

IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:)	Case No. 16-09373
Northwest Pediatric Services S.C.,)	Chapter 11
debtor/debtor-in-possession.)	Judge Cox

DEBTOR'S DISCLOSURE STATEMENT

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DEBTOR'S DISCLOSURE STATEMENT

Northwest Pediatric Services S.C. d/b/a Kid Care Medical S.C. an Illinois corporation, debtor/debtor-in-possession, ("Debtor") herein, submits this Disclosure Statement ("Disclosure Statement") pursuant to Section 1125 of the Bankruptcy Code, and in conjunction with its Plan of Reorganization ("Plan"), a copy of the Plan is attached to this Disclosure Statement as **Exhibit A**.

INTRODUCTION

The Debtor filed its voluntary petition for relief under Chapter 11 of the Bankruptcy Code on March 18, 2016 (the "Petition Date"). The Debtor has been operating its business and managing its financial affairs as a debtor-in-possession since the Petition Date. No trustee, examiner or committee of unsecured creditors has been appointed to serve in this reorganization case. The Plan is being filed within the exclusive periods established under Sections 1121(b) and 1121(d) of the Bankruptcy Code and prior Orders of the Bankruptcy Court. The Debtor is an Illinois corporation that operates eight (8) pediatric care facilities throughout the greater Chicago area. The Debtor employs approximately thirty-six people. The proposed Plan contemplates paying 100% of all debts.

On February 29, 2012, the Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code, known as case no. 12-07777 ("Previous Chapter 11 Case"), and on May 22, 2013, the Debtor confirmed its Third Plan of Reorganization (the "Previous Plan"). IRS and IDR were secured and priority unsecured creditors in the Previous Chapter 11 Case. Under the terms of the Previous Plan, IRS and IDR were to be paid twenty (20) payments over a five (5) year period. Each payment to the IRS was to be approximately \$138,000.

The Debtor made four (4) payments to the IRS and, upon information and belief, IDR and eleven (11) payments to all other creditors under the Previous Plan leaving nine (9) remaining payments to creditors other than IRS and IDR.

The Debtor defaulted under the Previous Plan due to the following reasons:

- A. Reduction of payment rate for HFS Medicaid providers, resulting in a rate reduction from Medicare to medicaid rates beginning 1/1/15, equivalent to a \$2.5 million annual loss to the Debtor, largely due to the failure of Congress to extend the Affordable Care Act and enhanced reimbursement rates;
- B. HFS outsourced payments for the six (6) Chicagoland counties to private insurance companies, causing payment delays, processing and quality control issues, and a complete payment stop by the Debtor's largest insurance company on September 1, 2015 for a period of three (3) months, resulting in lost revenue of \$1,663,872; and
- C. HFT reduced payments already owed for services already projected due to direct mandate of the State of Illinois budget balancing issues, resulting in an additional \$300,000 loss.

The Debtor is the proponent of the Plan. The Plan provides for distribution to the holders of Allowed Claims from the Debtor's operations.

Executory Contracts and Unexpired Leases

The Debtor is a party to eight (8) non-residential real estate leases and, three (3) service contracts. Upon information and belief, Debtor is not in default under any of its executory contracts.

Assumption means that the Debtor has elected to continue to perform the obligations under the contract or unexpired lease, and to cure defaults of the type that must be cured under the Bankruptcy Code, if any.

The Debtor currently has the following leases and executory contracts:

- a. 519 Dundee Road, East Dundee, IL 60110

- b. 1715 Algonquin Rd., Mt. Prospect, IL 60103 (the "Mt. Prospect Lease")¹
- c. 373 Summit St., Suites 100/101/104, Elgin, IL 60120
- d. 6620 N. Barrington Rd., Hanover Park, IL 60133
- e. 121 S. Wilke Rd., #605, Arlington Heights, IL 60106
- f. 2055 W. Army Trail Rd., #104, Addison, IL 60101
- g. 229 W. Grand Ave., Suite T, Bensenville, IL 60106
- h. 526 Main St., West Chicago, IL 60185²

(collectively, the "Business Leases"); and

- i. Service Agreement dated August 1, 2013 between the Debtor and Business Medical Solutions, Inc.;
- j. Service Agreement dated September 1, 2013 between the Debtor and EMR and ITS Records, Ltd.; and
- k. Service Agreement dated September 1, 2012 between the Debtor and Medical Support Solutions, Inc.

