

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

-----X	:	Chapter 11
In re	:	
	:	
Laboratory Partners, Inc., <i>et al.</i> , <sup>1</sup>	:	Case No. 13-12769 (PJW)
	:	
Debtors.	:	(Jointly Administered)
	:	
	:	<b>Hearing Date: November 26, 2013 at 2:00 p.m. (ET)</b>
	:	<b>(REQUESTED)</b>
-----X	:	<b>Obj. Due: As Set By the Court</b>

**DEBTORS’ MOTION FOR ORDER AUTHORIZING KEY EMPLOYEE INCENTIVE  
PLAN AND AUTHORIZING BUT NOT DIRECTING RELATED PAYMENTS  
PURSUANT TO BANKRUPTCY CODE SECTIONS 105(a), 363(b)(1) AND 503(c)(3)**

The debtors and debtors in possession in the above-captioned cases (collectively, the “Debtors” or the “Company”) hereby move (the “Motion”) for entry of an order, pursuant to sections 105(a), 363(b)(1) and 503(c)(3) of title 11 of the United States Code (the “Bankruptcy Code”), authorizing, but not directing, the Debtors to implement a key employee incentive plan and make related payments to key employees who perform critical functions in the Debtors’ ongoing efforts to maximize the value of their assets. In support of the Motion, the Debtors, by and through their undersigned proposed counsel, respectfully represent:

**PRELIMINARY STATEMENT**

1. The Debtors have faced liquidity issues for some time and have explored numerous strategic solutions. Throughout this process, the Debtors’ management has been

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<sup>1</sup> The Debtors and the last four digits of their taxpayer identification numbers are as follows: Laboratory Partners, Inc. (3376), Kilbourne Medical Laboratories, Inc. (9849), MedLab Ohio, Inc. (9072), Suburban Medical Laboratory, Inc. (0859), Biological Technology Laboratory, Inc. (4370), Terre Haute Medical Laboratory, Inc. (1809), and Pathology Associates of Terre Haute, Inc. (6485). Certain of the Debtors do business as MEDLAB. The Debtors’ mailing address for notice in these cases is: 671 Ohio Pike, Suite K, Cincinnati, OH 45245.

committed to facilitating the Debtors' operations and assisting with strategic initiatives. Recently, the Debtors' Board of Directors made the critical and difficult decision that the Company simply did not have sufficient funds or sources of liquidity to continue to operate in the ordinary course and that a chapter 11 filing was necessary. Following that determination, management has remained focused on two objectives: (i) maximizing the value of the Company's existing assets and operations in a manner that is reasonably calculated to repay as many of the Debtors' creditors as possible; and (ii) finding buyers for the Debtors' operations that will preserve as many jobs as possible.

2. The management team's efforts have been frustrated by circumstances beyond their control, including declining revenues from government-imposed permanent reductions in rates of reimbursement. Rather than walk away, however, the management team is committed to seeing the sale and chapter 11 process through and should be incentivized to maximize the sale proceeds to the highest achievable levels. The Debtors' Board of Directors and Chief Executive Officer recognize the need to keep the management team intact and focused during this critical period. As a result, following several weeks of discussions, the Debtors developed an incentive plan (the "KEIP") that is intended to balance the needs of the Debtors' creditors and the Debtors' key employees (the "Key Employees").

3. In sum, the KEIP provides for modest incentive payments to the Key Employees upon achievement of certain milestones related to sales of the Debtors' assets.

### **JURISDICTION**

4. This Court has jurisdiction to consider the Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue of these cases and

this Motion in this district is proper pursuant to 28 U.S.C. §§ 1408 and 1409. The predicates for the relief requested herein are sections 105(a), 363(b)(1) and 503(c)(3) of the Bankruptcy Code.

## **BACKGROUND**

### **A. General Background**

5. On October 25, 2013 (the "Petition Date"), the Debtors commenced their bankruptcy cases by filing voluntary petitions for relief under chapter 11 of the Bankruptcy Code. No trustee or examiner has been appointed in these cases. The Debtors are operating their businesses as debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. On November 7, 2013, the Office of the United States Trustee for the District of Delaware appointed an official committee of unsecured creditor (the "Committee").

6. The Debtors, headquartered in Cincinnati, Ohio and primarily doing business as MEDLAB, provide clinical diagnostic laboratory services to long-term care facilities, hospitals and physician offices through a network of clinical laboratories.

