

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

|                             |   |                             |
|-----------------------------|---|-----------------------------|
| IN RE:                      | ) | Chapter 11                  |
|                             | ) |                             |
| INTEGRATED HEALTH SERVICES, | ) | Case Nos. 00-389 (MFW)      |
| INC., et al.,               | ) | through 00-825 (MFW)        |
|                             | ) |                             |
| Debtors.                    | ) | (Jointly Administered Under |
|                             | ) | Case No. 00-389 (MFW))      |

---

**MEMORANDUM OPINION**<sup>1</sup>

This case is before the Court on the Application of Integrated Health Services, Inc. ("IHS") and its affiliates (collectively "the Debtors") for an order approving a settlement agreement reached with Dr. Robert N. Elkins, the current President and Chief Executive Officer of IHS, pursuant to which Dr. Elkins will resign all positions with the Debtors and his employment agreement will be modified. The Application is opposed by the United States. After hearings held on November 28 and December 8, 2000, and briefing by the parties, we grant the Debtors' Application.

I. FACTUAL BACKGROUND

Dr. Elkins, a co-founder of IHS, has been CEO and Chairman of the Board since 1986. He served as President from 1986 to 1994 and from 1998 to present. His employment with the Debtors is covered by an employment agreement dated January 1, 1994.

---

<sup>1</sup> This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052, which is applicable to contested matters pursuant to Rule 9014.

Subsequent to the bankruptcy filing, the Official Unsecured Creditors' Committee ("the Committee") suggested that Dr. Elkins should be replaced with an executive with more experience in turnaround management and reorganizations. After extensive negotiations among the Debtors, the Committee, and Dr. Elkins, a settlement was achieved which resolved issues regarding the termination of Dr. Elkins' employment agreement, his claims against the estates, the claims of the estates against him, his relatives and affiliates, and the retention of Joseph Bondi as Chief Restructuring Officer for the Debtors.

The settlement agreement originally provided that:

(1) Dr. Elkins will resign all positions with the Debtors and be paid any salary and other obligations due through the closing date; (2) Dr. Elkins will be subject to a one year non-compete with respect to all Debtors; (3) Dr. Elkins will consult with the Debtors for 100 hours over the next year; (4) Dr. Elkins will waive all claims against the Debtors, including his shareholder interests; (5) the Debtors will pay Dr. Elkins \$1,494,000 and transfer certain personal property to him (consisting of artwork worth over \$1 million); (6) the Debtors will forgive loans made to Dr. Elkins totaling over \$34.5 million and the Debtors will pay withholding taxes (approximately \$18.9 million) on the income realized by Dr. Elkins as a result of that forgiveness of debt; and (7) the Debtors will release and indemnify Dr. Elkins, his

relatives and affiliates<sup>2</sup> and will include those parties in any releases or injunctions included in the plan of reorganization.

The Debtors filed an Application for approval of the settlement agreement with Dr. Elkins on July 27, 2000. Objections were filed by Buchanan/SCC, Inc., the United States Trustee ("the UST"), Robert Mills and related parties, certain tort claimants, and the United States. By the November 17 hearing, all objections except the United States' had been resolved and an amended settlement agreement had been filed. That amendment provided additional benefits to the Debtors: (1) Dr. Elkins will not receive the artwork worth over \$1 million; (2) Dr. Elkins and his wife will grant the Debtors an option to acquire their interest in Monarch for \$1 at any time prior to the effective date of the Debtors' plan of reorganization and the Monarch entities will not be included in the releases; and (3) the term of Dr. Elkins' non-compete agreement will be three years.

At the conclusion of the November 17 hearing we continued the hearing to permit the Debtors to present additional testimony

---

<sup>2</sup> The other released parties include Dr. Elkins' spouse, her son, his mother, and the following corporations in which Dr. Elkins has an interest: Platinum Health Plan, LLC; Lifeway Partners, LLC; RNE Skyview LLC; RNE Partners, LLC; Matrix Care, LLC; Elkins and Nicholson Investment Group; Integrated Properties; Woods Drive, Inc.; and Commerce Drive, Inc. ("the Elkins Released Parties"). Originally the releases included Monarch LLC, MAC, Monarch LP, Monarch Jacksonville and their affiliates (collectively "Monarch"), but they were deleted as part of the amendment. The relationship of Dr. Elkins to each of the Elkins Released Parties and their relationship to the Debtors is described on Exhibit D-12.

in support of the settlement.<sup>3</sup> The continued hearing was held on December 8, 2000.

## II. JURISDICTION

This Court has jurisdiction over this core proceeding pursuant to 28 U.S.C. §§ 1334 and 157(b)(1), (b)(2)(A), (B), (C), (M) and (O).

## III. DISCUSSION

Settlements are subject to approval pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure. They require the Court to balance the value of the various claims by and against the estate that are sought to be compromised. Myers v. Martin (In re Martin), 91 F.3d 389, 393 (3d Cir. 1996). The Court in Martin recognized "four criteria that a bankruptcy court should consider in striking this balance: (1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors." Id. (citing In re Neshaminy Office Bldg. Assocs., 62 B.R. 798, 803 (E.D. Pa.

---

<sup>3</sup> At the November 17 hearing, the Debtors presented the testimony of Mr. Bondi who had only recently been hired by the Debtors and had not been involved in the investigation of the validity of the claims of the Debtors and Dr. Elkins or the negotiated settlement. Therefore, his testimony was premised largely on hearsay and advice of counsel.

1986)). See also Protective Comm. for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968).

In approving a settlement the Court is not to determine that the settlement is the best that can be achieved by the debtor. "The responsibility of the bankruptcy judge . . . is not to decide the numerous questions of law and fact raised . . . but rather to canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'" Cosoff v. Rodman (In re W.T. Grant Co.), 699 F.2d 599, 608 (2d Cir. 1983) (quoting Newman v. Stein, 464 F.2d 689, 693 (2d Cir. 1972)).

The United States objects to the reasonableness of the settlement; it asserts that the benefit to Dr. Elkins of the settlement exceeds \$54 million while the Debtors are getting virtually nothing. Under the settlement, Dr. Elkins is receiving approximately \$1.5 million in cash, the forgiveness of \$34.5 million in loans and payment of income taxes he owes of \$18.9 million. The United States asserts that the Debtors are receiving precious little in return and that consequently the settlement is not reasonable. The Debtors dispute this, and at the hearings held on November 17 and December 8, 2000, they presented testimony in support of the settlement.

In accordance with the standards for approval of settlements, we review the issues, without deciding them, to determine whether the settlement falls "below the lowest point in the range of reasonableness." Newman, 464 F.2d at 693.

A. Cash payment of \$1.5 million

The United States asserts that even the amount of the cash payment to Dr. Elkins exceeds the amount of any claim he would have if he were simply terminated by the Debtors. Pursuant to section 502(b)(7) of the Bankruptcy Code, any claim of an employee for damages under an employment agreement is limited to one year's salary. See, e.g., In re Visiting Nurse Ass'n, 176 B.R. 748, 751 (Bankr. E.D. Pa. 1995). Dr. Elkins' annual compensation is only \$809,935.<sup>4</sup>

The Debtors assert that the determination of Dr. Elkins' claim is not so simple. Dr. Elkins has asserted that some of his claims are not subject to the cap under section 502(b)(7) of the Bankruptcy Code. For example, Dr. Elkins has asserted a claim of over \$26.5 million under the Supplemental Executive Retirement Plan ("the SERP") which he asserts is in the nature of retirement benefits and, therefore, not subject to the cap. See, e.g., Folson v. Prospect Hill Resources (In re Prospect Hill Resources, Inc.), 837 F.2d 453, 455 (11th Cir. 1988) (claim for vested retirement benefits is not subject to section 502(b)(7) cap); In re Irvine-Pacific Commercial Ins. Brokers, Ins., 228 B.R. 245, 248 (B.A.P. 9th Cir. 1998) (same); In re Rexene Corp., 183 B.R. 369 (Bankr. D. Del. 1995), rev'd on other grounds, 1996 WL 571545 (D. Del. 1996); In re CPT Corp., Bankr. No. 4-90-5759, 1991 WL

---

<sup>4</sup> Although Dr. Elkins has a bonus provision in his agreement, there was no evidence that the Debtors would meet the earnings threshold required for him to earn that bonus in 2000. He received no bonus in 1999.

255679, at \*4 (Bankr. D. Minn. Nov. 26, 1991) (same). While the cases cited by Dr. Elkins may be distinguishable (since they did not involve the termination of an employee post-petition), the Debtors acknowledge that there is at least a litigable issue that may result in a claim by Dr. Elkins which substantially exceeds the section 502(b)(7) cap or the amount provided in the settlement agreement.

In addition, Dr. Elkins asserts a claim in excess of \$1 million as an administrative claim because he asserts that part of his severance claim is based on services rendered by him post-petition. See, e.g., In re Roth American, Inc., 975 F.2d 949, 952 (3d Cir. 1992); In re Allegheny Int'l, Inc., 118 B.R. 276, 278 (W.D. Pa. 1990); Cramer v. Mammoth Mart, Inc. (In re Mammoth Mart, Inc.), 536 F.2d 950, 954 (1st Cir. 1976). The Debtors disagree with that position, but they concede that the issue is a contested one.

B. Forgiveness of loans of \$34.5 million

The United States asserts that the forgiveness of the loan debt owed by Dr. Elkins to the Debtors (\$34.5 million) is clearly excessive and not justified.

The Debtors respond that the loan debt is not debt arising from the rejection of an employment agreement, but is a separate debt arising under a program established to encourage the Debtors' highest paid executives to purchase stock in the company. Even if it is viewed as part of Dr. Elkins' employment

agreement, the debt is not being forgiven as a result of the settlement, but is merely a consequence of the termination of the employment agreement. Under the terms of the notes themselves, the loans to Dr. Elkins are forgiven over time according to a set formula. If, however, Dr. Elkins is terminated without cause by the Debtors, the loans are immediately forgiven in full. Unless the Debtors are able to terminate Dr. Elkins for cause,<sup>5</sup> they will never be able to collect the loans from him. Thus, the Debtors assert that the debt owed by Dr. Elkins under the notes is illusory, not collectable and its forgiveness does not affect any material rights of the Debtors.

C. Payment of \$18.9 million in withholding taxes

The United States argues that the Debtors' agreement to pay \$18.9 million in withholding taxes for Dr. Elkins is unreasonable and is equivalent to paying that amount to Dr. Elkins.

The Debtors presented the testimony of Peter Elinsky from KPMG who stated that the forgiveness of the loans of \$34.5 million resulted in income to Dr. Elkins for which taxes of approximately \$18.9 million are due. Mr. Elinsky testified that the Debtors are obligated to pay such withholding taxes independently of Dr. Elkins. See, e.g., 26 U.S.C. § 3403.

---

<sup>5</sup> Under his employment agreement, Dr. Elkins can be terminated for cause only if (1) he is convicted of a felony involving moral turpitude or (2) he commits willful gross neglect or misconduct resulting in material economic harm to IHS unless he believed in good faith that his actions were in IHS' best interests.

Although the payment of those taxes may benefit Dr. Elkins, the Debtors' failure to pay them would subject the Debtors to possible penalties and interest.

In addition, Dr. Elkins has asserted that, if the Debtors pay the withholding tax, they cannot seek contribution from him. (See Exhibit D-13, a memorandum of law dated November 8, 2000, from Dr. Elkins' counsel supporting that position.) While the Debtors do not concede this point, it is another litigable issue. Even if the Debtors are correct and they can assert a claim for contribution against Dr. Elkins, they may never collect it. As noted above, Dr. Elkins has asserted substantial claims against the Debtors (in excess of \$40 million). He has also asserted that he has the right to recoup or setoff those claims against any claim the Debtors may have against him, including any claim for contribution on account of the tax claims. Further, Dr. Elkins, in his deposition and in a statement (Exhibit US-1), has stated that he does not have sufficient non-exempt assets to pay that tax obligation and the other tax obligations which will arise as a result of the loan forgiveness.

Thus, the Debtors assert that they have an independent obligation to pay the withholding tax and have no realistic possibility of recovery from Dr. Elkins. Therefore, the Debtors' agreement to pay the taxes as part of the settlement does not create any additional burden on the Debtors and avoids the imposition of post-petition penalties and interest.

D. Non-compete

The United States argues that the non-compete provision of the settlement agreement is really of no benefit because Dr. Elkins is already bound by a non-compete provision in his existing employment agreement. Although the employment agreement bars competition only with IHS, the United States asserts this is all the Debtors really need since there is no evidence that Dr. Elkins could compete with the Debtors' other businesses (such as RoTech). Dr. Elkins has no experience in those areas, and he has testified that he has no present intention to compete against any of the Debtors.

The Debtors argue that the new non-compete is broader than that in the employment agreement, since it covers all the Debtors' businesses, not just IHS, and is for three years instead of one year. Although Dr. Elkins has had no experience in the RoTech business, the Debtors argue that he has proven able to start a business from scratch and build it into a large successful business, just as he did with IHS.

More significantly, however, the Debtors assert that there is a danger that if they reject the employment agreement with Dr. Elkins (or do not fully perform under it), they will not be able to enforce the non-compete provision in that agreement. Dr. Elkins has cited cases which specifically provide that non-compete agreements are not enforceable against a former employee if the employer has breached the employment agreement. See, e.g., Pollard v. Autotote, Ltd., 852 F.2d 67, 71 (3d Cir. 1989);

McCann Surveyors, Inc. v. Evans, 611 A.2d 1, 3 (Del. Ch. 1987); Knowles-Zeswitz Music, Inc. v. Cara, 260 A.2d 171 (Del. Ch. 1969). While those cases involve non-bankruptcy situations, the Debtors assert that the Bankruptcy Code provision which permits rejection or assumption of contracts generally provides that a debtor may not retain the benefits of an executory contract, while rejecting the onerous parts. See L.R.S.C., Co. v. Rickels Home Centers, Inc. (In re Rickels Home Centers Inc.), 209 F.3d 291, 298 (3d Cir. 2000) (debtors must reject executory contracts in their entirety and cannot keep benefits while shedding obligations); Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co., 83 F.3d 735, 741 (5th Cir. 1996) (same).

While the Debtors could argue that rejection of the agreement and the consequent allowance of a rejection damages claim is sufficient consideration to permit enforcement of the non-compete, Dr. Elkins may assert otherwise and insist that the Debtors must actually pay his claims for severance before the Court can conclude that there is consideration to support enforcement of the non-compete. See, e.g., McCann Surveyors, 611 A.2d at 3 (to enforce a non-compete agreement, the court must find that it is supported by consideration or a substitute for consideration).

Even if the Debtors are not required to assume or reject the employment agreement in whole (and can successfully extend the time within which they must make such a decision), the Debtors assert they would still be required to pay Dr. Elkins' salary

during the period within which they seek to enforce the non-compete. At Dr. Elkins' current salary, that would be \$2.4 million.

E. Releases

As part of the settlement, the Debtors are releasing claims which they may have against Dr. Elkins and the Elkins Released Parties. (See Exhibit D-12.) The Debtors proffered the testimony of their CFO, C. Taylor Pickett, who stated that the Debtors had dealings with only two of those entities and that the Debtors are unaware of any claims they may have against any of the Elkins Released Parties. They also proffered the testimony of James S. Feltman of Arthur Andersen, LLP ("AA"), the financial advisors to the Committee. Mr. Feltman testified that AA analyzed certain transactions between the Debtors and certain affiliates of Dr. Elkins (including RNE Skyview, one of the Elkins Released Parties) and concluded that the estate did not have claims resulting from those transactions.

The United States objects to the provision in the Order that would release claims of any other entity against Dr. Elkins, not just the Debtors' claims. Specifically, the United States objects to the release of any claims of third parties, including the United States, against Dr. Elkins or the Elkins Released Parties. The Debtors did not address this issue. It is clear from the agreement itself, however, that there is no present release of any claims against Dr. Elkins or the Elkins Released

Parties, other than claims which the Debtors or their estates may have. The agreement does require that the Debtors use reasonable efforts to include Dr. Elkins in any release granted in the plan of reorganization to the Debtors' directors and officers. Since the approval of the settlement agreement does not itself grant such a release, this issue need not be addressed at this time.

#### IV. CONCLUSION

Upon review of the settlement agreement as a whole, we conclude that it is reasonable. The Debtors presented testimony that they and the Committee investigated the best manner for terminating Dr. Elkins and retaining an experienced turnaround executive. Since termination for cause was not possible, the alternatives were a termination without cause or settlement.

In either of the latter events, the debt owed by Dr. Elkins in the amount of \$34.5 million would be automatically forgiven. That forgiveness of debt would create taxable income for Dr. Elkins and taxes of \$18.9 million. The Debtors would be obligated to withhold taxes in that amount. It is uncertain whether Dr. Elkins would be legally obligated (or financially able) to repay the Debtors for that tax payment.

Further, on termination of his employment agreement, Dr. Elkins would have a pre-petition claim against the Debtors of at least \$810,000. He asserts he would have a claim in excess of \$40 million and an administrative claim between \$1 million and \$26.5 million.

