UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re: MEDomics, LLC, Debtor(s).	Case No.: 2:16-bk-14355-NB CHAPTER 7 **MEMORANDUM DECISION DENYING DR. SOMMER'S MOTION FOR RECONSIDERATION RE ALLEGED ADMINISTRATIVE EXPENSES** [No Hearing Held]

The debtor's field was genetic testing. That field is "cutting edge," which is not necessarily a good thing from a business standpoint, because historically it was difficult to convince insurers to pay for the debtor's work.

Dr. Steve S. Sommer was the debtor's founder, president, chief medical officer, chief scientist, and chief operating officer ("CEO"). Dkt. 299, p. 2:3-5.[1] At all relevant times he was also the debtor's landlord, and a guarantor of certain debts to secured

[1] For brevity, filed documents are referred to by docket number rather than their full title ("dkt. __" or, for documents filed in the adversary proceeding associated with this case, 2:16-ap-01311, "adv. dkt. __"). Unless the context suggests otherwise, references to a "Chapter" or "Section" ("§") refer to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq. (the "Code"), a "Rule" means the Federal Rules of Bankruptcy Procedure ("FRBP"), Federal Rules of Civil Procedure ("FRCP"), Federal Rules of Evidence ("FRE"), or Local Bankruptcy Rules ("LBR"), and other terms have the meanings provided in the Code and the Rules.

creditor Wells Fargo Bank, N.A. ("Wells Fargo"). Initially, as CEO of a "debtor in possession," he exercised the powers and had the fiduciary duties of a trustee for the benefit of creditors under sections 1101(1), 1106, 1107.

Dr. Sommer did not live up to his fiduciary duties. So this court appointed a chapter 11 trustee. *See* dkt. 110.

Nevertheless, this court sought to preserve the debtor as a going concern for the benefit of all parties in interest, including not only creditors, employees, and patients, but also Dr. Sommer himself. Because Dr. Sommer was essential to the operation of the business – and giving him the benefit of the doubt that he was well-intentioned, if misguided, in his earlier failure to live up to his fiduciary duties – this court permitted him to continue to operate the debtor under the trustee's supervision. This court also took the extraordinary step of protecting Dr. Sommer by enjoining Wells Fargo's collection efforts against him as guarantor. *See* dkt. 146; adv. dkt. 15.

Once again, however, Dr. Sommer did not live up to his duties. He made numerous expenditures without authorization from the chapter 11 trustee or this court. To the contrary, the trustee directed Dr. Sommer not to commit the debtor to doing more work or incurring more expenses than the trustee believed, in his business judgment, that the debtor could handle; but Dr. Sommer did so anyway.

Having over-committed the debtor, Dr. Sommer told the trustee that the bankruptcy estate had to hire more staff. When the trustee refused, Dr. Sommer abruptly ceased to generate any additional receivables for October or November, 2016. Dr. Sommer also brought motions to compel the trustee to hire three more employees (dkt. 191), and to reimburse him for $144,238.31 in expenses that he claimed were incurred for the benefit of the bankruptcy estate. Dkt. 196. The trustee, meanwhile, sought to have this case converted from a chapter 11 reorganization to a chapter 7 liquidation.

This court converted this case to chapter 7 (with the trustee continuing to serve as trustee). Dkt. 228. This court also ruled that Dr. Sommer had the burden to show

that his expenditures were "actual" and "necessary" expenses of administration, and that he had failed to do so. Nevertheless, this court did allow him $47,488.24 out of the $144,238.31 that he requested because the Trustee had not opposed that reduced dollar amount. Dkt. 264.

Now Dr. Sommer has filed his motion for reconsideration and supporting papers. Dkt. 286, 297, 299. Again, he wants to be compensated for his unauthorized actions, even though the limited resources of this bankruptcy estate will be woefully inadequate to pay creditors, and might well be inadequate to pay the trustee and other administrative expenses.

Dr. Sommer fails to meet the legal standards requiring him to prove that his expenditures were "necessary" to the administration of the estate, not to mention his additional burden to show clear error or other sufficient grounds for relief on a motion for reconsideration. He also fails to cite to specific evidence in the record to support his factual assertions. Moreover, this court previously conducted its own extensive review of the evidence in the record, and has now reexamined the record, and the record does not support Dr. Sommer's position. For all of these reasons, his motion will be denied by a separate order.

(1) Background

On April 5, 2016 (the "Petition Date") the debtor filed its voluntary chapter 11 petition. This court held numerous hearings, often on shortened notice at Dr. Sommer's request. Prior to those hearings this court generally issued detailed tentative rulings, directing the parties to issues of particular concern to this court. Except as modified, those tentative rulings were adopted as this court's final findings of fact and conclusions of law. *See, e.g.,* dkt. 224, 225, 264.

(a) Proceedings leading up to Dr. Sommer's Administrative Expense Motion

This court granted the debtor authority to use cash collateral, but only on a limited basis. *See, e.g.,* dkt. 20 at p. 4, para. 7, and dkt. 37, 53, 139. At first the primary interest in the cash collateral appeared to be held by Wells Fargo; later by a different

creditor ("Socket"), but in any event, under Section 363(c) a debtor in possession is not permitted to use cash collateral without authorization from the Bankruptcy Court (or the consent of all creditors with an interest in the cash collateral).