7. More specifically, the Debtors provide clinical laboratory and anatomic pathology services to (i) skilled nursing facilities in Illinois, Indiana, Kentucky, Maryland, Michigan, Missouri, Ohio, Virginia and Washington DC (the "Long-Term Care Division"), (ii) physicians, physician offices and medical groups (the "Talon Division"), in Indiana and Illinois, and (iii) Union Hospital, Inc. in Terre Haute and Clinton, Indiana.

8. The events leading up to the Petition Date and certain of the facts and circumstances supporting the relief requested herein are set forth in the *Declaration of William A. Brandt, Jr. In Support of First Day Relief* (D.I. 2) (the "First Day Declaration"), filed on the Petition Date.

**B. The Key Employee Incentive Plan**<sup>2</sup>

9. The KEIP, a copy of which is annexed hereto as **Exhibit A**, generally provides as follows:

<b>A. Purpose</b>	<p>To provide incentives to the Debtors' Key Employees to maximize the value of the Debtors' assets by effectuating sales of the Debtors' assets at the highest possible value.</p> <p>For purposes of the KEIP, "Debtors" shall mean Laboratory Partners, Inc., Kilbourne Medical Laboratories, Inc., MedLab Ohio, Inc., Suburban Medical Laboratory, Inc., Biological Technology Laboratory, Inc., Terre Haute Medical Laboratory, Inc., and Pathology Associates of Terre Haute, Inc.</p>
<b>B. Administrator</b>	The Debtors' Chief Executive Officer, at the direction of the Debtors' Board of Directors.
<b>C. Eligibility</b>	Key Employees of the Debtors who are identified on Exhibit 1 to the KEIP shall be eligible to participate in the KEIP.
<b>D. Bonus Opportunities</b>	<p>The Key Employees shall be eligible for certain cash bonus opportunities identified on Exhibit 2 to the KEIP under the terms and conditions set forth in the KEIP, provided that, except as otherwise provided in Section G of the KEIP, the Key Employee is employed by the Debtors on the closing of the sale of all or a significant portion of the assets related to the Debtors' Long-Term Care Division (the "<u>LTC Division Sale</u>") or the Talon Division (the "<u>Talon Division Sale</u>"), as applicable.</p> <p>The maximum aggregate cash bonus payments to all Key Employees under the KEIP shall not exceed \$785,104.</p>
<b>E. Milestones</b>	<p>(1) <i>Long-Term Care Division</i>: Within 30 days following the LTC Division Sale:</p> <p>(a) <u>Fixed LTC Bonus</u>: Certain Key Employees shall receive the Fixed LTC Bonus, as identified on Exhibit 2 to the KEIP, in an aggregate amount not to exceed \$313,873; <u>provided, however,</u></p>

<sup>2</sup> The descriptions herein are qualified in their entirety by reference to the KEIP. To the extent there is a discrepancy between the terms of the KEIP and the descriptions contained herein, the terms of the KEIP control. Capitalized terms not otherwise defined herein shall have the meanings ascribed to them in the KEIP.

that no Key Employee shall be entitled to the Fixed LTC Bonus if the Net Asset Sale Proceeds from the LTC Division Sale are not sufficient to repay in full all amounts then due and owing under the Debtors' postpetition financing facility. Notwithstanding the foregoing, to the extent that the aggregate amount of Net Asset Sale Proceeds available to pay the Fixed LTC Bonuses under this subsection 1(a) is less than \$313,873, each Key Employee eligible for a Fixed LTC Bonus shall be entitled to receive a pro rata portion of such available amount.

(b) Variable LTC Bonus Pool: Certain Key Employees as identified on Exhibit 2 to the KEIP shall receive equal shares of the Variable LTC Bonus Pool, but only to the extent that the Net Asset Sale Proceeds from the LTC Division Sale exceed \$5.0 million. For purposes of the KEIP, "Variable LTC Bonus Pool" shall mean 8% of any Net Asset Sale Proceeds from the LTC Division Sale that exceed \$5.0 million, but in no event shall the Variable LTC Bonus Pool under the KEIP exceed \$120,000.

