables have reported that they are unaware of any services that Renee Rasmussen provided to Gables since the bankruptcy filing.

8. Payments to Rasmussen's Sons: At least four sons have been on the Gables payroll after the filing of the bankruptcy. These are Benjamin, Brady, Danny, and Joshua. Supposedly, the sons were being paid to perform lawn care and other maintenance. Payments to two of the sons have been relatively small, consistent with providing lawn care services. The payments to two others have been much larger.

a. B. Rasmussen: Since the filing of the bankruptcy, B. Rasmussen has been paid $1,718.50 by Gables.

b. D. Rasmussen: Since December, Gables has paid $1,390.00 to D.

[22] If Rasmussen only had Gables pay for gas for one vehicle instead of seeking mileage reimbursement, it is possible that the net cost to Gables would have been lower than reimbursing his mileage. Without know the actual number of miles Rasmussen drove for personal and for business use, the Trustee cannot determine which method would have been cheaper. As evidenced by the bankruptcy claim filed by Les Schwab, before the bankruptcy filing, Rasmussen had charged Gables for new tires for one of his vehicles.

Rasmussen.

c. Brady Rasmussen: Gables has paid $17,298.00 to Brady Rasmussen since the bankruptcy filing.

d. Joshua Rasmussen: Since the filing of the bankruptcy, Gables has paid $6,165.00 to Joshua.

Employees of Gables do not recall the sons providing services consistent with the large payments to these two sons.[23]

Claim for Unemployment Compensation.

The Trustee has been contacted by the Idaho Department of Labor in connection with applications for unemployment compensation filed with the State of Idaho by Keith and Renee Rasmussen. Gables has provided documents and information to the Department of Labor relating to the nature of their removal from Gables and the payments to them. The Department of Labor will make its own determination whether unemployment compensation will be paid to them.

Options for Recovering Diverted Funds from Rasmussen

The Trustee is evaluating different options for recovering funds that were improperly diverted by Rasmussen and his family members. Options under consideration are:

- Seek Priority or Secured-Creditor Status in Rasmussen's Personal Bankruptcy. Gables filed an administrative claim in Rasmussen's personal Chapter 7 bankruptcy. The Chapter 7 trustee is challenging this claim, disputing that the monies spent on remodeling Rasmussen's home increased the value of Rasmussen's bankruptcy estate. The Trustee is evaluating whether the cost of pursuing this claim is likely to result in a recovery of more

[23] These sons were on the Gables payroll before the bankruptcy filing. The number of hours they reported working and the amount they were paid after the bankruptcy filing are consistent with the hours and amounts before the filing.

funds than the cost of asserting the claim.[24] The Rasmussen chapter 7 trustee has alleged, to date, that the real property that was remodeled with these funds is fully encumbered with existing liens and, therefore, an improvement in the value of the property would benefit the lien holder, not the Rasmussen bankruptcy estate.

- Seek a Lifting of the Bankruptcy Stay. In light of the improper diversion of funds, the Trustee could ask the Court to lift the automatic stay in Rasmussen's personal bankruptcy and allow the Trustee to pursue assets that Rasmussen might otherwise retain as exempt property, such as equity in a residence or vehicles. This approach also would require expending resources of the Gables bankruptcy estate and, if successful, might reduce assets available to pay creditors of Rasmussen's personal bankruptcy. The merits of this approach are being considered, but at this time this approach does not seem merited.
- Pursue an Objection to the Dischargeability of the Debt or to Rasmussen's Discharge. The Trustee is examining whether the diversion of funds creates a cause of action under 11 USC §523 or, alternatively, under 11 USC §727 to preserve the right to pursue Rasmussen despite the bankruptcy filing. The Trustee is informed that many parties are also examining this relief, including the US Trustee under 11 USC §727. The Trustee's initial analysis is that while he holds a viable cause of action, the ultimate recovery from Rasmussen due to all of the competing interests may not warrant the time and expense to be incurred by Gables in pursuing those actions.
- Pursue Rasmussen Outside of Bankruptcy. If other factors result in Rasmussen being

[24] The Trustee recognizes that if this approach is pursued and is successful, it will result in transferring assets from Rasmussen's personal bankruptcy estate to the Gables bankruptcy estate. In other words, it will reduce funds available for Rasmussen's creditors to increase funds available for Gables creditors. In the end, many claimants are creditors in both bankruptcies.

denied discharge of his bankruptcy petition – in other words, if other parties incur the expense of seeking a denial of discharge – the Trustee could assert a claim for constructive trust against the property that was improved using funds from Gables. In this scenario, the Trustee could go after the real property, but would be competing with secured lenders for priority. It is expected that this approach would result in contested litigation as to whether the Trustee's claims are superior to claims of existing secured lenders.

At this point, the Trustee is not highly confident that pursuing any of these options is likely to return significantly more monies to the bankruptcy estate than would be expended by the Trustee and his counsel in pursuing the claims. The Trustee is continuing to evaluate these and other options that might be pursued.

X. DESIREABILTY OF THE CONTINUATION OF THE GABLES BUSINESS

One of the matters required to be addressed in a report such as this is the "desirability of continuation" of the debtor's business. The Trustee believes the business of Gables should be continued, for several important reasons:

1. The three facilities are currently earning net revenue, after making adequate protection payments to the secured creditors. This positive cash flow generates cash to fund operations of the bankruptcy estate and is expected to make the facilities more attractive to potential buyers.
2. The three facilities used by Gables are special-purpose facilities. Their value is highly dependent on their use providing assisted care. If the business were to be discontinued, the value of those facilities would drop significantly, reducing their value as an asset available to repay creditors.