Nevertheless, Dr. Sommer appeared to have used cash collateral to pay employees without court authorization. He later recharacterized those payments, but ultimately it does not matter how they are characterized because all alleged versions of the facts violated his duties.

In paying the employees he either caused the debtor to use cash collateral without authority (violating Section 363(c)), or he made an unauthorized loan to the debtor (violating Section 364), or (he later claimed) he paid the debtor's employees directly out of his own funds, which created what he now claims is an obligation of the debtor (thereby violating Section 363(b) and 364). In any event he did not disclose those transactions, which hid the debtor's troubled financial condition. In addition, there were unrebutted assertions that under his management the debtor had not paid certain payroll taxes or maintained workers' compensation insurance, and he had caused the debtor to repay loans he allegedly had made to the debtor. *See, e.g.,* dkt. 83, Ex.1&2, *and* dkt. 159 at p. 2 (belated disclosure of alleged loan repayments to Dr. Sommer).

This court ordered the appointment of a Chapter 11 Trustee, David M. Goodrich (the "Trustee"). Dkt. 114. There was no appeal of that order.

(b) The Administrative Expense Motion and the Staffing Motion

At a hearing on October 11, 2016, the Trustee stated that he had repeatedly spoken with Dr. Sommer about the need to obtain authorization from the Trustee or this court rather than engaging in unauthorized transactions, such as hiring more employees or paying them more than the Trustee authorized. Dkt. 291 (Tr. 10/11/16), pp. 25:23-29:22. Nevertheless, Dr. Sommer stated that, after the Trustee cut payroll, he felt "compelled" to act without authorization from the Trustee or this court. Dkt. 184, p.8:1-4. *See also* dkt. 297, Ex. A, p. 20:10-16.

On November 23, 2016 Dr. Sommer filed motions, on an emergency basis, to have these and other expenditures treated as allowed administrative expenses (the "Administrative Expense Motion," dkt. 196) and to compel the trustee to hire additional staff (the "Staffing Motion," dkt. 191). Dr. Sommer relies heavily on a "Business Evaluation Summary" (the "Business Plan") prepared by Mr. Michael D'Amato, a business consultant (dkt. 192, p. 2, para. 2 & Ex. B) and also a "Cash Flow Analysis" prepared by Mr. Alex Rachmanony, a Certified Public Accountant, and a partner of Grobstein Teeple LLP (the "CPA Cash Flow Analysis"). Dkt. 191, p. 135 & Ex. C (dkt. 191-3).

This court set an expedited hearing for November 29, 2016. Other parties in interest filed opposition papers (dkt. 217-220) that pointed out flaws in the Business Plan and CPA Cash Flow Analysis. This court also independently reviewed those things. *See, e.g.,* dkt. 285 (Tr. 11/29/16) p. 11:3-14.

At the hearing the Trustee noted that the debtor's future projections depended on an anticipated higher collection rate that had not been adequately supported:

> [TRUSTEE:] And as the Court may recall or may understand, [] this Debtor doesn't collect 100-percent of its receivables. [In future, will the collection rate be in line with] historical, which is between 25 and 27-percent, maybe 27.5, or is it somewhere close to 35 to 40-percent, which is what is projected [by Dr. Sommer?] We don't know yet, and I don't know where the projected numbers come from. [Dkt. 285 (Tr. 11/29/16) p. 6:4-11 (emphasis added)]
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> * * *
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> There are other things that have occurred that may lead to a drop off on collections. And if three people are … retained, or whatever we decide to do, in three months we may be regretting that decision because they all have to be laid off at that point.
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> So, as I've always believe[d I] expressed to the Court and to Doctor Sommer, prudence is probably the better approach here. [Dkt. 285 (Tr. 11/29/16) p. 7:7-14 (emphasis added)]

The Trustee requested more time, to see if Dr. Sommer could back up his projections. Dr. Sommer opposed any additional time, arguing that this was an emergency both because of his own desperate need for cash and because he could not "ethically, morally and possibly from a malpractice standpoint, continue to generate

billings without an ability to perform the services" – in other words, he conceded that he had generated more billings than the debtor could perform, and that was the reason, he alleged, why he abruptly ceased generating any billings: "October and November were two months in which billings were not generated." Dkt. 285 (Tr. 11/29/16) p. 9:17-19 & p. 10:4-9 (emphasis added); *and see also* dkt. 299, p. 10:2-5.

Dr. Sommer's counsel concluded:

> We would ask the Court to authorize the payment of $60,000 to avert a disaster. Because, again, the twin disasters, if he can't get the staff he needs to perform the services that he is supposed to be performing, and if he can't cover his living expenses, he's going to have to leave. … [Dkt. 285 (Tr. 11/29/16) p. 12:12-17]
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> We really need to be able to commit to taking on the additional staffing, at least two of them, pretty much within a week or two. [*id.* p.12:20-22]
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> * * *
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> It's going to take some time to recruit … [so] we would anticipate probably the first professional coming in toward the end of [January].
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> [T]he point here is that if he knows that's happening, he can then resume. In fact, he was telling me what he would start doing tomorrow to start generate billings again. [Dkt. 285 (Tr. 11/29/16) p. 17:11-22 (emphasis added)]

One creditor favored "some funds going to Mr. Sommer for authorizing two new people," but subject to "tying additional resources to collection, not to billing." Dkt. 285 (Tr. 11/29/16) p. 16:10-12 (emphasis added). As discussed further below, the distinction between collection and billing is very important.