(2) *Talon Division*: Within 30 days following the Talon Division Sale:

(a) Fixed Talon Bonus: Certain Key Employees shall receive the Fixed Talon Bonus, as identified on Exhibit 2 to the KEIP, in an aggregate amount not to exceed \$251,231; provided, however, that no Key Employee shall be entitled to the Fixed Talon Bonus if the Net Asset Sale Proceeds from the Talon Division Sale are not sufficient to repay in full all amounts then due and owing under the Debtors' postpetition financing facility. Notwithstanding the foregoing, to the extent that the aggregate amount of Net Asset Sale Proceeds available to pay the Fixed Talon Bonuses under this subsection 2(a) is less than \$251,231, each Key Employee eligible for a Fixed Talon Bonus shall be entitled to receive a pro rata portion of such available amount.

(b) Variable Talon Bonus Pool: Certain Key Employees as identified on Exhibit 2 to the KEIP shall receive equal shares of the Variable Talon Bonus Pool, but only to the extent that the Net Asset Sale Proceeds from the Talon Division Sale exceed \$6.0 million. For purposes of the KEIP, "Variable Talon Bonus Pool" shall mean 5% of any Net Asset Sale Proceeds from the Talon Division Sale that exceed \$6.0 million, but in no event shall the Variable Talon Bonus Pool under the KEIP exceed \$100,000.

(3) *Definitions*: For purposes of the KEIP, the following definitions shall apply:

	<p>(a) “Long-Term Care Division” shall mean the Debtors’ clinical laboratory and anatomic pathology services to skilled nursing facilities in Illinois, Indiana, Kentucky, Maryland, Michigan, Missouri, Ohio, Virginia and Washington DC.</p> <p>(b) “Talon Division” shall mean the Debtors’ clinical laboratory and anatomic pathology services to physicians, physician offices and medical groups in Indiana and Illinois, and, to the extent such assets are included in such division sale transaction, the Debtors’ clinical laboratory, anatomic pathology and nuclear imaging services to Union Hospital in Terre Haute and Clinton, Indiana.</p> <p>(c) “Net Asset Sale Proceeds” shall have the meaning assigned to such term in the Senior Secured, Super-Priority Debtor-In-Possession Credit Agreement dated as of October 30, 2013, as the same may be amended or modified from time to time.</p>
<p><b>F. Release</b></p>	<p>To be eligible to receive any bonus described under the KEIP, a Key Employee shall execute and deliver to the Debtors a release in the form provided by the Administrator in his sole discretion, which shall include a release by such Key Employee of all known and unknown claims by such employee against any of the Debtors, including, without limitation, (i) any claim against any of the Debtors with respect to the Key Employee’s employment by any of the Debtors; provided, however, that such release shall not extend to or affect any indemnification or advancement rights or claims otherwise available to Key Employees, and (ii) if applicable, any claim, right or interest to any amounts earned or accrued with respect to any other plans, agreements, obligations or policies relating to retention, change in control, severance, bonuses or incentives.</p>
<p><b>G. Termination of Employment; Resignation</b></p>	<p>(1) Other than as provided in provided in paragraph (3) below, if a Key Employee is terminated by the Debtors for cause or resigns prior to the date of the LTC Division Sale or Talon Division Sale, as applicable, such Key Employee shall not be eligible to receive any payments under the KEIP.</p> <p>(2) Other than as provided in paragraph (3) below, if a Key Employee is terminated by the Debtors without cause within thirty (30) days prior to the date of the LTC Division Sale or Talon Division Sale, as applicable, the Key Employee shall be eligible to receive such payments as the Key Employee would receive if the Key Employee was employed by the Debtors through the date of the LTC Division Sale or Talon Division Sale, as applicable.</p> <p>(3) If a Key Employee is terminated by the Debtors without cause or resigns prior to the date of the Talon Division Sale but, at the request of the Debtors, provides transition services to the Debtors pursuant to, and in</p>

