

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Phoenix Medical Technology, Inc.

Debtor.

C/A No. 00-07253-W

JUDGMENT

Chapter 11

FILED

at \_\_\_\_\_ O'clock & \_\_\_\_\_ min. \_\_\_\_\_ M

MAR 30 2001

BRENDA K. ARGOE, CLERK  
United States Bankruptcy Court  
Columbia, South Carolina (3)

ENTERED

MAR 30 2001

V. L. D.

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the Court finds that sufficient cause exists in this case to convert it to a Chapter 7 case. Therefore, a Chapter 7 Trustee shall be appointed and shall duly perform his or her statutory duties as well as undertake the reviews as specified in detail in the Order. The appointed Chapter Trustee shall personally appear before the Court on **April 24, 2001 at 10:30 a.m.** at the J. Bratton Davis United States Bankruptcy Courthouse, 1100 Laurel Street, Columbia, South Carolina to address the concerns that the Court set forth in the Order.

  
UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,  
March 30, 2001.

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**CERTIFICATE OF MAILING**

The undersigned deputy clerk of the United States  
Bankruptcy Court for the District of South Carolina hereby certifies  
that a copy of the document on which this stamp appears  
was mailed on the date listed below to:

**MAR 30 2001**

*joint index*

*RH*  
DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE, *UST via mail*

**VANNA L. DANIEL**

Deputy Clerk

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF SOUTH CAROLINA

IN RE:

Phoenix Medical Technology, Inc.

Debtor.

C/A No. 00-07253-W

**ORDER**

Chapter 11

**FILED**  
at \_\_\_\_\_ O'clock & \_\_\_\_\_ min. \_\_\_\_\_  
**MAR 30 2001**  
BRENDA K. ARGOE, CLERK  
United States Bankruptcy Court  
Columbia, South Carolina (3)

**ENTERED**  
**MAR 30 2001**  
**V. L. D.**

THIS MATTER comes before the Court upon its Rule to Show Cause filed on March 2, 2001 to determine if cause exists for the dismissal or conversion of the above-referenced bankruptcy case. After a review of the records of previous hearings and pleadings, and for the reasons stated below, the Court finds that cause exists and hereby converts the case to a Chapter 7 case.

**FINDINGS OF FACT**

Phoenix Medical Technology, Inc. ("Debtor") is a South Carolina corporation which manufactured disposable latex, vinyl and nitrate gloves. It ceased its manufacturing operations before filing a voluntary petition under Chapter 11 of the Bankruptcy Code on August 21, 2000. Upon the filing of the bankruptcy petition, Debtor requested an emergency hearing to seek authority pursuant to 11 U.S.C. §§105 and 364(d)(1) to obtain post-petition financing from LaSalle Business Credit, Inc. ("LaSalle"), its primary secured creditor. Debtor asserted that it was seeking to incur debt with LaSalle for the purpose of securing and preparing assets for an expedient liquidation for the benefit of all creditors, in as much as there was an expectation of equity above the claims of LaSalle. At the hearing on said interim post-petition financing, Debtor's counsel indicated that Debtor would agree to the loan terms proposed by LaSalle rather

than seek the use of collections from accounts receivable because it needed funds and “did not have cash collateral in so far as its accounts receivable were directly collected by LaSalle into a lock box over which the creditor had dominion and control.” Furthermore, both counsel for LaSalle and Debtor indicated that through the characterization of providing funds as a loan rather than use of cash collateral “LaSalle was not getting any more than it already had.”

It was originally stated that an expedited sale process would occur in October of 2000 and that a Plan of Reorganization would be filed by Debtor on or about that time, therefore minimizing the need to incur post-petition debt. The parties proposed to initially offer Debtor’s business as a going concern and, if unsuccessful, projected for an auction sale of the assets. In either case, both Debtor and LaSalle forecasted that there was equity in the assets which would benefit unsecured creditors. It was not until January 2001 that LaSalle accepted that upon a prospect of no equity, it would agree to carve out a 3% dividend to unsecured creditors.