Meanwhile, the Trustee opposed Dr. Sommer's Administrative Expense Motion, stating:

> [A]lmost all these expenses are things that are incurred and then later I'm told about.
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> The big ones which I refer to are the ones that shouldn't even be in there, are employees. One employee was hired by Doctor Sommer without my consent and actually against my directive. And he paid for this person out of his own pocket, and now he wants to be reimbursed for that. I think -- I can't tell you how many times I told him that was inappropriate, and that he shouldn't even bother asking for those fees to be reimbursed.
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> * * *
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> There are other things like that, that are examples of payments made. One payment made to a pseudo professional who's never been employed, again, without my consent. [Dkt. 285 (Tr. 11/29/17) pp. 20:12-22 *and* 21:6-9 (emphasis added)]

Despite this court's very serious concerns about Dr. Sommer's acts and failure to obtain authorization, this court granted temporary relief on both the Administrative Expense Motion and the Staffing Motion to preserve whatever value the debtor's operations might have. The Trustee was provisionally authorized to distribute up to $60,000 to Dr. Sommer on account of his alleged administrative claims, expressly reserving whether any final approval would be for a greater or lesser dollar amount. Dkt. 206. Meanwhile Dr. Sommer was authorized to interview but not hire additional staff.

(c) The December 13, 2016 Hearing

The continued hearing on December 13, 2016 addressed multiple matters, including not only the Administrative Expense Motion and the Staffing Motion but also, in connection with a continued status conference, the issue of whether to convert the case from a chapter 11 reorganization to a chapter 7 liquidation. *See* dkt. 283 (Tr. 12/13/16) pp. 35:16-37:18 (discussing procedural basis to convert case at a status conference). The Trustee's papers included a detailed analysis of Dr. Sommer's purported administrative expenses and concluded that he was entitled to no more than $47,448.24. *See* dkt. 219, pp. 4:13-8:10 & pp. 10-13; *and* dkt. 295.

In the tentative ruling prior to the hearing (dkt. 224, Ex. A, part (1)(a)(i) of tentative ruling) this court reviewed various weaknesses in the debtor's Business Plan and the CPA Cash Flow Analysis and, more broadly, Dr. Sommer's arguments (*id.,* part (1) *passim*). At that hearing counsel for Dr. Sommer reiterated:

> [B]illings were not generated for the months of October or November [because] current staffing is not adequate to cover all that new billing, so that's the reason we [are] here with this motion for the additional staffing. [Dkt. 283 (Tr. 12/13/16) pp. 5:24-6:5 (emphasis added)]

This court responded:

> [I]t seems like, from my perspective – and I want you to explain to me why I'm wrong, here -- it sounds like what happened is that Doctor Sommer went out and sold this [genetic testing] to a bunch of patients, got more business by far than he could handle, and then came and said to the Chapter 11 Trustee, "You're between a rock and a hard place here. You've got to do what I want, which is to use the existing funds to hire more staff at a much

> faster rate than what you had told me to do, because otherwise we've over-committed, and we can't live up to our commitments."
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> In the meantime, … we didn't yet have any track record of whether the insurance companies would actually be reimbursing [the debtor, at an adequate percentage, for all the new billing] …. [A]ll of [this] is to say I'm listening, I'm prepared to be convinced, but I'm not hearing, so far, a precise enough breakdown of -- there were these new billings generated, and there were also these collections. … I don't know that the insurance companies are actually paying … in sufficient numbers to make this all work. [Dkt. 283 (Tr. 12/13/16) pp. 6:25-7:19 (emphasis added)]

Dr. Sommer's counsel did not point to any specific evidence in the record that would address how the debtor was going to generate sufficient collections to generate a net profit after taking into account all relevant expenses, including the cost of at least three additional employees. Later in the hearing, Dr. Sommer took the stand and this court once again asked him to provide evidence on this issue.

Dr. Sommer started by testifying that the patient retention that generated billing had gone up "dramatically." Dkt. 283 (Tr. 12/13/16) p. 24:1-13. This court asked Dr. Sommer to focus on "collection" more than "billing." Dkt. 283 (Tr. 12/13/16) p. 25:14-17 (emphasis added).

Dr. Sommer did not directly address that issue. Rather, he testified that "we bill very soon" after obtaining "samples" (of patients' DNA), "and so [sic] sometimes they're used as synonyms" (*i.e.,* "billing" and "collection"). He added that normally "it should take about four to five months to do the testing" but as to "the patients that were ascertained in September, it's more than a year before it gets done, if everything continues [*i.e.,* without more staffing]." Dkt. 283 (Tr. 12/13/16) pp. 25:18-26:2 (emphasis added); *and* dkt. 284 (Tr. 1/17/17) pp. 11:23-12:8. Dr. Sommer expressed hope that, if he could hire three more employees, "we're going to catch up" and "[i]t's going to be less than a year, much less." Dkt. 283 (Tr. 12/13/16) p. 29:9-20.

