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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:

DEACONESS HOSPITAL, LLC, *et al.*,

Debtors.

Case No. 03-25461

Chapter 11
(jointly administered)

Judge Pat E. Morgenstern-Clarren

**MEMORANDUM OF OPINION**

The movants ask for court authority under 11 U.S.C. § 363(b) to enter into two transactions outside of the ordinary course of business: (1) Nour Management Co. requests that it be paid $3,500.00 a week (for a total of $84,000.00) for postpetition management services rendered to the debtors from November 21, 2003 through May 7, 2004; and (2) the debtors Deaconess Hospital, LLC, Pearlview Square, Inc., and Indoga, Inc. move for authority to pay Nour $5,000.00 a week for its continued management services from May 7, 2004 forward. (Docket 458, 463). The United States trustee, the unsecured creditors committee, and creditors GE HFS Holdings, Inc. and Bank One, N.A. object. (Docket 498, 508, 520, 521).

## JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2).

## THE HEARING

The court held a hearing on June 24, 2004 and the parties submitted post-hearing briefs

by June 30, 2004.[1] George Saad, M.D. was the only witness.

## FACTS[2]

George Saad, M.D., is the owner and CEO of debtors Pearlview and Indoga. He is also the sole member of debtor Deaconess Hospital, LLC. Dr. Saad personally guaranteed certain of the debtors' debt. He is an insider of the debtors within the meaning of bankruptcy code § 101(31). Additionally, he is the sole owner and president of Nour Management Company, a property management and investment company. Nour has four employees, including Dr. Saad.

In October 2000, Deaconess Hospital, LLC purchased Deaconess from the PHS bankruptcy estate. Nour and Deaconess then entered into a contract under which Nour agreed to provide management services to Deaconess in exchange for $100,000.00 a month. This contract was not offered into evidence. Dr. Saad testified that Nour employee Jennie Gilcrest worked 8-10 hours a day on Deaconess matters, specifically preparing the borrowers' base information, talking to banks, and keeping books to help the bookkeeper. Deaconess soon ran into financial difficulties and stopped paying Nour in September 2001. No payment has been made since that date.

According to Dr. Saad, in October 2003 Nour and Deaconess changed their agreement to call for payment of $50,000.00 a month. After the November 2003 filing, the agreement changed

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[1] Docket 524, 525, 532, 535, 536.

[2] These findings of fact reflect the court's weighing of the evidence, including determining the credibility of the witness. In doing so, the court considered the witness's demeanor, the substance of his testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language or nuance of expression. *See* FED. R. BANKR. P. 7052, incorporating FED. R. CIV. P. 52 (applied to contested matters under FED. R. BANKR. P. 9014).

to $3,500.00 a week. Contrary to this assertion, no party filed a motion to assume the prepetition agreement, no party filed a motion to retain Nour, and these last two contracts were not introduced into evidence either. There was, therefore, no credible evidence to show the terms of such agreements.

At the time of the bankruptcy filing, Dr. Saad did not investigate any specific alternatives to retaining Nour. He felt that other providers would be more expensive. In support, he cited two companies that provide management services to health care entities. The court does not find the comparisons convincing, however, because there was very little information to back up the conclusory information about the companies. Also, Dr. Saad testified that he made these inquiries in 2000 (three years before the bankruptcy filing) and the services that were to be rendered at that time were for a full service operating hospital, not a closed facility. He also testified that it is customary for a management company to charge 7½ -10% of revenues. Again, this figure was presented in the context of an operating entity rather than a liquidation, which is where this case currently stands. Dr. Saad also referred to amounts paid by PHS for management services when it was operating Deaconess as a full service hospital. These numbers, standing without any context as to services rendered and terms governing those services, are not compelling. And Dr. Saad had no personal knowledge on that topic, other than reading from a PHS balance sheet. The testimony does not, therefore, establish that the rates charged by Nour were reasonable for the services rendered.

Dr. Saad testified that in December 2003, Nour took over some of the duties that had been performed by the Deaconess CFO, including maximizing accounts receivable and dealing with insurance issues, in addition to maintaining mechanical equipment, and trying to find a

buyer for the estates' assets.

