

MEMORANDUM OPINION
(bench opinion)

September 12, 2003

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE
NORTHERN DIVISION

IN RE:	:	
	:	
MEDEX REGIONAL	:	Case No. 03-31932
LABORATORIES, L.L.C.	:	Chapter 11
	:	
Debtor	:	

BEFORE THE HONORABLE RICHARD STAIR, JR.

UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

FOR THE DEBTOR:

DEAN B. FARMER, ESQ.
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Knoxville, Tennessee 37901-0869

FOR THE OFFICIAL COMMITTEE OF
UNSECURED CREDITORS:

MAURICE K. GUINN, ESQ.
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FOR WELLMONT HEALTH
MANAGEMENT SERVICES, LLC:

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APPEARANCES (Continued):

FOR FIRST TENNESSEE BANK, N.A.:

ROBERT R. CARL, ESQ.
900 South Gay Street, Suite 2200
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FOR STATE OF FRANKLIN LEASING CORPORATION:

KYLE R. WEEMS, ESQ.
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FOR THE UNITED STATES TRUSTEE:

PATRICIA C. FOSTER, ESQ.
800 Market Street, Suite 114
Knoxville, Tennessee 37902

1 THE COURT: This matter is before me on the Amended Third Motion by
2 Debtor-in-Possession for Authority to Obtain Secured Credit Pursuant to 11 U.S.C.
3 § 364(c)(1), (2), and (3) filed on August 29, 2003. By this Motion, the Debtor seeks
4 to obtain an additional \$705,000.00 in secured financing pursuant to 11 U.S.C.
5 § 364(c) from Wellmont Health Management Services, LLC (Wellmont). The
6 Official Committee of Unsecured Creditors filed the Objection of Committee of
7 Unsecured Creditors to Amended Third Motion by Debtor-in-Possession for Authority
8 to Obtain Secured Credit on September 5, 2003.

9 This is a core proceeding. 28 U.S.C. § 157(b)(2)(A), (D), and (O) (West
10 1993).

11 The Debtor is in the business of performing clinical lab services for private
12 physicians and hospitals operated by Wellmont located primarily in Upper East
13 Tennessee in the Tri-Cities area, although I understand there are and have been
14 hospitals perhaps in other areas also. The services it performs are, as I understand the
15 record, sophisticated lab analyses generated, I guess, primarily from blood samples.
16 It takes these samples by reports from physicians and hospitals through e-mail, fax, or
17 paper at the present time.

18 The Debtor filed the voluntary petition initiating this Chapter 11
19 bankruptcy case on April 8, 2003, and has operated as a debtor-in-possession since
20 that time. On April 23, 2003, I entered an Order authorizing the Debtor to obtain
21 financing in the amount of \$2,500,000.00 from Wellmont. On May 20, 2003, I
22 entered a second Order allowing the Debtor to obtain an additional \$1,500,000.00 in
23 secured financing from Wellmont. A third Order was entered on July 31, 2003,
24 authorizing the Debtor to, once again, obtain secured financing from Wellmont, this
25 time in the amount of \$1,100,000.00. That is a total of \$5,100,000.00 to date. The

1 Motion presently before me, if granted, will increase that secured financing up to
2 \$5,805,000.00. The Debtor argues that this extension of financing, that is, the
3 \$705,000.00, is necessary to effectuate the following capital expenditures that it
4 contends will dramatically enhance the efficiency and quality of the medical services it
5 currently provides the physicians and hospitals it serves:

6 (1) A Chemistry Platform Change necessitating \$215,000.00 to buy out a
7 lease with Citicorp Vendor Finance, Inc., to purchase a Bayer Advia Centaur, to
8 move two Bayer 1650 chemistry machines from Knoxville to Bristol, and to move a
9 Bayer central link and work cell from Knoxville to Bristol. Savings to the Debtor, if
10 this action is undertaken, are testified to approximate \$42,000.00 monthly.