This court again asked Dr. Sommer to focus on providing some "assurance that the insurance companies are going to be paying," such as evidence that the debtor performs tests that identify medical issues to which a known cure can be applied. Dkt.

283 (Tr. 12/13/16) p. 31:10-22 (emphasis added). Again, Dr. Sommer did not allay this court's concerns.

Instead he responded by confirming that it is difficult to know whether any particular genetic testing will or will not be helpful – which only reinforced this court's concerns that it may be difficult to predict whether insurers will pay for any particular genetic test. Specifically, Dr. Sommer testified that "there is no single therapy at all," but there are some "examples of success in this sea of ignorance that we still have." Dkt. 283 (Tr. 12/13/16) pp. 31:23-33:8 (discussing one eventual success story involving an 11 year old girl).

This court concluded:

> Dr. Sommer's testimony continued the process of conflating billings and collections. I heard, and it's a wonderful, glorious example for one child to be getting some sort of benefit out of this, but what that doesn't tell me is whether insurers as a whole are recognizing [all the things that] the debtor is doing, as something that they're going to compensate, which has multiple layers to it.
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> It has to mean that the actual science itself is sound. It has to mean that the insurance companies are persuaded that the science itself is sound. It has to mean that, even if it's all sound, that the cash flow works, that the amount that you can generate from insurance collections offsets and, in fact, generates a profit [over and above] the expenses.
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> So none of [Dr. Sommer's evidence] has gotten me there. [Dkt. 283 (Tr. 12/13/16) p. 34:19-35:8 (emphasis added).]

The Trustee argued that, due to the debtor's inability to perform the testing to which Dr. Sommer had committed the debtor, and related problems, "This case needs to convert, and we need to close the business, and I intend to close the business tomorrow. I don't think there's any point, unless the Court tells me otherwise, to operate another day." Dkt. 283 (Tr. 12/13/16) p. 17:17-20.

This court did orally order conversion to chapter 7 (later memorialized in a written order), adding:

> I recognize that this is a horrible outcome, not only for all of the other reasons that have been stated, but also for the Chapter 11 Trustee. I mean, I don't perceive this as something that the Chapter 11 Trustee is doing lightly, or even willingly. His own fees, and those of his attorney, and other admin[istrative] expenses are very much at stake here, and it would be completely antithetical to his own self-interest, not to mention his duties as a

> Chapter 11 Trustee, to pull the plug on a business that has a viable path. [Dkt. 283 (Tr. 12/13/16) pp. 37:19-38:3]

At the end of the hearing, Dr. Sommer requested that he be permitted to supplement his Administrative Expense Motion to provide additional documents, with a continuance so that this court could review those documents *in camera*. Even though the deadline for Dr. Sommer to provide his argument and evidence had passed prior to the hearing, this court granted that request and set a further continued hearing for January 17, 2017. *See* dkt. 283 (Tr. 12/13/16) pp. 41:14-46:4, p. 48:9-22, & p. 50:13-17, *and* dkt. 264 & 287.

(d) The January 17, 2017 Hearing

In addition to further proceedings on the Administrative Expense Motion, this hearing involved a status conference and consideration of a proposed settlement which would have paid Dr. Sommer $50,000 for settling his claims against the estate and taking the debtor's medical records even though (i) it was not at all clear that he had allowable claims, or that the estate would be administratively solvent, and (ii) taking the medical records appeared to be a substantial benefit to him, not to mention his ethical and legal obligation, such that it did not seem necessary or appropriate to pay him to do so. In that context this court stated:

> I continue to be extremely troubled that at every step of the process here, Doctor Sommer seems to have taken any obligations that he has as something that's entirely optional … [including] … disposing of patient records in a proper way, or complying with cash collateral obligations, or complying with the directions of this Court about how to run the bankruptcy case [or, as reported to this court at that hearing, his alleged failure to notify the Trustee before entering the premises to take the debtor's records]. He's been given a lot of leeway here, and he just seems to be completely [flouting his obligations]. [Dkt. 284 (Tr. 1/17/17) p. 20:6-16; *and see generally id.* at pp. 17:19-24:7.]

As to the Administrative Expense Motion, this court ruled that, having considered the additional documents provided by Dr. Sommer, he still had failed to meet his burden to show that his expenditures were "actual" and "necessary" expenses of administration. Nevertheless, this court did allow him $47,488.24 out of the $144,238.31 that he

requested because the Trustee had not opposed that reduced dollar amount (apparently because, giving Dr. Sommer the benefit of the doubt, he might have believed that the Trustee had authorized those expenditures and/or because the Trustee might have authorized those expenditures had he been asked, regardless whether in retrospect they actually were necessary or appropriate). *See* dkt. 285 (Tr. 11/29/16) pp. 19:13-21:14; dkt. 286 p.6:15-16.