After the chapter 11 filings, the debtors entered into a series of agreed orders with lenders GE HFS Holdings, Inc. and Bank One authorizing first the use of cash collateral and then the terms under which GE would provide postpetition financing. (Docket 31, 52, 100, 227, 301, 373, 419, 491). The orders all provide that no payments shall be made to insiders. Dr. Saad testified that he was not aware of this provision, an assertion that the court finds lacks credibility because Dr. Saad's personal counsel signed each of the orders and Dr. Saad attended most if not all of the hearings where the issue was discussed. Starting with the January 30, 2004 order, the orders include budgets. One budget line item is for Nour, with the stated restriction that the parties reserve their rights with respect to whether the fees should be allowed and prohibits payment without further court order. (Docket 227).

The debtors closed the doors to patients about a week after the bankruptcy filing. Since then, they have been liquidating the estates' assets, including negotiating and consummating an asset sale to MetroHealth Systems. (Docket 396, 397). For the period from November 29, 2003 through February 6, 2004, the debtors had at least 19 employees in these positions: director of nursing, director of human resources, chief information officer, director of communications, director of plant operations, general mechanic, manager of environmental services, EVS lead attendant, security officer, staff accountant, director of material management, storeroom clerk, medical records analyst, coding specialist, director of patient accounting, manager of patient accounting, cashier for patient accounts, patient account representative, and radiology clerk.[3]

[3] In the November 29, 2003 through January 21, 2004 time frame the debtors had additional employees. *See* movants' exh. 3.

(Movants' exhs. 3, 4).

There are only a few things that remain to be done by the debtors or on their behalf. These include responding to record requests (which appears to be referring people to Iron Mountain, the company storing the records), attending to accounts receivable until First Federal Credit Control, Inc. takes over (which should happen imminently), prosecuting the litigation against GE, reviewing claims, and providing telephone service and supplies such as stamps and access to copiers.

As noted, Deaconess made its last payment to Nour in September 2001. Dr. Saad considered the management fees that Nour accrued to be a capital contribution that would help the ailing institution. The testimony was not clear as to whether he was referring to the prepetition or postpetition fees, or both.

## THE POSITIONS OF THE PARTIES

Nour moves under 11 U.S.C. § 363(b) to be paid $84,000.00, representing fees of $3,500.00 a week from the date of the bankruptcy filing through May 7, 2004. Although Nour does not specify what category of payment it is requesting, the court assumes it requests payment as an administrative expense. Nour argues that the parties agreed to this weekly payment because the figure is included in the budget submitted with the cash collateral orders. Nour also contends that the payment should be approved under the business judgment test and that the insider issue is relevant only to a § 327 motion and not to a motion under § 363(b)(1). Nour further argues that equity requires that GE's objection be overruled because GE failed to fund certain postpetition operations.

The debtors support Nour's request, agreeing that the debtors appropriately used their

business judgment and acted in good faith to retain Nour. They differ from Nour, however, on the effect of the cash collateral orders, contending that the orders permit them to seek this relief rather than compel the conclusion that the relief has already been agreed to by putting a number into the budget. The debtors also move under § 363(b) for authority to pay Nour $5,000.00 a week for services from May 7, 2004 forward.

The motions are opposed by the United States trustee, the unsecured creditors committee, GE, and Bank One. The UST contends that the movants are asking the court to approve "payment of an administrative expense claim outside of the ordinary course of business by retroactively adopting a prepetition management agreement." (UST Post-Hearing Brief at 6). The UST challenges the sufficiency of the evidence under § 363(b): to support the debtors' decision to enter into a contract with Nour, to show any arm's length negotiation between Nour and the debtors, or to explain why the debtors needed Nour when the debtors maintained a significant number of employees and a large payroll until fairly recently. The committee contends that the movants failed to meet their burden of proving what services were provided, the necessity of such services, and the benefit to the estates. GE argues that the cash collateral orders preclude payment and that the movants did not prove all elements of the business judgment test under § 363(b). Additionally, GE and the UST argue that Dr. Saad intended the management fees to be capital contributions and that equity cannot be returned until all creditors are paid in full under § 1129(b)(2)(B).