(collectively, the "Service Contracts")

The Debtor is unaware of any other executory contracts or unexpired leases. If you object to the rejection of your executory contract or unexpired lease or to the assumption of your executory contract or unexpired lease, the proposed cure of any defaults, or the adequacy of assurance of performance, you must file and serve your objection to the Plan within the deadline for objecting to the confirmation of the Plan, unless the Court has set an earlier time. The Debtor, at present, plans to assume all of the Business Leases and Service Contracts.

The deadline for filing a proof of claim based upon a claim arising from the rejection of a lease or contract through the Plan will be thirty days after the Effective

¹ The Debtor is not the tenant under the Mt. Prospect lease. The Debtor does operate at the Algonquin Road Address, but Dr. O is the lessee.

² Although the Debtor is currently intending to assume all of the Business Leases, the Debtor is still in the process of analyzing the economic viability of all of the Business Leases, and it is still possible some may be rejected prior to Confirmation of the Plan.

Date. Any claim based on the rejection of a contract or unexpired lease will be barred if the proof of claim is not timely filed, unless the Court orders otherwise. The Debtor shall have thirty (30) days after the filing of the proof of claim for rejection damages to object to the claim, if any.

Risk Factors

Certain risk factors are inherent in most commitments made pursuant to a Plan of Reorganization in a Chapter 11 case. If such plans are accepted, it is usually because they represent a greater hope for returns and dividends than in a liquidating Chapter 7 case. All of the risk factors inherent in commitments made pursuant to a Plan of Reorganization in Chapter 11 cases are present in this case.

The Debtor's business is dependent upon payment from the State of Illinois and insurance companies. This risk factor has been the cause of two Chapter 11 filings by the Debtor.

The Plan contemplates that the Debtor's current officers, Dr. O, Dr. Lucy Park and Dr. Rahkal Reddy will continue to be officers, and will continue to own the same percentage interests in the Reorganized Debtor. Dr O's experience with the Debtor and its patients has an incalculable value. Dr. O owns 90% of the outstanding shareholding interests.

SUMMARY OF TREATMENT OF CLAIMS AND INTERESTS UNDER THE PLAN

The Plan has one (1) category of Administrative Claims, eight (8) classes of creditors (Classes 1 through 8), and one (1) class of interests (Class 9). These Claims and Interests, and the treatments thereof, under the Plan consist of the following:

Class 1: The Allowed Secured Claim of the IRS in the amount of \$2,048,575.64 (the "IRS' Filed Secured Claim")³ will be paid 100%, with 3% interest, over a period of five

³ The Debtor believes that the IRS' Filed Secured Claim can be reduced by the amount of \$746,508.10, for two reasons. First, the Debtor has reason to dispute the priority of the "penalty to petition date" shown on the IRS' Filed Secured Claim. Second, the Debtor's collateral to which the IRS' Filed Secured Claim attaches has far less value than the IRS' Filed

(5) years from the Petition Date, in quarterly installments, beginning with the first quarter following ninety (90) days after the Effective Date, unless the IRS and the Debtor agree to different treatment. The Class 1 Claim of the IRS is unimpaired.

Class 2: The Allowed Secured Claim of Alexian Brothers Medical Center (“Alexian Brothers”) in the approximate amount of \$100,000. Alexian Brothers will be repaid quarterly payments of \$9780.18, beginning with the first quarter of 2017. Any post-petition arrearages will be added to the quarterly payment in the last two months of repayment to Alexian Brothers. The Debtor believes the amount of the arrearage is minimal. The Class 2 Claim of Alexian Brothers is impaired because Alexian Brothers will have to wait to be repaid any post-petition arrearages at the end of the loan period.

Class 3: Consists of the Allowed, Unsecured Priority 507(a)(4) Claims of the Debtor’s employees for wages earned within 180 days of the filing of the Previous Chapter 11 Case, but only to the extent of \$11,725 per employee. Class 3 is impaired under the Plan because these claims will not be paid with interest.

Class 4: Consists of the Allowed, unsecured, priority tax claims of the IRS in the amount of \$257,294.40. Class 4 is unimpaired because the IRS will be paid 3% interest on its claims, unless the IRS, IDES and the Debtor agree to a different treatment. Class 4 claim will be paid 100% of its claim in quarterly installments, beginning ninety (90) days after the Effective Date.

Class 5: The Allowed, Unsecured Tax Claims of IDR in the amount of \$172,589.03. Class 5 is unimpaired because IDR will be paid 3% interest on its claim, unless IDR and the Debtor agree to a different treatment. The Class 5 claim will be paid in quarterly installments beginning ninety (90) days after the Effective Date.

Secured Claim. As a result, the IRS’ Secured Claim will be repaid in the amount of \$1,302,067.54.

Class 6: Consists of the Allowed, Unsecured Non-Priority Pre-petition Wage Claims of the Debtor's employees in the Previous Chapter 11 Case. Class 6 is impaired because the employees will be paid 100% of their claims without interest, on a quarterly basis over a sixty (60) month period, beginning ninety (90) days after the Effective Date.

Class 7: Consists of Allowed, Unsecured, Non-Priority Claims of IRS and IDR, in the amount of \$828,349.57. Class 7 will be repaid 100% of their Allowed Claims over a five (5) year period, with quarterly payments beginning ninety (90) days after the Effective Date. Class 7 is impaired because no interest will be paid.

Class 8: Consists of all other Allowed, General Unsecured Claims will be paid quarterly 100% over a period of sixty (60) months beginning ninety (90) days after the Effective Date. Class 8 is impaired because all members of this class will be paid 100% of their claims, but without interest.

Class 9: Consists of the Debtor's Equity Holders, who will retain their interests.

Administrative Claims⁴

Administrative Claims are provided for in Article II, Section 2.1 of the Plan, and consist of the Allowed Claim for fees and expenses of the law firm of Crane, Heyman, Simon, Welch & Clar ("CHSWC"), counsel for the Debtor, employed pursuant to an Order entered by the Bankruptcy Court. The fees and expenses of CHSWC are projected to be approximately \$50,000 in excess of the pre-petition \$35,000 retainer paid to CHSWC, and an interim fee award in the amount of \$14,661.48.

CHSWC shall not be paid unless and until the Bankruptcy Court has entered appropriate orders allowing the compensation and reimbursement of expenses requested.

⁴ All amounts projected for professional fees are the Debtor's estimates and are, therefore, subject to change.

Equity Interests

Allowed Class 9 Interests: Class 9 Interests are not impaired under the Plan. Debtor's shareholders are Orawon Sukavachana, MD (90% interest), Lucy Park, MD (5% interest), and Rahkal Reddy, MD (5% interest). Under the Plan, the Debtor's shareholders shall retain their respective equity interests and Dr. O shall continue to manage the business.

Claims Objections

Except as otherwise ordered by the Bankruptcy Court or as otherwise provided in the Plan, the Debtor shall file any and all objections to the allowance of claims or interests on or within 120 days of Confirmation of this Plan, unless extended by Order of the Bankruptcy Court. Cause shall not be a requirement for an extension of this deadline.

PURPOSE OF DISCLOSURE STATEMENT

This Disclosure Statement is provided to all of the known holders of Claims against and Interests in the Debtor who are entitled to vote their acceptance or rejection of the Plan. This Disclosure Statement is disseminated in connection with the solicitation of acceptances of the Plan filed by the Debtor. The purpose of this Disclosure Statement is to provide such information as would enable a hypothetical, reasonable investor, typical of the holder of Claims and Interests which are impaired under the Plan, to make an informed judgment about the Plan.

The information contained in this Disclosure Statement has been submitted by the Debtor, unless specifically stated to be from other sources. No representations concerning the Debtor or this Plan, other than those set forth in this Disclosure Statement, have been authorized by the Debtor. The Debtor believes that all of the information contained in this Disclosure Statement is accurate. However, the Debtor is unable to warrant that there are no inaccuracies.

Under the Bankruptcy Code, a Class of Claims is considered to have accepted the Plan if both a majority in number and two-thirds (2/3) of the dollar amount of those actually voting vote to accept the Plan. The Claims of those who do not vote are not counted in determining whether the requisite statutory majority in number and dollar amount have voted for acceptance. Acceptance by the statutory majority will bind the minority who dissent and those who fail to vote.

The Plan requires that the holders of Allowed Claims in Classes 2, 3, 6, 7 and 8 vote on Confirmation of the Plan.

HISTORY AND BACKGROUND

In the Fall of 2011, the company was in severe financial distress due to the reasons discussed previously in this Disclosure Statement. In the Previous Chapter 11 Case, the Debtor's Plan was filed on January 8, 2013.

The reader's attention is directed to **Exhibit B**, attached hereto, which is the affidavit of Lawrence Kammes in support of the Debtor's Motion to Use Cash Collateral in the current Chapter 11 case, signed by Mr. Kammes on March 24, 2016 ("Kammes Affidavit").⁵ If Congress had passed the third year of the Affordable Care Act Enhanced Rate Program, the Debtor's income would have been sufficient to allow continued payment to the IRS under the Plan in the Previous Chapter 11 Case. However, the third year was not passed, sending the Debtor into a spiral of financial instability from 2012 until the present.

At the time of the filing of the Previous Chapter 11 Case, the Debtor employed approximately 178 employees. Within one year of the filing of the current Chapter 11 Case, the Debtor reduced its employees to 150. As shown in the Kammes Affidavit, the Debtor has successfully reduced the number of employees from 150 to 38. Additional staff

⁵ Lawrence Kammes was the Debtor's beloved and extremely competent financial advisor. Mr. Kammes' death in June of 2016 was a severe setback for the Debtor. He will be missed in many ways.

reductions are being implemented to ensure that all operating expenses are outsourced to commercial entities by contract, allowing the Debtor to consist solely of 9 - 12 Full Time Equivalent Medical Providers ("FTE"), who are billed as providers only, having no responsibility for any activity other than the delivery of medical services (pediatrics and obstetrics as appropriate). The transformation from a single entity employing 178 people to nine to 12 medical providers will make the Debtor profitable and capable of paying its outstanding Chapter 11 debt over a sixty (60) month period, or, in the case of tax debt, within five (5) years from the Petition Date.

The healthcare industry and the Affordable Care Act attempt to insure lower costs for the delivery of healthcare through the following means:

1. Motivating the industry to be paid for "good patient outcomes";
2. Moving away from a "fee for service" payment model to more of the HMO style now being used through the concept of Health Centers, pursuant to Federal law, capable of delivering healthcare for Medicaid and Medicare patients; and
3. Tort reform via the Federal Tort Claims Act ("FTCA"), separating the issue of each states' rights to control their respective court laws to allow entities to be protective from abusive lawsuits without the need for professional liability insurance.

In order to facility the Debtor's profitability, it is necessary for the medical providers to be contracted to other medical providers, called Managed Care Organizations ("MCO"), and other large insurance companies who comply with the ACA. The significant changes in the Debtor's payment sources and payment model were created after the Debtor's Plan was confirmed in the Debtor's Previous Chapter 11 Case.

In order to facilitate the Debtor's new business model, that of HRSA approved health centers, significant administrative review is required prior to being awarded approved

status. Prior to the Petition Date, the Debtor loaned money to entities named EMR and ITS, Ltd. ("EMR") in order to establish the first HRSA approved health center, since HRSA does not fund "start ups."

EMR has repaid the loan during the course of the Debtor's Chapter 11 Case with payments ranging from \$65,000 to \$220,000 per month. EMR is shown in the Debtor's statement of financial affairs as having been loaned \$2.2 million by the Debtor, and has repaid \$1,121,559.

With the loan to EMR was in place, the necessary funding to receive federal approval allowed the Debtor to continue downsizing. The objective was to leave only medical providers within the Debtor's organization available to contract with approved insurance companies, MCO's and other approved medical companies and hospitals. All of this allowed a process called "change of scope," to include additional health center locations, following HRSA guidelines.

The Debtor's plan of reorganization assumes that all operational expenses and contracts for services by the medical staff (providers) will be in full compliance with Federal law, subject to the HRSA approvals and oversight. In short, the Debtor has outsourced all of its operations except for the providing of medical services. The Service Contracts provide an insight into the outsourcing of each function.

SUMMARY

Exhibit F contemplates the Debtor as an entity with only 9 - 12 full time Equivalent Medical Providers, producing sufficient profits to pay all of the Debtor's plan obligations in full over five (5) years.⁶

⁶ Or, in the case of the IRS and IDR, whatever period of time remains of the five (5) year period beginning with the Petition Date.

OTHER ASPECTS OF THE PLAN

The Debtor shall be the disbursing agent charged with making the payments required under the Plan to the holders of Allowed Claims. Management of the Debtor will remain unchanged after Confirmation.

Upon Confirmation of the Plan, the Debtor shall be revested with its assets, subject only to the terms and conditions of the Plan. The Debtor shall be entitled to continue to operate and manage its business and financial affairs without further Order of the Bankruptcy Court. Payments to creditors pursuant to the Plan will be made from existing cash and from funds from continued business operations.

Upon Confirmation, an injunction under Section 524 of the Bankruptcy Code shall arise to prevent any party from foreclosing its lien or security interest or otherwise enforcing its Claims against the Debtor and its assets in this bankruptcy case except as authorized in the Plan. Such injunction shall not affect any secured creditor's right to foreclose upon any security interest provided in the Plan in the event of any post-Confirmation default under the Plan. This injunction will remain in effect until all distributions under the Plan have been made.

The Plan is self-executing. Upon payment as required by the Plan, any liens supporting such Claims shall be deemed released and discharged.

All executory contracts and unexpired leases which exist between the Debtor and any other party, whether such executory contract be in writing or oral, which has not been previously assumed, assigned, rejected or otherwise terminated by the Debtor shall be assumed upon Confirmation of the Plan pursuant to Sections 365 and 1123(b)(2) of the Bankruptcy Code. Any and all Claims asserted by any party arising from the rejection of executory contracts and unexpired leases pursuant to the Plan must be filed on or within thirty (30) days following the rejection. Further, with respect to Claims for default relating to any unexpired lease or executory contract that is assumed pursuant to the Plan, any and all such Claims must also be filed on or within thirty (30) days following Confirmation.

Allowed Claims emanating from the rejection of unexpired leases and executory contracts will be treated as Class 8 Claims. Allowed Claims for default emanating from the assumption of unexpired leases and executory contracts will be treated as Administrative Claims. Any person failing to file such a Claim within the time provided in the Plan shall be forever barred from asserting such Claim and shall not receive any distribution under the Plan. The provisions for assumption, assignment and rejection shall be equally applicable to executory contracts and unexpired leases of real and personal property.