(e) The Administrative Expense Order

On January 23, 2017 this court issued an order denying the remainder of the relief requested by the Administrative Expense Motion, and requiring a disgorgement of $12,551.76 of the $60,000 the trustee had already been authorized to distribute (dkt. 264). That order adopted this court's tentative ruling issued prior to the hearing, which stated in part:

> This is a failed chapter 11 case, converted to chapter 7 (dkt. 228, 12/16/16). The debtor's principal is Dr. Sommer, and he not only asserts a large prepetition claim but is now asserting an administrative expense claim (dkt. 196).
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> The basis for that administrative expense claim is certain transactions that were neither disclosed to parties in interest nor authorized by this court, including advancing payroll. This court previously issued a tentative ruling (dkt. 224, Ex. A, at p. 4 of 21) that would allow $47,448.24 - not because it had been shown to actually benefit the bankruptcy estate, but because arguably that amount would have been authorized at the time even if Dr. Sommer had disclosed the relevant facts, including the debtor's deteriorating finances, and because of a lack of objection to that dollar amount. *See also* dkt. 206 (interim order preserving all rights).
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> At the hearing on 12/13/16 this court was persuaded to accept further evidence from Dr. Sommer and took this matter under submission. Now, having considered that further evidence, and as further explained below, the tentative ruling remains unchanged: to allow $47,448.24 and no more.
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> (a) Unauthorized transactions/overview. Some transactions do not require court authorization. Pursuant to 11 U.S.C. [§§] 363(c) and 503(b)(1)(A), debtors-in-possession and Trustees are authorized to enter into transactions, or use property of the estate, in the ordinary course of business without notice or a hearing absent a court order otherwise. Payroll is normally considered an expense made in the ordinary course of business.
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> But to the extent that Dr. Sommer used his own money for such payroll expenses, that amounted to either (i) a loan to the debtor, which required court authorization (s*ee* 11 U.S.C. [§] 364), or (ii) an advance to employees, which he did at his own risk. In either event, he is now asserting that he should be granted an administrative claim based on his advance of fund[s]. There are two problems with this approach.
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> First, just like his unauthorized use of cash collateral (*see* dkt. 139) [very limited authority to use of cash collateral] [*and, e.g.,* dkt. 159 at p. 2

(unauthorized use of cash collateral to repay loan by Dr. Sommer)], Dr. Sommer's advances of payroll expenses were in furtherance of a business model that appears on its face to be faulty, and in any event he has not borne his burden to show that the expenses of that model were reasonable and necessary. Specifically, Dr. Sommer caused the debtor to pursue genetic testing that was time consuming and expensive, and he never established that this resulted (or reasonably could be expected to result) in enough payments by insurers or patients to be profitable.

If he had obtained prior authorization for his transactions (after full disclosure) then the bankruptcy estate presumably would have borne the risk of a faulty business plan. But because Dr. Sommer acted on his own, without disclosure or authorization, he must show why retroactive authorization is appropriate.

Another problem (in addition to not showing an actual benefit to the estate) is that Dr. Sommer deprived all parties in interest of information from which they (and this court) could determine whether the debtor should undertake the risks he caused it to take. Put differently, by not disclosing what he was doing, Dr. Sommer masked the true financial circumstances of the debtor.

If creditors and the U.S. Trustee had this information they could have addressed the situation months ago - either by taking remedial steps or, if that were not possible, by seeking to convert the case before the bankruptcy estate used up much of its available cash. For example, when the U.S. Trustee filed its motion to dismiss or convert this case on 6/1/16 (dkt. 83), it was known that the debtor had not paid certain payroll taxes but, unbeknownst to the court and creditors, it also could not make payroll without Dr. Sommer's advances (dkt. 83, Ex. 1&2, especially PDF p.13). *See also* dkt. 123 (order denying U.S. Trustee's motion).

With this background, this court turns to the statutory standards for an administrative claim.

(b) Administrative claims under section 503(b).

Under 11 U.S.C. [§] 503(b)(1)(A) administrative expenses include the "actual, necessary costs and expenses of preserving the estate ...." (Emphasis added.) Dr. Sommer has not shown that his expenses were "necessary" for "preserving" the estate. To the contrary, based on the record before this court his acts apparently depleted rather than preserved the estate, and in any event he has not shown that expenditures in furtherance of his business plan were "necessary" to preserve the estate.

Under 11 U.S.C. [§] 503(b)(3)(D), administrative expenses also include the expenses of a creditor in making a "substantial contribution" in the case. But, again, Dr. Sommer has not shown how the funds that he advanced in fact made any contribution to the bankruptcy estate, let alone a "substantial" contribution.

(c) Conclusion as to Dr. Sommer

The tentative ruling on his motion (dkt. 196) remains unchanged: to allow $47,448.24 and no more. The chapter 7 trustee should lodge an appropriate order pursuant to the usual procedures.

[Administrative Expense Order, dkt. 264 (emphasis altered)]

(f) The Reconsideration Motion

After Dr. Sommer filed his motion for reconsideration of the Administrative Expense Order (the "Reconsideration Motion," dkt. 286), both Wells Fargo and the Trustee filed responses (dkt. 294 and 295). Pursuant to the usual procedures of the undersigned, the Reconsideration Motion was taken under submission.

(2) Legal standards

The Reconsideration Motion is brought under Rules 59 and 60(b), made applicable by Rules 9023 and 9024. Dkt. 286, p. 2:8-10. As Dr. Sommer acknowledges, he must show that relief is justified by "mistake, inadvertence, surprise, or excusable neglect" or "any other reason justifying relief" or to "prevent injustice" or correct a "clear error of law or fact." Dkt. 286, MPA pp. 9:24-10:20 (PDF pp. 12-13) (citations omitted).