## DISCUSSION

Bankruptcy code § 363 governs a debtor's use of its property in chapter 11. *See* 11 U.S.C.§ 363. The section "is designed to strike [a] balance, allowing a business to continue its

daily operations without excessive court or creditor oversight and protecting secured creditors and others from dissipation of the estate's assets." *Med. Malpractice Insur. Assoc. v. Hirsch (In re Lavigne)*, 114 F.3d 379, 384 (2d Cir. 1997) (quoting *In re Roth Am.*, 975 F.2d 949, 952 (3rd Cir. 1992)). A debtor in possession may operate its business unless the court orders otherwise and in doing so § 363(c) permits the debtor to enter into transactions and use its property in the ordinary course of that business. *See* 11 U.S.C. §§ 1107(a), 1108, and 363(c). Any unsecured debt which the debtor incurs under such circumstances is an allowable administrative expense. *See* 11 U.S.C. § 364(a). On the other hand, a debtor in possession may not enter into transactions or use its property outside the ordinary course of its business without notice and a hearing and court authorization. *See* 11 U.S.C. § 363(b)(1) (providing that a debtor in possession may "use, sell, or lease, other than in the ordinary course of business, property of the estate[]" after notice and a hearing).[4] Unsecured debt which a debtor incurs outside the ordinary course of its business is only entitled to administrative priority if it is incurred with court approval upon notice and a hearing. *See* 11 U.S.C. § 364(b). The parties agree that the transaction at issue is outside of the ordinary course.

The standard for determining whether a debtor should be authorized to enter into a transaction outside of its ordinary course of business is whether the debtor has a sound business reason for doing so. *See Stephens Indus., Inc. v. McClung*, 789 F.2d 386 (6th Cir. 1986). A finding of sound business justification necessarily includes a determination that a transaction was made in good faith. *See In re Country Manor of Kenton, Inc.*, 172 B.R. 217, 220-21 (Bankr. N.D. Ohio 1994). Transactions involving insiders must be given particular scrutiny. *See In re*

[4] Bankruptcy code § 1107(a) makes § 363(b)(1) applicable to a debtor in possession.

*Whet, Inc.*, 33 B.R. 443, 446 (Bankr. D. Mass. 1983).

Transactions which are outside the ordinary course are void absent notice and an opportunity for hearing. *See Lavigne,* 114 F.3d at 385. Although the court may have authority to retroactively authorize a transaction, this relief should be granted only under extraordinary circumstances. *See* 11 U.S.C. § 105(a) (authorizing the court to issue orders necessary or appropriate to carry out the provisions of title 11). *See also In re Consol. Auto Recyclers, Inc.*, 123 B.R. 130, 141 (Bankr. D. Me. 1991) (noting that retroactive authority is appropriate if it will further the purposes of the bankruptcy code and not prejudice any party); *Nat'l City Bank v. Imbody (In re Imbody)*, 104 B.R. 830, 834 (Bankr. N.D. Ohio 1989) (stating that retroactive authority is only appropriate in unusual circumstances). *But see In re Ockerlund Constr. Co.*, 308 B.R. 325, 330 (Bankr. N.D. Ill. 2004) (noting that a bankruptcy court's equitable powers cannot be employed to override the specific statutory provisions for this purpose). The same standard applies to *nunc pro tunc* orders regarding a debtor's postpetition obligations under § 364(b). *See In re Massetti*, 95 B.R. 360, 364 (Bankr. E.D. Pa. 1989). Relevant considerations on this issue include whether: (1) authority would have been granted had an application been timely made; (2) creditors have been harmed; (3) the debtor and the other party to the transaction believed they had authority to enter into the transaction; and (4) the equities compel such relief. *See In re Lehigh Valley Prof'l Sports Clubs, Inc.*, 260 B.R. 745, 828-29 (Bankr. E.D. Pa. 2001).

**Nour's Motion**

Nour moves to be paid $84,000.00 for services rendered postpetition. The parties differ on the effect that the cash collateral orders have on this motion. Nour thinks that the orders require it to be paid and the objectors contend that the orders prohibit it. It is clear from those

orders that the parties were not agreeing that Nour would be paid the amount itemized in the budget whenever it sought payment and Nour's argument to that effect is unavailing. At the same time, the objecting parties are incorrect that the orders provide that such payment may never be made. A payment could not be made while the orders were in effect, but the last cash collateral order with this prohibition expired and no order has taken its place. Nour is not, therefore, barred from raising the issue.

Under § 363, the debtors may only enter into this transaction after notice and a hearing. Nour did not file its motion until more than six months after the bankruptcy filing and after it claims to have rendered services. This motion may only be granted if the court concludes both that the motion states good cause and that retroactive relief should be granted. On the latter point, Nour did not establish that relief should be granted back to the date on which Nour began to render services to the debtors. Nour had full knowledge that it had not been paid before the filing and that it was not being paid after the filing and that other parties disputed the propriety of the arrangement with an insider. Despite this, Nour continued to take action without obtaining court approval. The debtors, owned and operated by the same person who owns and operates Nour, also failed to seek authority despite knowing all of these facts. Under these circumstances, there is no reason for the court to override the statutory provisions of notice and a hearing and grant *nunc pro tunc* relief, even if it were permissible to do so. The request to do so is denied.

Additionally and alternatively, even if *nunc pro tunc* relief is available, Nour did not establish that cause exists to grant the motion because Nour did not prove that the debtors used appropriate business judgment in continuing a relationship with Nour. The debtors have always conducted their business through Dr. Saad as the fiduciary and Nour has always conducted its

business through Dr. Saad; therefore, any transaction between the debtors and Nour has been conducted on both sides by Dr. Saad. This is a classic case where the court should look carefully at the events underlying the debtors' decision to do business with Nour. There was little if any basis provided for Dr. Saad's statement that the debtors had entered into a contract modification postpetition with Nour, which lessens his credibility on this issue. The court finds that the debtors did not present sufficient evidence to show that they used sound business judgment in deciding to continue to do business with Nour. Dr. Saad did not do a careful analysis of the alternatives available to the debtors at the time of the bankruptcy filing and the court is not at all convinced that his general information about hospital management services is sufficient to support his feeling that the debtors could not engage another entity at a lower rate.

The evidence as to exactly what Nour did for the debtors is also unconvincing. The debtors had a number of employees on the payroll for several months and their job descriptions and responsibilities overlap heavily with what Nour allegedly did. Dr. Saad testified that he carefully considered which responsibilities should be done by him as the debtors' fiduciaries and which should be done by Nour, but the testimony was too general to establish what Nour did or whether it was beneficial to the estates. Moreover, some of the work Dr. Saad ascribed to Nour is actually a good example of what a debtor and its fiduciaries are supposed to be doing. For instance, Dr. Saad testified that Nour helped with the sale of the debtors' assets and that, without elaboration, he did not think it could have been accomplished without Nour. The debtors, however, retained Melcap Partners as their investment advisor for the sale and the debtors had the obligation to work with Melcap. Dr. Saad should have been wearing his debtors' fiduciary "hat" in that work, not his owner of Nour hat. Nour did not meet its burden of proving either that

the debtors used sound business judgment in engaging Nour and alternatively, even if it did meet that burden, did not prove that it is appropriate to grant retroactive authorization to the debtors to have entered into this arrangement.[5]

**The debtors' motion**

The debtors' motion to retain Nour to perform management services from May 7, 2004 forward is similarly not supported by the evidence. In particular, the evidence shows a lack of good faith on the part of the debtors and Nour. Nour wanted to be paid $3,500.00 a week for the months that the debtors had some limited operations; now, with the debtors essentially closed down, Nour wants to be paid $5,000.00 a week for its services. The reduction by the debtors in the number of their employees does not *ipso facto* show that there are more services to be rendered by a management company. In large measure, the employees have been reduced because the functions they performed have either been eliminated or transferred to third parties. The remaining functions are essentially those that the debtors' fiduciary is expected to carry out. To the extent there is something specific that the debtors are not able to perform, the debtor has options under the bankruptcy code for seeking to retain the needed help. The evidence at the hearing, however, did not establish such need or that Nour is the right party to provide it or that $5,000.00 a week is a reasonable amount to pay for it.

[5] As noted above, Nour also argued that GE should be prohibited from objecting because GE failed to fund the debtors' operations. Nour did not provide any authority to support this and the court deems it waived for purposes of this issue.

## CONCLUSION

For the reasons stated, Nour's motion is denied and the debtors' motion is denied. A separate order will be entered reflecting these decisions.

Date: 22 July 2004

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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