After some delay, on October 18, 2000, Debtor applied for approval of the employment of an Internet auctioneer to assist Debtor in the advertising and in the sale of its business, and Bankruptcy Market.com’s employment application was approved by the Court on October 24, 2001 and entered on October 31, 2000. However, it was not until December 15, 2000 that Debtor filed an Application to Sell Free and Clear of Liens All Assets of the Estate and noticed the application to all creditors and interested parties. On January 24, 2001, the Court entered an Order Authorizing Sale of Assets Free and Clear of Liens which provided that the sale was to be finalized forty-five (45) days after the entry of the order, with the sale to be conducted with

reserve.<sup>1</sup>

Throughout the case, Debtor has continued to borrow funds from LaSalle. On August 21, 2000, Debtor filed the first Motion seeking authority pursuant to 11 U.S.C. §§105 and 364(d)(1) to obtain post-petition financing from LaSalle. On September 11, 2000, the first Order Authorizing Interim Post-Petition Financing and Approving Agreement for Post-Petition Financing was entered, and it covered the period of time from September 8, 2000 through December 8, 2000. It was not until that period of authorization had expired that Debtor, on December 15, 2000, filed a second motion seeking post-petition financing. The second motion did not request an expedited hearing to approve the borrowing of the funds and Debtor apparently continued to borrow funds without the Court's approval. A Second Order Authorizing Interim Post-Petition Financing and Approving Agreement for Post-Petition Financing covering the period of December 8, 2000 through February 9, 2001 was not entered until February 7, 2001. On that same date, just two days before its authorization to borrow

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<sup>1</sup> More specifically, the Order provided:

In the event that the bid price for any asset does not meet the reserve price set forth in the Application, with exhibits, then the asset may be removed from the Sale and may not be sold.

In the event that a bid is entered during the Sale which appears to be an acceptable offer, the Debtor and LaSalle may elect to accept this bid at that time, without waiting for the remaining sales period to expire. In that event, the debtor will provide notification on the Internet auction site of the Internet to accept the bid and will provide a ten day period during which additional higher bids can be accepted. In the event that no higher bids are entered within ten days of the Internet notification, then the bid accepted by the debtor and LaSalle will be the final bid and the asset will be sold.

expired, Debtor filed the third motion seeking post-petition financing, but once again did not ask for said motion to be heard on an expedited basis; thus, it was scheduled to be heard on March 27, 2001. By that time, LaSalle had filed a Motion for Relief from Stay and the Court had issued its Rule to Show Cause to also be heard on March 27, 2001. During February 10, 2001 through March 27, 2001, Debtor continued borrowing funds from LaSalle without Court order.

As reported at the March 27, 2001 hearing, the parties' sale efforts did not prove very successful and produced a gross amount of a little over \$20,000. On February 26, 2001, La Salle filed a Motion for Relief from the Automatic Stay requesting that the Court allow the modification of the stay effective after the expiration of the Auction Period so that it could sell the collateral to the extent it was not sold through the auction and apply the proceeds to the amounts due and owing on its claim.

### **CONCLUSIONS OF LAW**

Section 1112(b) of Title 11 provides in pertinent part that a bankruptcy court may dismiss or convert a case:

- whichever is in the best interest of creditors and the estate, for cause, including--
- (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
  - (2) inability to effectuate a plan;
  - (3) unreasonable delay by the debtor that is prejudicial to creditors;
  - (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
  - (5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;
  - (6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified

plan under section 1129 of this title;  
(7) inability to effectual substantial consummation of a confirmed plan;  
(8) material default by the debtor with respect to a confirmed plan;  
(9) termination of a plan by reason of the occurrence of a condition specified in the plan; or  
(10) nonpayment of any fees or charges required under chapter 123 of title 28.