11 (2) An Information Technology Infrastructure Move necessitating
12 \$190,000.00 to vacate a data facility at Eastman, to move the Information Technology
13 Department to a Wellmont facility, to purchase software licenses and hardware, and to
14 obtain Cerner Corporation assistance in effectuating the move, resulting in projected
15 monthly savings to the Debtor of approximately \$45,000.00. I understand the move is
16 costly because of the sophisticated nature of the Centaur equipment to be moved that
17 requires a very specialized handling.

18 (3) Modifications to the Order Entry and Results Reporting necessitating
19 \$300,000.00 to reject a lease with Cerner Corporation, to purchase an "e-Pathlink"
20 application lab results reporting system, to update the system to comply with new
21 health care reporting regulations and the requirements of customers, to reduce order
22 entry personnel, to enhance client retention, and to secure new business, resulting in
23 projected savings to the Debtor approximating \$47,000.00. It is my understanding
24 that the "e-Pathlink" system will remove redundancies in the Debtor's current system
25 and will give it a much more sophisticated and responsive ability to analyze lab results

1 or to obtain lab results.

2 In all, the Debtor by the utilization of the \$705,000.00 in capital
3 expenditures projects monthly savings in its operations of \$134,000.00, which, the
4 testimony suggests, should allow it to recover these expenses in approximately five
5 months. Clearly, the mathematics support this if, indeed, it receives the projected
6 savings.

7 The Committee objects to the Motion arguing that the Debtor should not be
8 allowed to incur additional secured debt for capital expenditures in light of the
9 following circumstances: (1) the Debtor has incurred postpetition losses
10 approximating \$1,800,000.00; (2) the Debtor has not filed a plan of reorganization;
11 (3) the Debtor has not advised the Committee of its business plan as to the continued
12 outreach operations and other matters; and (4) the Debtor has projected a loss of
13 \$626,852.00 and a negative cash flow of \$2,730,371.00 between July 2003 and
14 December 2003. The Committee argues that Wellmont, and not the Debtor, should
15 be required to pay for the completion and installation of the "e-Pathlink" application
16 system.

17 In making a determination of whether to approve an amendment to existing
18 postpetition secured financing under § 364(c), and "particularly where the amendment
19 makes extensive changes in the post-petition financing package and where there is
20 serious opposition by creditors to the proposal," the court should consider the
21 following factors on a case-by-case basis:

22 (1) That the proposed financing is an exercise of sound and
23 reasonable business judgment;

24 (2) That the financing is in the best interest of the estate and its
25 creditors;

- 1 (3) That the credit transaction is necessary to preserve the
2 assets of the estate, and is necessary, essential, and appropriate
3 for the continued operation of the Debtors' businesses;
4 (4) That the terms of the transaction are fair, reasonable, and
5 adequate, given the circumstances of the debtor-borrower and
6 the proposed lender; and
7 (5) That the financing agreement was negotiated in good faith
8 and at arm's length between the Debtors, on the one hand, and
9 the Agents and the Lenders, on the other hand.

10 *In re Farmland Indus., Inc.*, 294 B.R. 855, 880-81 (Bankr. W.D. Mo. 2003)
11 (adopting factors set forth in *In re Worldcom, Inc.*, 2002 WL 1732646 (S.D.N.Y.
12 July 22, 2002); *In re Phase-I Molecular Toxicology, Inc.*, 285 B.R. 494 (Bankr.
13 D.N.M. 2002); *In re W. Pac. Airlines, Inc.*, 223 B.R. 567 (Bankr. D. Colo. 1997);
14 and *In re The Crouse Group, Inc.*, 71 B.R. 544 (Bankr. E.D. Pa. 1987)). The Debtor
15 bears the burden of proof as to these factors. *Farmland Indus., Inc.*, 294 B.R. at 879.
16 From the record presented me this morning, there is nothing to suggest that the
17 negotiations between the Debtor and Wellmont were anything other than in good faith.
18 I will not address that factor further and will proceed to briefly address the other four
19 factors.