Dr. Sommer also cites Local Bankruptcy Rule 9013-4. This court does not interpret that rule as attempting to expand national Rules 59 and 60(b), and even if it did that would be impermissible. *See In re Hung Tan Pham*, 250 B.R. 93 (9th Cir. BAP 2000). In any event, even if the local rule were to establish any additional grounds for reconsideration, it would not change the following analysis.

(3) Analysis

Dr. Sommer asserts that this court had an "unjustified prejudice" against him and, more generally, he alleges "irregularity," "abuse of discretion," "insufficiency of evidence to justify decision," and "errors of law." Dkt. 286, MPA at p. 3 (PDF at p.6), lines 20-23 (tracking Local Rule 9013-4). Dr. Sommer claims that this court disregarded "<u>abundant evidence presented to the Court that showed profit, profitability and a feasible business plan</u>." Dkt. 286, MPA at pp. 3:24-4:1 (PDF at pp. 6-7) (emphasis added).

(a) Dr. Sommer fails to cite any <u>specific</u> evidence in the record, which by itself is fatal to his Reconsideration Motion

Dr. Sommer's Reconsideration Motion is most notable for what it does not do: it fails to point to any specific evidence in the record that would support his assertions.

Instead he refers vaguely to all financial data in the record and he expects the other parties and this court to hunt through that data for something relevant:

> Abundant financial data (the 'Financial Data') exists in the record, in addition to the D'Amato [Business Plan] and [the CPA Cash Flow Analysis]: These consist of MORs [Monthly Operating Reports]; evidence of billing and revenue results from the Debtor's billing; the Reports submitted by the Trustee to the Court at the status conferences held on July 5, August 2, September 12 and October 14, as well as Declarations filed by Dr. Sommer himself, compiling and summarizing operating results, and reporting on progress toward reorganization. [Dkt. 286, MPA at p. 17 n. 8 (emphasis added)]

Even on the few occasions when the Reconsideration Motion alleges specific facts, it fails to cite to any part of the record that supports those allegations. For example, Dr. Sommer states in a footnote, "Collections for July 2016 were approximately $125,000" and "approximately $135,000" August of 2016," but there is no citation to any evidence supporting these numbers. Dkt. 286, n. 11, at p. 28:24-26. At another point he states, "As the Financial Data show, in the six months from July to December, more than $600,000 was received from insurance companies" while generating receivables of over $2.8 million (dkt. 299, p. 2:8-10 & p. 8:10-9:1); but again he fails to cite any evidence in the record.

There are over 300 filed documents on the docket of this case (plus more documents in the adversary proceeding). The "Financial Data" consist of dozens of (unspecified) documents on that docket, amounting to hundreds of pages.

Dr. Sommer's attempt to place the burden on other parties and this court to hunt through the record is rejected. It is his burden to show both (a) why his expenses were "actual" and "necessary" expenses of preserving the estate and (b) also, in the context of a motion for reconsideration, why he did not point to any such evidence before. His failure to cite to evidence in the record is a sufficient basis, by itself, to deny his motion for reconsideration. *See, e.g., Independent Towers, WA v. Washington,* 350 F.3d 925, 929-30 (9th Cir. 2003) (argument forfeited when it was based on "spaghetti approach" of "heav[ing] the entire contents of a pot against the wall in hopes that something would stick").

(b) Alternatively, this court's own review of the record shows that Dr. Sommer has failed to meet his burden of proof

Dr. Sommer has the burden to show that his expenditures were "necessary" costs of preserving the bankruptcy estate, notwithstanding the Trustee's business judgment to the contrary. In addition, he must show a clear error of law or fact, or other grounds for reconsideration.

When Dr. Sommer filed his Administrative Expense Motion this court extensively reviewed the record, and concluded that Dr. Sommer has not carried his burden. He still has not carried that burden now, in his Reconsideration Motion. If anything, the record shows that he caused substantial harm to the bankruptcy estate.

(i) Overcommitting the debtor did not benefit the estate

According to the Business Plan, the debtor's billing increased postpetition by 540%. Dkt. 192, Ex. B, pp. 6-7 of 14. Dr. Sommer touts this huge increase as if it were a good thing, but he ignores the fact that it greatly overcommitted the debtor.

True, signing up more patients would almost instantly increase billings because "we bill very soon" after obtaining "samples" of their DNA. Dkt. 283 (Tr. 12/13/16) pp. 25:18-26:2; *and see* dkt. 284 (Tr. 1/17/17) pp. 11:23-12:8. But the debtor was billing for work that it had not yet performed.

Dr. Sommer testified, "it should take about four to five months to do the testing" but as to "the patients that were ascertained in September, it's more than a year before it gets done, if everything continues [*i.e.,* without more staffing]." Dkt. 283 (Tr. 12/13/16) pp. 25:18-26:2; *and see also* dkt. 299, p. 10:2-5. Meanwhile, the debtor would have already collected whatever it was able to collect for those services. *See* CPA Cash Flow Analysis, dkt. 191, Ex. C, Assumption D (at dkt. 191-3, PDF p. 12) (projecting future collections stretching for 6 month period after billing); *and see also* Business Plan, dkt. 192, pp. 3:17-4:1 and Ex. B, p. 9 of 14, top line.

This placed the debtor at a substantial risk of liability arising from its over-commitments. Dr. Sommer's own purported expert, Mr. D'Amato, concedes that without

substantial increases in resources and staff the debtor was headed for "business failure because of the inability to complete the existing workload, attrition of some or all of the existing staff, and potential clawbacks by insurance companies for services that aren't rendered or are incomplete." Dkt. 192, pp. 3:17-4:1 (emphasis added).

In other words, far from benefitting the debtor, vastly increasing billings without being able to do the work exposed the debtor to potentially vast liability.

(ii) The debtor's alleged success stories are unsubstantiated, and in any event there is no showing that any medical successes resulted in a viable business

Dr. Sommer points to alleged success stories (*e.g.,* dkt. 299, pp. 3:1-5:15). It is difficult to know if these really were successful outcomes. There is no verification by any third party with appropriate expertise.

But assuming without deciding that the debtor really did have some notable medical successes, there is still no information that would show how these individual stories are relevant for bankruptcy purposes. For example, there is no data about the costs of these particular services, how much the debtor was paid in return for those services, or any other way to measure whether these stories, however heartwarming, resulted in any ability to pay creditors. Moreover, supposing for the sake of discussion that these individual instances really do reflect instances of success (both medical and financial), Dr. Sommer fails to show that these particular instances are indicative of an overall change in the debtor's financial prospects.

In other words, Dr. Sommer has not made the link between individual medical stories and his assertion that his unauthorized expenditures were "necessary" to preserve this bankruptcy estate.

(iii) Dr. Sommer has not shown that the debtor could spend its way to profitability

Dr. Sommer relies heavily on the Business Plan for the proposition that, if more resources and staff were provided, then the debtor would become profitable. But the Business Plan is a projection for the future based on assumptions.

For example, it assumes a future collections rate of 33-40% of billings (dkt. 192, Ex. B, p. 6 of 14), which is higher than the debtor's historical collections of 27.5% or less in 2015. Dkt. 183 (Tr. 11/29/16), p. 2:8-9 & p. 6:4-11; dkt. 192, Ex. B (Business Plan), p. 9 of 14 (11 lines down from top) ("Revenue collected Post-Petition Billings" based on "Assuming collections are N% of billed amount ….") (emphasis added).

The Business Plan's projected range of 33-40% turned out to be overly optimistic. Revised projections from MED-Billing Solutions reduced the range to between 30% and 35% (dkt. 183, p. 2:11-12) and the CPA Cash Flow Analysis used an estimated 30%. Dkt. 191, Ex. C, Assumption "C" to cash flow projections (at dkt. 191-3, PDF p. 12). *See also id.* at dkt. 191-3, PDF p. 14 of 17. At best, as the Trustee has pointed out, the debtor's "billings and collections are sporadic and unpredictable." Dkt. 171, p. 3:1.

Almost no actual collections data is provided by Dr. Sommer, and what is provided is cherry-picked and misleading. For example, his initial arguments (dkt. 286, n. 11, at p. 28:24-26) focus on two months in which collections were over $100,000 (July and August of 2016) while disregarding the much lower collections for the following month and almost every other month on which his Business Plan was based. *See* Business Report, Ex. B, Appendix A, p. 29 (dkt. 192) (postpetition collections of only $132.60 for May 2016, $12,998.00 for June 2016, and $40,226.28 for September 2016, as well as low collections for six months prepetition).

His later arguments (dkt. 299, p. 2:8-10 & p. 8:10-9:1) point to the "six months from July to December" in which "more than $600,000 was received from insurance companies." But that averages collections of only about $100,000 per month ($600,000

÷ 6 months = $100,000/mo.), and it actually compares poorly against the greatly increased $2.8 million in billings over that same period. If anything, $600,000 in collections over six months appears to be a decrease in the percentage of collections: $600,000 ÷ $2.8 million = 21%, which is far less than the 33-40% assumed by the Business Plan.[2]

Moreover, assuming for the sake of discussion that the debtor could maintain a meaningful increase in its rate of collections in future, any benefit would be reduced if not eliminated by related expenses. The Business Plan acknowledges:

> *Billing & Collections*
> Billing and collection of MEDomics services to insurance companies is the key source of income for the Company. Almost every procedure (97%) that MEDomics bills is submitted to a patient's insurance company. Only three percent of patients pay cash for MEDomics services.
> Submitting claims, following-up with requests of info, re-submitting, and following-up for payment requires coordination of internal resources as well as from their [recently hired] medical billing company, Med-Billing Solutions (Simi Valley, CA).
> Med-Billing Solutions charges five percent of the total amount collected. The goal for Med-Billing Solutions is to reduce the aging of the account receivables and to maximize the collection percentage. Currently the collection percentage is approximately 32% of billed claims. However, conversations with Med-Billing Solutions indicate that 33-40% is reasonable to expect if more resources and dedicated staff can be applied to the claims process. [Dkt. 192, Ex. B, p. 6 of 14]

In other words, not only does the Business Plan assume an increase the rate of collections over both historical and postpetition experience, but it is predicated on a substantial increase in expenditures on collections, both external (the 5% charge by newly hired Med-Billing Solutions) and internal (more administrative staff "dedicated" to the collection process). Any net benefit to the debtor is speculative.