The issues are complex and it is unclear whether the Debtors would be successful or could collect if they were. The expense, delay and disruption to the Debtors caused by litigation with their founder, CEO and president is significant. The Debtors, Committee and lenders support the settlement; no other interested party, except the United States, has opposed it. Consequently, we conclude that the settlement agreement with Dr. Elkins is reasonable.

An appropriate Order is attached.

BY THE COURT:

Dated: January 3, 2001

\_\_\_\_\_  
Mary F. Walrath  
United States Bankruptcy Judge

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

|                             |   |                             |
|-----------------------------|---|-----------------------------|
| IN RE:                      | ) | Chapter 11                  |
|                             | ) |                             |
| INTEGRATED HEALTH SERVICES, | ) | Case Nos. 00-389 (MFW)      |
| INC., et al.,               | ) | through 00-825 (MFW)        |
|                             | ) |                             |
| Debtors.                    | ) | (Jointly Administered Under |
|                             | ) | Case No. 00-389 (MFW))      |

**O R D E R**

AND NOW, this **3RD** day of **JANUARY, 2001**, upon consideration of the Application of the Debtors for an Order Approving an Agreement with Dr. Robert N. Elkins, and the amendment thereto, and the Objection of the United States thereto, and after briefing by the parties and a hearing, it is hereby

**ORDERED** that the Debtors' Application is **GRANTED**; and it is further

**ORDERED** that the settlement agreement, as amended, between the Debtors and Dr. Robert N. Elkins is hereby **APPROVED**.

BY THE COURT:

---

Mary F. Walrath  
United States Bankruptcy Judge

**SERVICE LIST**

James A. Patton, Esquire  
Robert S. Brady, Esquire  
Joel A. Waite, Esquire  
Edmon L. Morton, Esquire  
YOUNG CONAWAY STARGATT & TAYLOR, LLP  
11th Floor, One Rodney Square North  
P.O. Box 391  
Wilmington, DE 19899-0391  
Counsel for Debtors

Michael J. Crames, Esquire  
Arthur Steinberg, Esquire  
Marc D. Rosenberg, Esquire  
KAYE SCHOLER FIERMAN HAYS & HANDLER, LLP  
425 Park Avenue  
New York, NY 10022-3598  
Counsel for Debtors

Joanne B. Wills, Esquire  
Steven K. Kortanek, Esquire  
Maria Aprile Sawczuk, Esquire  
KLEHR HARRISON HARVEY BRANZBURG & ELLERS LLP  
919 Market Street  
Suite 1000  
Wilmington, DE 19801  
Counsel for the Official Committee  
of Unsecured Creditors

Glenn Rice, Esquire  
William Silverman, Esquire  
OTTERBOURG STEINDLER HOUSTON & ROSEN, PC  
230 Park Avenue  
New York, NY 10169  
Counsel for the Official Committee  
of Unsecured Creditors

Michael R. Lastowski, Esquire  
DUANE, MORRIS & HECKSCHER, LLP  
1201 Orange Street, 10th Floor  
Wilmington, DE 19801  
Counsel for Buchanan/SCC, Inc.

Richard W. Wolfe, Esquire  
4800 Nob Hill Road  
Fort Lauderdale, FL 33351  
Counsel for Buchanan/SCC, Inc.

Susan B. Morrison, Esquire  
WILKES & McHUGH, P.A.  
Tampa Commons, Suite 800  
One North Dale Mabry Highway  
Tampa, FL 33609  
Counsel for Certain Tort Claimants

Benjamin C. Ackerly, Esquire  
Amy K. Dilworth, Esquire  
HUNTON & WILLIAMS  
Riverfront Plaza, East Tower  
951 East Byrd Street  
Richmond, VA 23219-4074  
Counsel for Robert Mills  
and related parties

Ellen Slights  
Assistant United States Attorney  
Chase Manhattan Center  
1201 Market Street  
Suite 1100  
P.O. Box 2046  
Wilmington, DE 19899-2046

J. Christopher Kohn, Esquire  
James G. Bruen, Jr., Esquire  
Matthew J. Troy, Esquire  
Attorneys Civil Division  
U.S. DEPARTMENT OF JUSTICE  
P.O. Box 875  
Ben Franklin Station  
Washington, DC 20044

Daniel K. Astin, Esquire  
Richard L. Shepacarter, Esquire  
OFFICE OF THE UNITED STATES TRUSTEE  
601 Walnut Street  
Curtis Center, Suite 950 West  
Philadelphia, PA 19106