20 Sound and Reasonable Business Judgment.

21 "[G]enerally, a debtor-in-possession has significant latitude in making
22 judgments about the operation of [its] business." *The Crouse Group, Inc.*, 71 B.R. at
23 550; *see also Cent. States S.E. & S.W. Areas Health & Welfare & Pension Funds v.*
24 *Columbia Motor Express, Inc. (In re Columbia Motor Express, Inc.)*, 33 B.R. 389,
25 393 (Bankr. M.D. Tenn. 1983) ("The Bankruptcy Code favors the continued

1 operation of a business by the debtor as debtor-in-possession and a presumption is
2 accorded to the management decisions of the debtor-in-possession." Under the
3 business judgment rule, courts recognize the broad management discretion of a
4 company's board of directors, and they are not inclined to substitute their own
5 judgment in the place thereof absent a finding of fraud, self-interest, bad faith, or
6 negligence. See *United Artists Theatre Co. v. Walton (In re United Artists Theatre*
7 *Co.)*, 315 F.3d 217, 233 (3d Cir. 2003); *In re Global Crossing, Ltd.*, 295 B.R. 726,
8 743 (Bankr. S.D.N.Y. 2003); *In re Simasko Prod. Co.*, 47 B.R. 444, 449 (Bankr. D.
9 Colo. 1985); *Lewis v. Boyd*, 838 S.W.2d 215, 220-21 (Tenn. Ct. App. 1992).

10 The Debtor argues that each of the capital expenditures to be funded by the
11 additional financing will create "dramatic, real monthly operating cost savings, . . .
12 [will make] the Debtor more profitable by increasing efficiency with available
13 resources[, and will make] the Debtor more attractive to potential customers."

14 At the time it commenced its bankruptcy case, the Debtor conducted
15 operations primarily out of Chattanooga, Knoxville, and Bristol, although, as I have
16 indicated, it is my understanding there were labs located in other areas servicing
17 physicians and hospitals in those areas. Subsequent to the bankruptcy, it has closed
18 its Chattanooga and Knoxville offices and is locating all of its efforts in the Tri-Cities
19 area through its Bristol office. From the testimony heard this morning, it appears that
20 the \$705,000.00 in capital expenditures for which the Debtor seeks approval really
21 has two purposes: first, to complete the relocation of its assets to the Bristol office
22 and, second, to acquire and utilize upgraded technology that will allow it to function
23 in a competitive environment thereby allowing it to retain current clients and to
24 procure additional clients.

25 I find nothing in the record to suggest that the Debtor, officers, and

1 directors exercised anything other than reasonable business judgment in deciding to
2 pursue this loan.

3 Best Interests of the Estate and Its Creditors.

4 Like many other issues concerning whether an action is in the best interests
5 of the bankruptcy estate and/or creditors, the determination of whether to grant the
6 Debtor's Motion is left to the discretion of the court, based upon the evidence
7 presented, and must be decided on a case-by-case basis. *See, e.g., In re Remsen*
8 *Partners, Ltd.*, 294 B.R. 557, 565 (Bankr. S.D.N.Y. 2003); *Farmland Indus., Inc.*,
9 294 B.R. at 884; *Goodwin v. Mickey Thompson Entm't Group, Ltd. (In re Mickey*
10 *Thompson Entm't Group, Ltd.)*, 292 B.R. 415, 420 (B.A.P. 9th Cir. 2003).

11 It is clearly in the best interest of creditors that this Debtor reorganize. At
12 present, it is losing upwards of \$200,000.00 per month and the expenditures it
13 proposes to make will help reduce expenses and allow the Debtor a greater
14 opportunity to service its existing customers and to obtain new customers. I do not
15 know how long this Debtor can survive if the status quo is actually maintained.