The Bankruptcy Court shall retain jurisdiction for certain specified purposes. Any distribution under the Plan that remains unclaimed sixty (60) days after the distribution is made will become property of the Debtor, and will not be recouped in subsequent distributions. The Debtor will have the right to make any distribution to creditors earlier than required by the Plan. The Debtor shall have the right, power and authority after Confirmation of the Plan to commence any preference, fraudulent conveyance or other litigation it deems appropriate.⁷ The Bankruptcy Court shall retain jurisdiction for such litigation.

The provisions of the Plan shall bind all creditors, Interest holders and parties in interest. Except as expressly provided in the Plan or the Bankruptcy Code, no interest or penalties accruing on or after March 18, 2016, shall be paid on any Claim nor shall any creditor claiming any such interest or penalty be entitled to have its Claim for interest or penalty allowed for payment. To the extent necessary, pursuant to Section 1129(b) of the Bankruptcy Code, the Debtor intends to request that the Bankruptcy Court confirm the Plan if all applicable requirements of Section 1129(a) of the Bankruptcy Code, other than Section 1129(a)(8), are met.

⁷/ The Debtor believes that no such litigation claims exist.

LIQUIDATION ANALYSIS

Failure of the Debtor to obtain Confirmation of the Plan could result in a forced liquidation or a conversion to a case under Chapter 7 of the Bankruptcy Code and immediate termination of the Debtor's business operations. Under the Plan, all creditors are being paid 100% of the allowed amount of their Claims. Therefore, by definition, creditors are receiving as much or more than they would receive in a forced liquidation.

In the event of a forced liquidation, any proceeds realized from liquidation of the Debtor's assets will first be used to pay the costs of collection, which for purposes of this discussion, the Debtor has estimated to be an amount equal to 10% of the gross collection proceeds. Once the costs of collection have been paid, Secured, Administrative and Priority Claims will be paid. Only after making the above disbursements of liquidation proceeds could any distribution be made to general unsecured creditors. In this case, the Debtor has secured claims in excess of \$2 million, and assets having a liquidation value of only \$1.5 million.

Clearly, the dividend being paid to unsecured creditors under the Plan represents substantially more than such unsecured creditors would ever receive in a liquidation (which according to the above analysis, is nothing).

Clearly, upon forced liquidation, unsecured creditors would get nothing. In fact, the Bank would also likely receive substantially less than that being paid to the Bank under the Plan. Accordingly, the Plan offers all creditors substantially more than such creditors would receive in a liquidation.

IMPLEMENTATION OF THE PLAN

As discussed throughout this Disclosure Statement, distributions under the Plan shall be made from future operations..

FEASIBILITY AND FAIRNESS OF PLAN

Attached to this Disclosure Statement as **Group Exhibit C** are the Debtor's 2014 and 2015 tax returns, and attached as **Group Exhibit D** are the Debtor's corporate financial statements for 2013, 2014 and 2015. The purpose of these Exhibits is to provide creditors with historical financial information concerning the Debtor's ability to make the payments required under the Plan. These balance sheets and income statements were prepared by the Debtor, and are based upon an analysis of actual business activity. As further evidence of the feasibility of the Debtor's Plan, the Debtor attaches **Group Exhibit E**, consisting of the summary page of the Debtor's monthly reports filed since the Petition Date.

Finally, attached as **Exhibit F** are the Debtor's five (5) year budget projections, as prepared by Michael Vertanen, the Debtor's financial consultant, representing reasonable calculations based upon historical projections of the Debtor's business. These projections clearly reflect the Debtor's ability to perform under the proposed Plan.

The Debtor believes that the Plan represents an opportunity for the holders of Allowed Claims to receive substantially more than such claimants would receive in a forced liquidation. The Plan is also fair.

RECOMMENDATION

The Debtor recommends that those persons entitled to vote, vote to accept the Plan.

Northwest Pediatric Services S.C. d/b/a Kid Care
Medical S.C., an Illinois corporation,

debtor/debtor-in-possession

By: /s/Scott R. Clar
One of its Attorneys

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