3. Beyond the question of financial viability, these facilities provide important services to residents, their families, employees, and the communities in which they are located. Since the facilities are generating net income, the bankruptcy estate is not losing money be continuing to provide these services.

XI. PLANS FOR DISPOSITION OF THE FACILITIES

The reorganization plan initially put forth by Gables proposed that Gables would continue to operate the facilities for seven years, after which the remaining debts of Gables would be discharged. Under this plan, secured creditors and priority claims would be paid and some amounts would be paid toward the debts owed to unsecured claimants. In addition, the Idaho Falls properties would have been transferred to Niguel Sante, with a small portion of the purchase price to Gables.

The Trustee does not believe it makes economic sense to continue operating the facilities in bankruptcy for another seven years, especially since the bankruptcy would have be overseen by the Trustee.[25] That leaves three other primary options.

- Close the Facilities One option would be to close the facilities and allow the lenders to foreclose on the buildings and land. This option has the advantage of reducing the costs of operating the bankruptcy estate and preserving the accumulated cash to use in paying administrative costs and priority claims. The disadvantages of this approach are the severe disruption to residents, their families, Gables employees, and the communities.
- Sell the Facilities Gables could seek buyers for the properties. However, if the Trustee

[25] The initial reorganization plan was based on some optimistic assumptions. In light of the removal of the debtor in possession and the Trustee's belief that it would not make economic sense for him to operate Gables for seven years in bankruptcy, the Trustee has not conducted an independent evaluation as to whether the assumptions underlying the initial reorganization plan were realistic.

is not able to find buyers willing to pay more than the amount of secured debt on the facilities, there would be no net benefit to the estate by selling the facilities. This is because the Trustee would incur commissions, closing costs, and other expenses associated with the sales that would not be incurred if the Trustee permitted foreclosure of the facilities or just abandoned them to the secured lenders. Negotiations would have to be entered into with the secured creditors to ensure the estate was compensated for the expense incurred in selling the real property.

- <u>Allow the Lenders to Foreclose on the Properties</u> The disposition that might turn out to be most advantageous to creditors and residents of the facilities would be to allow the secured lenders to foreclose on the properties and let the lenders find buyers for each of the facilities. The Trustee currently is in negotiations with secured lenders for one of the facilities for a resolution along these lines. In this scenario, the Trustee would consent to let the secured lenders foreclose on the property in exchange for the bankruptcy estate being able to retain some of the adequate protection payments and the accumulated cash collateral. The Trustee would continue operating the facilities during the foreclosure process. When the foreclosure is completed, the lenders would provide their own management and oversight of the facilities.[26] The Trustee believes this could benefit not only the bankruptcy estate and the secured creditor, but also keep the residents in place and the current employees retained – thus maximizing the return to the estate and minimizing the collateral effects of dismissing residents and employees.

The Trustee also expects to revisit the executory contract involving the lease and purchase

[26] It is expected that the administrators and employees of this facility will be retained.

option with Niguel Sante for the Idaho Falls property. This may include assuming the contract if the required payments to Gables have been made, seeking more favorable terms from Niguel Sante, or avoiding the contract and resuming control over the Idaho Falls facility.

XII. CONCLUSION

The facilities are coping well with the bankruptcy; their occupancy rates are high, revenues exceed expenses, and residents and employees appear content. The facilities are worth substantially more as operating businesses than as empty real estate properties. However, it is not expected that they could be sold for more than the amounts of secured debts. Ordinarily, this would call for the Trustee to abandon the properties. But, such a result is not warranted here due to the important interests of the residents, employees, families, and communities. As a result, the Trustee is exploring other avenues for protecting the residents while still serving the legitimate interests of secured creditors.

Evaluation of the claims is extremely complicated. A substantial number of the Gables claims could be challenged as being debts only of Rasmussen, representing equity interests in the company, or being inequitable in light of the claimants already being overpaid. The Trustee: i) is sensitive to the perceived unfairness of challenging claims where the claims may have been related to the business of Gables, ii) recognizes that spending time challenging unsecured claims is productive only if he expects to make distributions to unsecured creditors, and iii) wants to ensure that challenging claims would be cost effective. These are thorny issues.

There are a number of preferential transfers and fraudulent transfers that might result in recoveries by the Trustee. Further analysis will be undertaken to determine the strength of the Trustee's legal positions and the expected net benefits of pursuing avoidance and recovery actions.

Substantial funds were diverted by Keith Rasmussen for his personal and family use. Legal grounds exist to seek recovery of those diverted funds. However, there is substantial question whether recovery efforts would result in net recoveries for the estate. The Trustee does not expect to take immediate action in light of doubts as to the availability of assets to satisfy any judgment against Rasmussen.

DATED this _28th__ day of October 2011.

/s/ R. Wayne Klein _________________
R. WAYNE KLEIN

APPROVED:

/s/ Joseph M. Meier 10/31/2011_____
JOSEPH M. MEIER,
Attorney for the Trustee

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the _31st__ day of October, 2011, I filed the foregoing electronically through the CM/ECF System, which caused the following parties or counsel to be served by electronic means, as more fully reflected on the Notice of Electronic Filing:

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/s/ Joseph M. Meier
JOSEPH M. MEIER