

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

PHYSIOTHERAPY HOLDINGS, INC., *et al.*,¹

Debtor.

Chapter 11

Case No. 13-12965 (KG)

Objection Deadline: December 12, 2013

Hearing Date: December 17, 2013 at 1:30 pm

Re: Docket Nos. 18 and 19

**UNITED STATES TRUSTEE’S OBJECTION TO
CONFIRMATION OF THE JOINT PREPACKAGED PLAN OF REORGANIZATION
OF PHYSIOTHERAPY HOLDINGS, INC. AND ITS DEBTOR AFFILIATES
PURSUANT TO CHAPTER 11 OF THE BANKRUPTCY CODE**

Roberta A. DeAngelis, the United States Trustee for Region 3 (“United States Trustee”), by and through her undersigned attorney, objects (the “Objection”) to the confirmation of Physiotherapy Holdings, Inc.’s (the “Debtors”) Joint Prepackaged Plan of Reorganization of Physiotherapy Holdings, Inc. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor’s federal taxpayer-identification number, are: Physiotherapy Holdings, Inc. (5193); Actra Rehabilitation Associates, Inc. (7806); Alexandria Sports, Inc. (7654); Benchmark Acquisition Corp. (3850); Benchmark Medical Management Company (0335); Benchmark O&P Holdings, Inc. (6848); Benchmark Orthotics & Prosthetics, Inc. (7000); Blue Hen Physical Therapy, Inc. (7267); Cape Prosthetics-Orthotics, Inc. (7914); Carrollton Physical Therapy Clinic, Inc. (2832); Integrity Physical Therapy, Inc. (1075); Keystone Rehabilitation Associates of Warren (8341); Keystone Rehabilitation Systems, Inc. (8380); Keystone Rehabilitation Systems of McMurray (6304); Leesburg Sports, Inc. (4190); MATRIX Healthcare Services, LLC (7344); MATRIX Rehabilitation, Inc. (3147); MATRIX Rehabilitation-Delaware, Inc. (2504); MATRIX Rehabilitation-Georgia, Inc. (4073); MATRIX Rehabilitation-Ohio, Inc. (2505); MATRIX Rehabilitation-South Carolina, Inc. (5603); MATRIX Rehabilitation-Texas, Inc. (9542); Morris Area Rehabilitation Association, Inc. (2043); North Dallas Physical Therapy Associates, Inc. (5331); Northstar Health Services, Inc. (7152); NSHS Services, Inc. (6789); Orthopaedic Services of Paducah, Inc. (3143); PhysioLink Corporation (3705); Physiotherapy Associates Holdings, Inc. (3367); Physiotherapy Associates, Inc. (7193); Physiotherapy Associates-Union Rehab, LLC (0041); Physiotherapy Corporation (3816); Physiotherapy-BMHI Holdings, Inc. (3361); Physiotherapy-BMI, Inc. (4107); Potomac Rehabilitation Services, Inc. (2725); Professional Rehab Associates, Inc. (2393); Progressive Therapy Services, Inc. (8449); Rehab Associates, L.L.C. (9381); Rehab Colorado, LLC (5804); Rehab Missouri, LLC (0587); Rehab Xcel, LLC (0586); Rehabilitation Consultants, Inc. (1166); R.S. Network, Inc. (9104); SMR Banyan Tree, Inc. (6933); Swanson Orthotic & Prosthetic Center, Inc. (2308); The Parks Physical Therapy and Work Hardening Center, Inc. (2926); Theraphysics Partners of Colorado, Inc. (2115); Theraphysics Partners of Texas, Inc. (9976); Therapy Associates of Martinsville, Inc. (1394); Trumbull P.T. Corp. (3855); Wisconsin Prosthetics and Orthotics, Inc. (7815). The Debtors’ main corporate address is 855 Springdale Drive, Suite 200, Exton, PA 19341.



Code (Docket No. 18) (the “Plan”). In support of this Objection, the United States Trustee respectfully states:

Preliminary Statement

1. A chapter 11 plan may not be confirmed unless the Court can find that the plan complies with the provisions of 11 U.S.C. § 1129(a). A plan proponent bears the burden of proof with respect to each and every element of 11 U.S.C. § 1129(a). *See In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 599 (Bankr. D. Del. 2001). As discussed below, the Plan is not confirmable because it contains certain debtor releases and nonconsensual third-party releases that are contrary to applicable law.

2. In addition, based on the definition of Releasing Parties and the terms of the Third Party Releases (defined below) future personal injury claimants, who may have been injured from the services provided at the Debtors’ facilities prior to the Petition Date and may assert that claim post-confirmation, do not appear to have effective redress for their claims.