16 Necessity of Transaction for Benefit of the Estate.

17 "That which is actually utilized by a trustee in the operation of a debtor's
18 business is a necessary cost and expense of preserving the estate and should be
19 accorded the priority of an administrative expense. That which is thought to have
20 some potential benefit, in that it makes a business more likely salable, may be a
21 benefit but is too speculative to be allowed as an 'actual, necessary cost and expense
22 of preserving the estate.'" *Broadcast Corp. of Ga. v. Broadfoot (In re Subscription*
23 *Television of Greater Atlanta)*, 789 F.2d 1530, 1532 (11th Cir. 1986). Generally,
24 debts that directly and substantially benefit the estate are considered necessary. *See*
25 *Beneke Co., Inc. v. Econ. Lodging Sys., Inc. (In re Econ. Lodging Sys., Inc.)*,

1 234 B.R. 691, 697 (B.A.P. 6th Cir. 1999).

2 The Debtor has argued that these proposed capital expenditures to be
3 funded by the additional funds requested will have an actual, direct, and substantial
4 benefit upon the bankruptcy estate. The record establishes that by instituting these
5 changes, the Debtor stands to benefit from net savings approximating \$134,000.00 a
6 month. Additionally, the Debtor states that in slightly over five months, the total
7 \$705,000.00 shall be recouped as a result of the proposed changes and associated
8 savings.

9 Clearly, these transactions benefit the estate.

10 Reasonableness and Adequacy of Terms.

11 There is little, if any, proof on this particular issue, the only proof being
12 that the \$705,000.00 borrowed can be recouped in 5.3 months, I believe, the record
13 establishes. At any rate, I find nothing in the record to suggest that there is any
14 impropriety or unreasonableness in the adequacy of the terms.

15 I find that the Committee's opposition to the Motion is, while
16 understandable, somewhat perplexing. Thus far the Committee has not opposed
17 postpetition financing from Wellmont of up to \$5,100,000.00, and it stands before me
18 undisputed that the Debtor, notwithstanding these loans, continues to lose money.
19 However, now that the Debtor seeks to borrow another \$705,000.00 that will allow it
20 to consolidate its laboratories into a central location, will allow it to upgrade its
21 technology, and is designed to allow it not only to retain clients it might otherwise
22 lose due to the redundant technology that it presently has and will also allow it to
23 obtain additional office clients and obtain projected savings of \$134,000.00 monthly,
24 the Committee expresses opposition. I understand the function of the Committee and
25 its desire to see that its members and all unsecured creditors ultimately receive a

1 dividend from this estate. Right now, however, that does not look very promising. I
2 am going to allow the Debtor to borrow the \$705,000.00. Hopefully, that will allow
3 things to turn around. The Committee is certainly not without remedy if things do not
4 go as projected. It has various avenues with which it can proceed at any time and
5 which will be, of course, as are all motions that are filed, considered by the court in
6 due course. Thus far it has not chosen to do so and I would hope it would not be
7 necessary if these changes give the Debtor the relief that it suggests that it will.

8 This Memorandum constitutes findings of fact and conclusions of law as
9 required by FED. R. CIV. P. 52(a). I will not ask the court reporter to transcribe my
10 opinion. If it is transcribed at the request of counsel for either the Committee or the
11 Debtor, Ms. Dunn will present the original to me and I will make such additions or
12 corrections as I deem appropriate. When filed, the opinion, of course, will be served
13 on counsel. I will see that an Order is entered this afternoon authorizing the Debtor to
14 proceed with the borrowing.

15 FILED: September 16, 2003

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/s/ Richard Stair, Jr.
RICHARD STAIR, JR.
U.S. BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-31932

MEDEX REGIONAL
LABORATORIES, LLC

Debtor

ORDER

For the reasons stated in the memorandum opinion dictated from the bench at the close of the evidence containing findings of fact and conclusions of law as required by Rule 52(a) of the Federal Rules of Civil Procedure, the court directs that the Amended Third Motion by Debtor-in-Possession for Authority to Obtain Secured Credit Pursuant to 11 U.S.C. §364(c)(1), (2) and (3) filed by the Debtor on August 29, 2003, seeking authority to obtain an additional \$705,000.00 in secured financing from Wellmont Health Management Services, LLC, is GRANTED with the financing to be under the terms set forth in the Amended Third Motion.

SO ORDERED.

ENTER: September 12, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE