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5 UNITED STATES BANKRUPTCY COURT
6 EASTERN DISTRICT OF CALIFORNIA
7 SACRAMENTO DIVISION
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10 In re)
11) Case No. 07-28444-A-11
12)
13 OCCMEDS BILLING SERVICES,) Docket Control No. WFH-2
14 INC.,) Date: November 30, 2007
15) Time: 11:30 a.m.
16 Debtor in Possession.)
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1 Upon the dispensing of the medicine to a patient, a
2 receivable would arise owed by the patient's worker's
3 compensation insurer to OccMeds. OccMeds would, at the time of
4 dispensing of the drug, advance a percentage of the invoice
5 amount to the doctor or clinic dispensing the drug. OccMeds
6 would handle all billing and collection procedures and would
7 submit invoices to the various workers compensation insurers.
8 Invoices would be paid directly to OccMeds. When the receivable
9 was actually paid by the insurer, OccMeds would deduct the cost
10 of the medicine dispensed and the amount of the advance
11 previously paid to the doctor, and then would make a second
12 payment to the dispensing doctor or clinic representing a
13 percentage of the "profit." OccMeds would retain a percentage of
14 the "profit" as its fee for processing invoices and advancing
15 funds.

16 This business model required OccMeds to advance funds before
17 OccMeds received payment from the insurance companies obligated
18 to pay for the medicine. In some cases, OccMeds was also
19 required to pay for the medicine dispensed before the cost was
20 reimbursed by the insurance companies. This created cash flow
21 difficulties that ultimately lead, in part, to the filing of this
22 case. To avoid these difficulties, OccMeds is modifying its
23 business model.

24 Under its modified business model, OccMeds will continue to
25 pay for medicines delivered to doctors and clinics, but OccMeds
26 will no longer advance funds to these doctors or clinics upon
27 their sale of medicine to patients. Instead, the receivables
28 will be owned by the doctors and clinics and OccMeds will collect

1 the receivable as agent for the doctors and clinics. OccMeds
2 will deduct the cost of medicine and a service fee, and will
3 remit the remainder to its doctor and clinic clients. It is
4 hoped that this modification will reduce OccMeds' capital outlay
5 for ongoing operations.

6 OccMeds' primary asset is its accounts receivable and
7 payment rights. When the petition was filed, its accounts
8 receivable totaled \$2,471,983. However, OccMeds estimates that
9 only 60%, or approximately \$1,247,130, is collectible.

10 The low rate of anticipated collection leads the court to
11 conclude that a sizeable amount of these receivables are past due
12 and will require litigation to collect.¹

13 OccMeds also claims that it is owed monies arising from
14 transactions in which OccMeds paid for medicine, and advanced
15 monies to doctor groups or pharmacies, based on receivables that
16 were later rejected by the underlying insurance companies.
17 OccMeds is owed \$1,324,021 for these over-advances, and predicts
18 that only 20-30% of them, a maximum of \$397,206, will be
19 collectible.²

20 OccMeds further maintains that it is entitled to recover the
21 cost of the medicine from the individual patients when a claim is
22

23 ¹ This conclusion is buttressed by the fact that Exhibit
24 C to the original motion indicates that of the \$2,471,983,
25 \$2,400,429 is owed by four clients who also owe \$1,304,725 of the
26 \$1,324,021 in over-advances made by OccMeds. These over-advances
27 are discussed below.

28 ² OccMeds' original motion gave the 20-30% estimate but
indicated this estimate would produce a \$417,013 recovery. This
is actually 31.5% of the total amount. The amount given above is
30% of the total.

1 disallowed by an insurer. OccMeds has a gross amount of
2 \$3,482,540 in claims against patients, and has assigned these
3 claims to a collection agency. OccMeds estimates that only 20%,
4 or \$487,555, is collectible.

5 Thus, when the petition was filed, OccMeds had total
6 receivables and rights to payment of \$7,278,544, but of this
7 amount, it judged that only \$2,151,699³ was collectible. OccMeds
8 acknowledged at an earlier cash collateral hearing that
9 substantial litigation and collection expense would be incurred
10 to make these collections.

11 OccMeds has three significant secured creditors with
12 interests in these receivables and rights to payment.

13 Murphy Austin holds a judgment lien to secure a claim in the
14 amount of approximately \$131,000. Murphy Austin's judicial lien
15 is in first priority position.

16 Bridge asserts a second priority blanket lien on all of
17 OccMed's assets, including accounts receivable and payment
18 rights, to secure a claim in the approximate amount of
19 \$1,351,000.

20 While Bridge is also secured by all of OccMeds' other
21 assets, the motion concedes that its tangible assets have
22 negligible value. The one other asset with material value is a
23 proprietary billing system which is comprised of computer
24 software. OccMeds believes that this software has a value of
25 \$250,000.

26
27
28 ³ After the \$19,807 adjustment made in footnote 2, this
total is reduced further to \$2,131,891.

1 The court, however, doubts this valuation, particularly if
2 the estate is liquidated and does not continue business
3 operations. The record does not convince the court that this
4 idiosyncratic piece of software will have a material value to a
5 foreclosing creditor. For purposes of evaluating whether Bridge
6 will be adequately protected if OccMeds uses its cash collateral,
7 the court assigns this asset no value.

8 On August 27, 2007, Stan Leavitt and Gerald Ray filed a
9 financing statement with the California Secretary of State.
10 OccMeds acknowledges that Mr. Leavitt and Mr. Ray are owed
11 approximately \$128,320, and that their claim is secured by its
12 accounts receivable and other assets. OccMeds believes, however,
13 that their lien is junior to the liens of Murphy Austin and
14 Bridge, and that their lien is not validly perfected.

15 Excluding the Leavitt-Ray lien, the secured claims total
16 approximately \$1,482,000, while the allegedly collectible
17 receivables and rights to payment total \$2,131,891. Given the
18 surplus of receivables, and given OccMeds' willingness to give
19 Bridge and Murphy Austin a replacement lien on post-petition
20 receivables, OccMeds maintains that it has adequately protected
21 their interests in its cash and therefore the court should permit
22 it to use that cash for its operations.

23 11 U.S.C. § 363(c) authorizes the use of cash collateral as
24 follows:

25 (2) The trustee may not use, sell, or lease cash
26 collateral under paragraph (1) of this subsection
unless -

27 (A) each entity that has an interest in such cash
collateral consents; or

28 (B) the court, after notice and a hearing,
authorizes such use, sale, or lease in accordance

1 with the provisions of this section.

2 (3) Any hearing under paragraph (2)(B) of this
3 subsection may be a preliminary hearing or may be
4 consolidated with a hearing under subsection (e) of
5 this section, but shall be scheduled in accordance with
6 the needs of the debtor. If the hearing under
7 paragraph (2)(B) of this subsection is a preliminary
8 hearing, the court may authorize such use, sale, or
9 lease only if there is a reasonable likelihood that the
10 trustee will prevail at the final hearing under
11 subsection (e) of this section. The court shall act
12 promptly on any request for authorization under
13 paragraph (2)(B) of this subsection.

14 11 U.S.C. § 363(e) provides as follows:

15 (e) Notwithstanding any other provision of this
16 section, at any time, on request of an entity that has
17 an interest in property used, sold, or leased, or
18 proposed to be used, sold, or leased, by the trustee,
19 the court, with or without a hearing, shall prohibit or
20 condition such use, sale, or lease as is necessary to
21 provide adequate protection of such interest. This
22 subsection also applies to property that is subject to
23 any unexpired lease of personal property (to the
24 exclusion of such property being subject to an order to
25 grant relief from the stay under section 362.

26 The court concludes that OccMeds will be unable to
27 adequately protect the interests of the secured creditors if it
28 uses their cash collateral.

29 First, OccMeds' assertion that Bridge and Murphy Austin are
30 over-secured is arguable at best. OccMeds finds itself in
31 financial difficulty in large part because it advanced
32 substantial sums to four clients in exchange for receivables
33 (approximately \$1,324,021) that have proven uncollectible.
34 Further, these same clients owe most of the "open" receivables
35 that were due on the petition date.⁴ It is incongruous to expect
36 that, when litigation is commenced against these clients to
37 collect \$1,304,725 in over-advances, they will promptly and

28 ⁴ See footnote 1.

1 willingly pay the \$2,400,429 in open receivables to OccMeds.

2 Viewed charitably, the receivables and rights to payment on
3 hand when the petition was filed assure only one thing - a lot of
4 litigation.

5 And, much of that litigation will be against the patients of
6 OccMeds' clients. OccMeds asserts \$3,482,540 in claims against
7 patients. Given the modest amounts that individual patients
8 undoubtedly owe for prescriptions, one wonders whether the
9 expense associated with litigation (even if it takes place in
10 small claims court) will be worth it.

11 Second, the new business model being instituted by OccMeds
12 has fallen significantly short of producing the receivables it
13 predicted at the beginning of this case. As noted in the
14 declaration of Scott R. Mitchell, through the week of November
15 19, OccMeds projected the generation of \$124,274 in post-petition
16 accounts receivable, but actually generated only \$44,371 in such
17 receivables, a negative variance of \$79,903. Moreover, none of
18 these post-petition receivables came from new clients.

19 Third, Bridge is worse off now than at the beginning of the
20 case.

21 Since the petition was filed, OccMeds has collected \$197,985
22 of pre-petition accounts receivable. It began this case with
23 \$48,669 of cash. Thus, OccMeds has collected a total of \$246,654
24 of Bridge's cash collateral.

25 OccMeds now has approximately \$189,108 of cash on hand and
26 \$44,371 of new post-petition accounts receivable, for a total of
27 \$233,479.

28 Thus, Bridge is \$13,175 (\$246,654 minus \$233,479) worse off

1 than it was at the beginning of the case.⁵

2 Fourth, not only is OccMeds' new business model producing a
3 reduced level of receivables, there is a substantial question as
4 to whether it creates a receivable in OccMeds' favor.

5 OccMeds does not create an account receivable when it bills
6 a client because payment of its 30-35% fee occurs only if the
7 insurance company or the patient pays OccMed's client. This may
8 be weeks or even months after the insurance company or patient is
9 billed. Moreover, because the client owns the account receivable
10 rather than OccMeds, OccMeds has no ability to collect from the
11 patient or the insurance company on its own behalf.

12 Fifth, while OccMeds has a pending settlement with Murphy
13 Austin that will eliminate one-half of its senior lien, the deal
14 requires payment of the remaining \$62,622 to Murphy Austin. This
15 nominally benefits Bridge. However, payment of the \$62,622 will
16 further deplete Bridge's cash collateral.

17 Sixth, OccMeds is also seeking a surcharge against OccMeds
18 pursuant to 11 U.S.C. § 506(c). If permitted, this will
19 reimburse OccMeds, at the expense of Bridge, for costs associated
20 with the collection of its pre-petition receivables and rights to
21 payment.

22 Central Bank v. Cascade Hydraulics & Utility Service, 815
23 F.2d 546 (9th Cir. 1987), provides the standard for evaluating a
24 request to surcharge a secured creditor's collateral. A trustee
25 or debtor in possession seeking to surcharge collateral must

26
27 ⁵ To the extent Bridge is holding \$37,807.33 of cash that
28 belongs to DSI as DSI maintains, Bridge will be that much more
worse off.

1 establish that the expenses incurred were (1) reasonable; (2)
2 necessary; and (3) beneficial to the secured creditor. Id. at
3 548. As explained in In re Debbie Reynolds Hotel & Casino, 255
4 F.3d 1061, 1068 (9th Cir. 2001):

5 "this is not an easy standard to meet. It is the party
6 seeking the surcharge that has the burden of showing a
7 'concrete' and 'quantifiable' benefit. The § 506
recovery is limited to the amount of the benefit
actually proven."

8 The court will not resolve the surcharge motion at this
9 time. However, it agrees with Bridge's argument that the mere
10 fact that a surcharge is being attempted corroborates Bridge's
11 argument that it is not over-secured and adequately protected.

12 In its motion to use cash collateral, OccMeds has maintained
13 that Bridge is over-secured. If so, the costs OccMeds incurs
14 collecting pre-petition receivables do not benefit Bridge.
15 Absent the bankruptcy petition, Bridge could direct OccMeds'
16 receivables to itself and, pursuant to the terms of its agreement
17 with OccMeds, add its collection expenses to its claim. As long
18 as the receivables exceeded the amount owed plus its costs,
19 Bridge would be paid.

20 Hence, in bankruptcy, Bridge is benefitted by OccMeds'
21 collection efforts only if it is under-secured and OccMeds
22 expends resources not subject to Bridge's lien in an effort to
23 collect or preserve Bridge's collateral. See In re Compton
24 Impressions, Ltd v. Queen City Bank (In re Compton Impressions,
25 Ltd), 217 F.3d 1256, 1261 (9th Cir. 2000) (denying motion to
26 surcharge because "the [b]anks could have fully recovered the
27 unpaid balance of their loan if they had initially foreclosed on
28 the property").

1 OccMeds has not carried its burden of establishing that it
2 can use its cash while adequately protecting Bridge's interest in
3 that cash.

4 A separate order shall be lodged by counsel for Bridge
5 denying further use of cash collateral.

6 Dated: December 1, 2007 at 11:30 p.m.

7 By the Court

8
9
10 _____
 Michael S. McManus, Chief Judge
 United States Bankruptcy Court