3. For these reasons, as set forth in greater detail below, confirmation of the Debtors’ Plan should be denied.

Jurisdiction

4. Under (i) 28 U.S.C. § 1334, (ii) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a), and (iii) 28 U.S.C. § 157(b)(2), this Court has jurisdiction to hear and determine whether the Plan should be confirmed and this Objection.

5. Under 28 U.S.C. § 586, the United States Trustee is generally charged with monitoring the federal bankruptcy system. *See United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3d Cir. 1994) (noting that United

States Trustee has “public interest standing” under 11 U.S.C. § 307 which goes beyond mere pecuniary interest); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 500 (6th Cir. 1990) (describing the United States Trustee as a “watchdog”).

6. Under section 307 of title 11 of the United States Code (the “Bankruptcy Code”), the United States Trustee has standing to be heard on the Plan and the issues raised in this Objection.

Background

General Background

7. On November 12, 2013 (the “Petition Date”), the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors continue to operate their business and manage its properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

8. On the Petition Date, the Debtors filed the Plan and the Disclosure Statement of the Joint Prepackaged Plan of Reorganization of Physiotherapy Holdings, Inc. and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code (Docket No. 19) (the “Disclosure Statement”).

9. On November 14, 2013, the Court entered an Order (A) Scheduling an Objection Deadline and Combined Hearing on Debtors’ Disclosure Statement and Plan Confirmation, (B) Approving Form and Notice of Confirmation Hearing, (C) Establishing Procedures for Objectives to the Disclosure Statement and the Plan, (D) Approving the Solicitation Procedures, (E) Waiving the Requirements for Meetings of Creditors or Equity Holders and (F) Granting Related Relief (Docket No. 49) scheduling the combined hearing to

consider the adequacy of the Disclosure Statement and the confirmation of the Plan for December 17, 2013.

10. If the Debtors' Plan is confirmed on or before January 15, 2014, then the Debtors are not required to file their schedules or statement of financial affairs. *See* Docket No. 103. The Debtors have not filed a motion to establish a bar date in this case.

Debtor Releases in the Plan

11. The Plan includes broad releases by the Debtors and their estates (the "Debtor Releases") and non-consensual third-party releases (the "Third-Party Releases"). *See* Plan, Articles VIII(D) and (E).

12. Article VIII(D) of the Plan provides releases by the Debtors and their estates to all "Released Parties," which is defined to include:

(a) the Debtors; (b) the Reorganized Debtors; (c) the Bridge Loan Agent; (d) the Bridge Loan Lenders; (e) the Consenting Noteholders; (f) the Ad Hoc Committee of Senior Noteholders; (g) the Senior Notes Indenture Trustee; (h) the Exit Facility Agent; (i) the Exit Lenders; (j) the Consenting Shareholders; and (k) with respect to each of the foregoing Entities in clauses (a) through (k), such Entities' predecessors, successors and assigns, subsidiaries, Affiliates, managed accounts or funds, and current (as of September 1, 2013) officers, directors, principals, members, partners, shareholders, employees, agents (other than third-party vendors performing services for the Debtors), financial advisors, attorneys, accountants, investment bankers, consultants, representatives, management companies, fund advisors, advisory board members and other professionals, and such Persons' respective heirs, executors, estates, servants, and nominees. Notwithstanding the foregoing, under no circumstances shall any of the Potential Defendants and Witnesses constitute a Released Party.

See Plan, Article I(A)(112).

***Non-consensual Third-Party
Releases in the Plan***

13. Article VIII(D) of the Plan sets forth the proposed Third-Party Releases. As with the Debtor Releases, the Third-Party Releases are in favor of all the “Released Parties.” See Plan, Article VIII(E). The Plan provides that each “Releasing Party” will providing the Third-Party Releases. *Id.* The term “Releasing Parties” is defined as:

(a) the Debtors; (b) the Bridge Loan Agent; (c) the Bridge Loan Lenders; (d) the Consenting Noteholders; (e) the Senior Notes Indenture Trustee; (f) the Consenting Shareholders; and (g) without limiting the foregoing clauses (a), (b), (c), (d), (e), and (f), and notwithstanding anything contained herein to the contrary, the Holders of Claims against and Interests in the Debtors and the Reorganized Debtors who (i) vote to accept the Plan or are presumed to have voted to accept the Plan under section 1126(f) of the Bankruptcy Code and (ii) for Holders of Senior Notes Claims, have opted-in to the settlement described in Article III.C.4 below.

See Plan, Article I(A)(113). As indicated by the language in Articles I(A)(113) and VII(E) of the Plan, the Third-Party Releases are being given not only by the holders of claims who voted to accept the Plan, but also by holders of claims who are presumed to have voted to accept the Plan under section 1126(f) of the Bankruptcy Code.²

14. Notwithstanding the nonconsensual Third-Party Releases, even if the Debtors had obtained consent, certain members of the proposed Released Parties, including the Debtors’ current directors, officers, employees and affiliates should not be included among those receiving Third-Party Releases when they have not provided any contribution to the Plan or consideration in exchange for such releases.

² Section 1126(f) provides “a class that is not impaired under a plan, and each holder of a claim or interest in such claims, are conclusively presumed to have accepted the plan.” 11 U.S.C. § 1126(f).

Discussion

The Debtors' Proposed Release Provisions are Impermissible Under Applicable Law

15. The Debtor Releases and the Third-Party Releases as set forth in the Plan are contrary to the standards set forth in *In re Washington Mutual, Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011), *In re Tribune Company*, 464 B.R. 126 (Bankr. D. Del. 2011), and other applicable case law in this District, as detailed below. Therefore, the Plan is not confirmable.

Releases by the Debtors and their Estates are Overbroad

16. Article VIII(D) of the Plan provides broad releases by the Debtors and their estates of many parties, including but not limited to, the Debtors, Reorganized Debtors', the Bridge Loan Agent, the Bridge Loan Lenders, the Consenting Noteholders, the Ad Hoc Committee of Noteholders, the Senior Notes Indenture Trustee, the Exit Facility Agent, the Exit Lenders, the Consenting Shareholders, the Consenting Shareholders, and with respect to each of the foregoing Entities, such Entities' predecessors, successors and assigns, subsidiaries, Affiliates, managed accounts or funds, and current (as of September 1, 2013) officers, directors, principals, members, partners, shareholders, employees, agents (other than third-party vendors performing services for the Debtors), financial advisors, attorneys, accountants, investment bankers, consultants, representatives, management companies, fund advisors, advisory board members and other professionals, and such Persons' respective heirs, executors, estates, servants, and nominees (hereinafter, the "Released Parties"). See Plan, Article I(A)(112).

17. Pursuant to the *Washington Mutual* decision, and *Tribune* decision, among others, the five factors set forth in *In re Zenith Elecs. Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999) and *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 937-38 (Bankr. W. D. Mo.

1994) should be considered to determine whether, notwithstanding section 524(e) of the Bankruptcy Code, a plan may provide for releases by debtors of non-debtor entities. *See Washington Mutual*, 442 B.R. at 346; *Tribune* 464 B.R. at 186; *In re Spansion, Inc.*, 426 B.R. 114, 142-43, n. 47 (Bankr. D. Del 2010); *In re Coram Healthcare Corp.*, 315 B.R. 321, 335 (Bankr. D. Del. 2004). The *Zenith/Master Mortgage* factors are as follows:

- i. identity of interests between debtor and non-debtor release, so that a suit against a non-debtor will deplete the estate's resources (e.g. due to debtor's indemnification of non-debtor);
- ii. substantial contribution to the plan by non-debtor;
- iii. necessity of release to the reorganization;
- iv. overwhelming acceptance of plan and release by creditors; and
- v. payment of all or substantially all of the claims of the creditors and interest holders under the plan.

Washington Mutual, 442 B.R. at 346 (citing *Zenith*, 241 B.R. at 110) (citing *Master Mortgage*, 168 B.R. at 937)). *See also Tribune*, 464 B.R. at 186 (citing *Zenith* for the same five factors to be considered with respect to debtor releases of non-debtor parties). The factors are neither exclusive nor conjunctive requirements, but simply provide guidance in a court's determination of fairness. *Tribune* 464 B.R. at 186, citing *Washington Mutual*, 442 B.R. at 346.

18. Neither the Debtors' Disclosure Statement nor the Plan set forth how any of the *Zenith/Master Mortgage* factors are met for the vast majority of parties who are receiving releases from the Debtors and their estates.

19. The Debtor Releases in the present case include a release of the Debtors' directors, officers, employees, affiliates and professionals. *See Plan*, Article I(A)(112). In *Washington Mutual*, the Court found impermissible certain releases given to a number of groups that are also to be releases by the Debtors in the Plan in the present case. There, the Court

determined that the release of the debtors' directors, officers and professionals were not justified. *Washington Mutual*, 442 B.R. at 349-50, 354. Although the Court determined that the first of the *Zenith/Master Mortgage* factors may have been met (identity of interests), the other four factors were not. *Id.* The *Washington Mutual* court commented that, with respect to their post-petition activities, the directors, officers and professionals of the debtors were receiving exculpations, which were sufficient, and releases were "unnecessary, duplicative and exceed the limits of what they are entitled to received." 442 B.R. at 350. The same is true here.

20. The Debtors have the burden to establish whether the *Zenith/Master Mortgage* factors have been met as to each of the Released Parties who are the beneficiaries of the Debtor Releases. Because an evidentiary predicate is necessary to approve the Debtor Releases, the United States Trustee reserves argument on this issue until the record at the confirmation hearing is closed.

***The Third-Party Releases
Are Nonconsensual***

21. The proposed Third-Party Releases in the Plan are nonconsensual. The Third-Party Releases benefit numerous non-debtors, and are being given not only by the holders of claims who voted to accept the Plan, but also by holders of claims who are presumed to have voted to accept the Plan under section 1126(f) of the Bankruptcy Code. *See* Plan, Articles I(A)(113) and VIII(E). As is the case with the Debtor Releases, the Third-Party Releases are in favor of all Released Parties. *See* Plan, Articles I(A)(113) and VIII(E).

22. The Debtors have not provided the holders of the claims in the non-voting classes with an opportunity to affirmatively opt-out of or opt-into the Third-Party Releases. Therefore, it is the position of the United States Trustee that the releases are nonconsensual.

23. Some Courts in this District have determined that third-party releases of non-debtors should be allowed only if they are consensual. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 352 (Bankr. D. Del. 2011), *citing, inter alia, In re Coram Healthcare Corp.*, 315 B.R. 321, 335 (Bankr. D. Del. 2004) (To be enforceable, “any such release must be based on consent of the releasing party (by contract or the mechanism of voting in favor of the plan).”); *In re Zenith Electronics Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999) (release provision had to be modified to permit third parties’ release of non-debtors only for those creditors who voted in favor of the plan); *In re Exide Technologies*, 303 B.R. 48, 74 (Bankr. D. Del. 2003)(approving releases which were binding only on those creditors and equity holders who accepted the terms of the plan).

24. In *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3d Cir. 2000), the Third Circuit surveyed cases from various circuits as to when, if ever, a nonconsensual third party release is permissible. The Court acknowledged that a number of Circuits do not allow such non-consensual releases under any circumstances. *See id.* at 212. Other Circuits, the Court found, “have adopted a more flexible approach, albeit in the context of extraordinary cases,” such as mass tort cases. *See id.* at 212, *citing Securities and Exchange Commission v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640, 649 (2d Cir. 1988). *See also, In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141 (2d Cir. 2005) (third party release may be granted “only in rare cases”).

25. The Third Circuit in *Continental Airlines* ultimately determined that the proposed releases in that case, which enjoined shareholder lawsuits against debtors’ directors and officers, did “not pass muster under even the most flexible test for the validity of non-debtor

releases.” *Continental*, 203 F.3d at 214. Therefore, the Court determined that it “need not speculate on whether there are circumstances under which we might validate a non-consensual release that is both necessary and given in exchange for fair consideration.” *Id.* at 214, n.11. However, the Court did describe the “hallmarks of permissible non-consensual releases” to be “fairness, necessity to the reorganization, and special factual findings to support these conclusions.” *Id.* at 214.

26. In the Debtors’ case there is nothing in the record to indicate that the high threshold necessary for approval of nonconsensual third-party releases has been met. The Debtors have the burden of establishing whether the Released Parties’ contribution to the Plan is sufficient to constitute “hallmarks of permissible non-consensual releases.”

27. In addition, it is hard to imagine what contribution to the Debtors’ Plan was given by the Debtors’ officers, directors, employees, and attorneys, the Debtors’ non-debtor affiliates and their officers and directors, or remaining non-debtor recipients, all of which are the recipients of non-consensual third-party releases. *See* Plan, Article I(A)(112). The Court in *Continental* found that the directors and the officers of the debtors in those cases did not satisfy the requirements to be entitled to a nonconsensual third party release. *See Continental*, 203 F.3d at 215 (“[W]e have found no evidence that the non-debtor D&Os provided a critical financial contribution to the Continental Debtors’ plan that was necessary to make the plan feasible in exchange for receiving a release of liability”).

28. The Debtors should not be allowed the unfettered discretion to force creditors to discharge non-debtors from liability, because a permanent injunction limiting the liability of non-debtor parties is a rare thing that should not be considered absent a showing of exceptional circumstances. *See Continental*, 203 F.3d at 213, n. 9, and cases cited therein.

29. Further, there are certain non-debtors that will be released by way of the Third-Party Releases that are not entitled to such a release from even those creditors and interest holders that vote to accept the plan. The Court in *Washington Mutual* disallowed even consensual third-party releases in favor of the Debtors' officers, directors and affiliates who will be the beneficiaries of consensual and non-consensual Third-Party Releases in this case.

30. In addressing third party release of the debtors' officers and debtors in *Washington Mutual*, the court held as follows:

[T]here is no basis for granting third party releases of the Debtors' officers and directors, even if limited to post-petition activity. The only 'contribution' made by them was in the negotiation of the Global Settlement and the Plan. Those activities are nothing more than what is required of directors and officers of debtors in possession (for which they have received compensation and will be exculpated); they are in sufficient to warrant such broad releases of any claims third parties may have against them.

442 B.R. at 354. The same is true here.

31. Under *Washington Mutual*, the Third-Party Releases in the present case should not extend to the Debtors' directors, officers, affiliates or any other non-debtor person or entity that did not make a substantial contribution to the Plan, or otherwise provide consideration for their release.

32. The Debtors have the burden of justifying the validity of the Third-Party Releases, whether consensual or non-consensual, for each and every party to be released. Because an evidentiary predicate is necessary to approve the Third-Party Releases, the United States Trustee reserves argument on this issue until the record at the confirmation hearing is closed.

***Nonconsensual Third Party Releases
and Tort Claims***

33. The Debtors request that this Court find that holders of claims in non-voting classes who are presumed to have voted to accept the Plan under the Bankruptcy Code have consented to the Third-Party Releases. *See* Plan, Articles I(A)(113) and VIII(E). The United States Trustee contends that consent to a proposed third-party release requires an affirmative act by the party from whom the release is being sought. Absent an affirmative action to opt-into or opt-out of the Third-Party Release the release is non-consensual, and should not be granted.

34. The implications of the foregoing are far-reaching. According to the Declaration of Martin McGahan, Chief Restructuring Officer and Interim Chief Executive Officer of Physiotherapy Holdings, Inc., In Support of First Day Pleadings (Docket No. 16), the “Debtors are the largest pure-play providers of outpatient physical therapy services in the United States with a national footprint of 581 outpatient rehabilitation and orthotics and prosthetics clinics located in 29 states plus the District of Columbia. With over 1,500 clinicians managing over 2.9 million patient visits per year, the Debtors provide the entire spectrum of outpatient rehabilitation therapy, including physical therapy, sports and industrial rehabilitation, hand and aquatic therapy, women’s health, pediatric and geriatric programs.” *See* Docket No. 16.

35. Based on the type of services provided at the Debtors’ facilities, in this case there may be future tort claims (“Tort Claims”),³ including personal injury claims, which may arise concerning services provided by the Debtors to its patients (“Future Tort Claimants”) prior to the Petition Date, which have not been realized. These Tort Claims may otherwise

³ The ultimate “determination of whether a claim arises in bankruptcy requires an analysis of interests created by non-bankruptcy substantive law.” *In re National Gypsum Co.*, 139 B.R. 397, 405 (N. D. Tex. 1992) (citations omitted).

confer liability upon the Debtors and some of the Released Parties. However, with the proposed definition of Releasing Party and the terms of the Third-Party Releases, these Tort Claims would be abruptly and finally cut-off.

36. The due process rights of the Future Tort Claimants with Tort Claims that occurred prior to the Petition Date are being stripped away by the terms of the Plan and there does not appear to be any proposed protections or avenues for recovery for Future Tort Claimants once the Debtors are reorganized and granted a discharged, and the Released Parties are shielded from liability as a result of the confirmation of the Plan.

37. It is not clear what treatment is accorded Tort Claims that arise from services provided by the Debtors, where those claims arose before the Petition Date and have yet to be asserted. The Plan's Third-Party Releases seems to bar those claims.

Conclusion

38. As detailed above, the Plan is not confirmable because it contains release provisions that are contrary to applicable law in this District.

39. The United States Trustee leaves the Debtors to their burden and reserves any and all rights, remedies and obligations to, *inter alia*, complement, supplement, augment, alter and/or modify this Objection, file an appropriate Motion and/or conduct any and all discovery as may be deemed necessary or as may be required and to assert such other grounds as may become apparent upon further factual discovery.

WHEREFORE, the United States Trustee requests that this Court issue an order denying confirmation of the Plan, and/or granting such other relief as this Court deems appropriate, fair, and just.

Dated: December 12, 2013
Wilmington, Delaware

Respectfully submitted,

ROBERTA A. DeANGELIS
UNITED STATES TRUSTEE

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