The process of determining whether a Chapter 11 case should be either converted or dismissed involves a two-step process: First, it must be determined that “cause” exists to dismiss the Chapter 11 proceeding or convert it to a Chapter 7. Second, it must be determined which of the two options is in “the best interest of creditors and the estate.” See, e.g. Rollex Corp. v. Associated Materials, Inc. (In re Superior Siding & Window, Inc.), 14 F.3d 240, 242 (4th Cir. 1994) (citing In re Mechanical Maintenance, Inc., 128 B.R. 382, 386 (E.D. Pa. 1991)). The Court finds that the facts of this case clearly show that cause exists to convert the case to a Chapter 7.

Since the beginning of the case, there has never been any prospect of rehabilitation of Debtor’s business. Debtor had ceased operating its business prior to the petition date and since the beginning, the parties’ goal was to quickly liquidate Debtor’s assets. During the seven months of the bankruptcy case, Debtor has continued to borrow substantial sums of money beyond its revenues from its primary secured creditor and post-petition lender, LaSalle, for the stated purpose of preserving and eventually selling its assets for the benefit of all of its creditors. During this period there has been a continuing loss to the estate. Furthermore, Debtor’s reorganization has been dominated by LaSalle from its inception and since the beginning Debtor ceded a significant amount of control to LaSalle, who has orchestrated Debtor’s Chapter 11 case and exercised significant control over the sale process.

The format of borrowing from LaSalle was approved based upon the assurances of counsel and the representation that the liquidation would be quick, to minimize expense, and produce a dividend to unsecured creditors. The case is presently over seven months old and, while Debtor has incurred a significant post-petition debt to LaSalle, only limited sales have taken place. Considering these circumstances, the overall delay in the case is unreasonable and a further indication that “cause” exists to warrant a conversion of the case. In addition, Debtor has failed to abide by the procedures required by this Court and failed to meet various deadlines. First, while the deadline to File a Plan and Disclosure Statement in this case was February 21, 2001, Debtor neglected to obtain an extension and did not file such documents until March 19, 2001, after the Court’s issuing of its Rule to Show Cause. The sale process also reflected delay. While the application to employ the auctioneer was approved by the Court in October of 2000, it was not until December 15, 2000, nearly two months after the approval of employment and only after the Court inquired at a hearing about the status of the sale process and urged that it be expedited, that Debtor finally noticed the sale of assets. Furthermore, despite the fact that the Internet auction sale was scheduled to conclude on March 10, 2001, Debtor failed to file a sale report as required by Fed. R. Bank. P. 6004, which required the Court and creditors to inquire about the results of the sale process at the hearing on March 27, 2001. The auction produced very limited sales; thus ultimately not proving as conclusive or beneficial as had been projected by the parties.

Lastly, Debtor failed to timely act in regards to the motions filed in the case requesting the Court’s approval of the post-petition financing agreement with LaSalle and actually borrowed funds prior to court approval. The Court also notes that the orders authorizing the post-petition



financing, which were prepared by LaSalle and reviewed by Debtor prior to their submission for the Court's consideration, were unnecessarily long and complicated and included various boiler-plate provisions which were apparently not applicable in this case.

The Court is further concerned that the arrangement or lack of arrangement involving the payment of Debtor counsel's fees taints his independence in the case. Upon inquiries made by the Court, Debtor's counsel indicated that he has relied and is relying upon the consent of LaSalle to supply funds necessary for payment of his fees and costs related to this case. Unlike the instance of a carve-out for professional fees in a cash collateral order issued at the beginning of the case, where a debtor's interest in the collateral allows the court to order an "invasion" of said collateral for the payment of administrative fees necessary to ensure Debtor's ability to perform its fiduciary obligations to creditors; in this case, Debtor's counsel relies on the prospect that in the future LaSalle will offer to lend Debtor funds for the express purpose of paying Debtor attorney's fees. Such a payment expectation "taints" Debtor counsel's independence. An expectation and reliance on the direct payment of the counsel's fees by a debtor's primary secured creditor and post-petition creditor give an appearance of a potential conflict of interest between a debtor's counsel duty to a Debtor and its creditors and his interest in being compensated by the secured creditor.