In addition, the Business Plan presumes a huge increase in staff to do the genetic testing, for two reasons. First, the debtor's staff were already overworked: "Dr.

[2] The calculation of percentage collections is not straightforward, because of lag times between billing and collections, and because of any later clawbacks, so the crude calculation in the text is only a very rough illustration. But the point is that Dr. Sommer has not provided those calculations at all, let alone shown that they are in his favor, and on their face they appear to show that if anything the rate of collections decreased.

Sommer is working over 110hrs/wk which is not sustainable" and "Current Admin staff cannot sustain the increased workload," not just from billing but also from "operations [and] intake." Dkt. 192, Ex. B, p. 8 of 14. Second, a lot more resources and staff would be needed to handle "the huge number of patients" that Dr. Sommer had signed up. Dkt. 191, p. 17, n. 3. The amount of additional work is not specified, but if the debtor's billing accurately tracked its increased commitments then the amount of genetic testing would have to increase roughly 540% from prepetition levels, requiring a huge increase in resources and staff devoted to genetic testing. Dkt. 192, Ex. B, pp. 6-7 of 14; *and* dkt. 192-2 at PDF p. 11.

Historically the debtor lost money. So the burden is on Dr. Sommer to show why the debtor somehow will become profitable by increasing volume 540%. His premise seems to be, as the old joke puts it, "we'll make up in volume what we lose on each sale." *See, e.g.,* https://forum.wordreference.com/threads/make-it-up-on-volume.2246666/ (similar version) (last checked 6/24/17).

(iv) The CPA Cash Flow Analysis likewise is based on unsupported assumptions

The CPA Cash Flow Analysis discloses that "[b]illing and revenue estimates are based on assumptions made by the Debtor and its personnel, specifically Dr. Steven Sommer," and the CPA "cannot verify the accuracy of these estimates." Dkt. 191, pp. 35-36, nn. 30 & 31. For example, the estimate of salaries and wages is based on Dr. Sommer's assumptions about the number of employees and their salaries, which are unspecified except that the headcount will need to increase over time from 6 to 47. *See* dkt. 191, Ex. C, p. 68 and "Reference"/"Assumption" F (at dkt. 191-3, PDF p. 12).

In sum, the CPA Cash Flow Analysis adds nothing because, just like the Business Plan, it is based on Dr. Sommer's assumptions. Those assumptions are unsupported.

(None of the foregoing discussion should be taken to denigrate in any way the work that was performed by the CPA or others. The point is, their work can only be as good as the information or assumptions supplied by Dr. Sommer.)

(v) Dr. Sommer has not shown that his specific expenditures were "necessary" to administering this estate

As this court stated in the tentative ruling prior to the December 13, 2016 hearing, courts have generally interpreted the "actual" and "necessary" requirement as a question of whether a transaction with the bankruptcy estate "directly and substantially benefitted the estate." *Collier on Bankruptcy,* ¶ 503.06 (16th ed. 2016); *see also Microsoft Corp. v. DAK Indus., Inc.,* 853 F.2d 700, 706 (9th Cir. 1988). As set forth at greater length in this court's tentative rulings and in the parties' briefs, the statute's authorization to pay administrative expenses is to be construed narrowly and applied cautiously. See dkt. 219, pp. 2:17-4:10.

Dr. Sommer seeks $30,841.26 for "Operating Expenses." Dkt. 287, at PDF p. 2 (second column). He fails to explain how these alleged expenses "directly and substantially benefitted the estate" beyond what the Trustee has agreed to pay. For example, this category appears to include numerous payments to Google the purpose of which is unspecified. *See, e.g.,* dkt. 287, at PDF p. 4 (listing payments of $225, $500, $401.81 to Google in May of 2016). Listing expenses without explaining them does not meet his burden to show a direct and substantial benefit to the estate.

Dr. Sommer also seeks $79,655.33 for salary advances, mostly in the first four months of this case, but continuing for seven months. Dkt. 287, at PDF p. 2 (second column). Again, he has failed to show that he "directly and substantially benefitted the estate" by these advances, which include overtime pay to handle the work to which Dr. Sommer overcommitted the debtor without authorization, and hiring employees that the Trustee told him not to hire.

Finally, Dr. Sommer seeks $29,900.29 for attending conferences, which helped him sign up more patients. Dkt. 287, at PDF p. 2 (first column). He has failed to show

that signing up more patients benefitted the bankruptcy estate "directly and substantially." To the contrary, he appears to have greatly harmed the estate by overcommitting the debtor.

(vi) Dr. Sommer's other arguments lack merit

Dr. Sommer's other assertions – such as claiming "unjustified prejudice," "irregularity," and "abuse of discretion" – appear to be premised entirely on overlooking his repeated disregard of his fiduciary duties, the Trustee's instructions, and this court's directions, as set forth above. His arguments lack merit.

(4) Conclusion

For the foregoing reasons, and the additional reasons stated by Wells Fargo and the Trustee (dkt. 294 and 295), this court is not persuaded to depart from the Administrative Expense Order. This court will issue a separate order that Dr. Sommer's Reconsideration Motion is DENIED.

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Date: June 28, 2017

Neil W. Bason
United States Bankruptcy Judge