Lastly, the continuation of this case under Chapter 11 of the Bankruptcy Code is not in the best interest of the unsecured creditors. As previously discussed, the sale of Debtor's assets as controlled by Debtor and LaSalle has not proved to be very successful.<sup>2</sup> Furthermore, Debtor

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<sup>2</sup> Despite the fact that the sale did not meet the parties' nor the Court's expectation, there has been no indication that such outcome was caused by the performance of the auctioneer.

has indicated that it has not identified any avoidance actions or other claims to pursue. After repeated inquiry by the Court as to the prospect of a dividend for the benefit to general unsecured creditors, on February 5, 2001 the parties entered into a Consent Order as to Distribution for Unsecured Creditors whereby the unsecured creditors were to receive at least 3% of the net proceeds to LaSalle. In fact, Debtor's counsel is presently holding some funds from this source. However, the prospect of any future dividend to the unsecured creditors pursuant to the agreement from further sales to be conducted and controlled by LaSalle outside of the bankruptcy case is undependable. In its Motion for Relief from the Stay, LaSalle represented that it was its intention to acquire control over the equipment on which it has a lien and remit a dividend for the unsecured creditor, as agreed to in the Consent Order as to Distribution for Unsecured Creditors, only in the event it did not credit bid, a prospect entirely within its control and therefore a matter on which other creditors cannot rely. In summary, the Court has lost confidence in the continuation of the sale process in a Chapter 11 case. For the reasons stated, the Court finds that sufficient "cause" exists in this case to convert the case to a Chapter 7.

Considering that there are assets that remain subject to a sale and that there are funds that have been collected pursuant to a carve-out order for the sole benefit of the unsecured creditors and which remain in Debtor's escrow account, it appears that the interest of all creditors would be better served in a Chapter 7 case in which a trustee could oversee the liquidation process, review potential claims which remain, and seek to protect the interests of the general unsecured creditors.

Upon his or her appointment, the Chapter 7 Trustee should expedite the consideration of matters in this case through Fed. R. Bankr. P. 2004 examinations or other reviews deemed

necessary to become fully informed of the facts of this case, and should personally appear before the undersigned to report his or her findings on **April 24, 2001 at 10:30 a.m.** at the J. Bratton Davis United States Bankruptcy Courthouse, 1100 Laurel Street, Columbia, South Carolina. In addition to the performance of his statutory duty, the Court requests that the Trustee be prepared to further address these matters:

- (1) The following pending Motions which are hereby continued from the hearing held on March 27, 2001 to that same time and date: (a) Motion by LaSalle Business Credit, Inc. for Relief From the Automatic Stay filed on February 26, 2001, (b) Motion for Third Order Approving Interim Post-Petition Financing with LaSalle Business Credit, Inc. filed on February 7, 2001, and (c) Motion by Carolina First for further Relief From the Automatic Stay.
- (2) Review the post-petition loans by LaSalle, the payments remitted to it, and the charges and fees it has assessed since the commencement of the Chapter 11 case.
- (3) Determine any claims which debtor may have. It is therefore,

ORDERED that sufficient cause exists in this case to convert it to a Chapter 7 case.

IT IS FURTHER ORDERED that a Chapter 7 Trustee shall be appointed and shall duly perform his or her statutory duties as well as undertake the reviews as specified in detail in the Order.

IT IS FURTHER ORDERED that the appointed Chapter Trustee shall personally appear before the Court on **April 24, 2001 at 10:30 a.m.** at the J. Bratton Davis United States Bankruptcy Courthouse, 1100 Laurel Street, Columbia, South Carolina to address the concerns that the Court set forth in the Order.

AND IT IS SO ORDERED.

Columbia, South Carolina,  
March 30, 2001.

  
UNITED STATES BANKRUPTCY JUDGE

**CERTIFICATE OF MAILING**

The undersigned deputy clerk of the United States  
Bankruptcy Court for the District of South Carolina hereby certifies  
that a copy of the document on which this stamp appears  
was mailed on the date listed below to:

**MAR 30 2001**

*RH*

**DEBTOR, DEBTOR'S ATTORNEY, TRUSTEE**

*UST via mail*

**VANNA L. DANIEL**

Deputy Clerk