	<p>accordance with, a written transition services agreement (as determined by the Administrator, in its sole discretion) through the date of the Talon Division Sale, such Key Employee shall be eligible to receive such payments under the KEIP as the Key Employee would receive if the Key Employee was employed by the Debtors through the date of the Talon Division Sale.</p> <p>(4) Notwithstanding anything in this Section G to the contrary, if upon a Key Employee’s termination by the Debtors without cause or resignation, (i) the Debtor requests that the Key Employee perform certain transition services to the Debtors (on terms and conditions established by the Debtors, in their sole discretion, pursuant to a written transition services agreement) and (ii) the Key Employee refuses to perform such services or otherwise fails to perform such services in accordance with the terms of the transition services agreement, the Key Employee shall not be eligible to receive any payments under the KEIP attributable to the applicable division sale.</p> <p>(5) <i>Definitions:</i> For purposes of the KEIP, the following definition shall apply:</p> <p>“Cause” shall mean the determination by the Administrator, in its sole discretion, that the Key Employee: (a) failed to substantially perform his or her duties and has not cured and corrected such failure within fifteen (15) days after notice thereof, other than due to such Participant’s disability; (b) engaged in gross misconduct, gross neglect, willful malfeasance or gross negligence in carrying out his or her duties (including, but not limited to, serious dereliction of any fiduciary obligation, abuse of alcohol or narcotics, or a violation of any law governing the workplace of any of the Debtors); (c) has breached any employment agreement or other agreement or obligation relating to employment between such Key Employee and any of the Debtors (other than an inadvertent and nonrecurring breach cured and corrected by such Key Employee within fifteen (15) days after notice thereof), and such breach causes, or is likely to cause, material harm to any of the Debtors; (d) engaged in any act or conduct of dishonesty involving fraud or embezzlement against any of the Debtors; or (e) acted or failed to act in a way that constitutes cause under the Key Employee’s employment agreement with any of the Debtors, if any, or any applicable policy handbook.</p>
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10. The KEIP is designed to maximize assets available for distribution to creditors by providing incentives to fifteen (15) Key Employees to drive as quickly and efficiently as possible

to a value-maximizing sale or sales of certain of the Debtors' assets (the "Sale Process"), as contemplated by the budget agreed upon by the Debtors and their postpetition secured lender (the "DIP Lender"). The Key Employees have unique and specialized knowledge and experience with respect to the Debtors' assets and industry, and the Debtors believe their services are essential to conducting an effective Sale Process that ultimately will benefit all creditors of the Debtors' estates. The KEIP is the product of significant discussions among the management team, the Chief Executive Officer and the Debtors' Board of Directors.

11. Prior to filing the Motion, the Debtors discussed the proposed incentive plan with the DIP Lender and the Debtors' prepetition senior secured lenders (the "Prepetition Lenders"), all of whom support the KEIP. Pursuant to the KEIP, the DIP Lender and Prepetition Lenders have agreed to carve out certain amounts from the proceeds recovered in the Sale Process for the Key Employees upon the achievement of certain sale-related milestones. The incentive payments and milestones have been set at levels to incentivize the Key Employees to maximize recoveries for all creditors as quickly as possible.

12. The incentive payments that may be earned by a Key Employee under the KEIP varies based on such Key Employee's position with the Debtors and anticipated role in and contribution to the Sale Process. As discussed herein, the precise amount of the incentive amount payable to each Key Employee will depend on the success of the Sale Process.

13. Prior to the commencement of these cases, the Debtors' management initiated the Sale Process to market the Debtors' assets to potential purchasers in order to address the Debtors' liquidity problems and realize the highest value possible for their assets. The KEIP is designed to provide additional incentives for the Key Employees to continue to push the Sale Process forward to the successful closing of transactions – which will only benefit the Debtors'



creditors – notwithstanding the fact that the Key Employees may be terminated at the conclusion of the Sale Process.

**RELIEF REQUESTED**

14. By this Motion, the Debtors seek entry of an order under Bankruptcy Code sections 105(a), 363(b)(1) and 503(c)(3): (a) approving the KEIP as described herein; and (b) authorizing, but not directing, the Debtors to implement the KEIP and make related payments.

**BASIS FOR RELIEF REQUESTED**

15. The success of the Sale Process and these cases depend on the willingness of the Key Employees to take on additional responsibilities to effectuate the Sale Process, manage the chapter 11 process, and continue operations in a constrained environment. These endeavors are critical to maximize the recovery for all of the Debtors' stakeholders.

16. As part of the Debtors' efforts to effectuate a successful Sale Process, which is a primary objective in these cases, and to negotiate and consummate the sales, the Debtors' Key Employees have been, and will be, called upon to take on significant responsibilities in addition to their normal day-to-day functions. The Sale Process contemplates the sale of certain of the Debtors' assets in a limited timeframe, which requires the Key Employees and others to conduct marketing efforts, prepare financial and operational analyses at the request of potential bidders, and maintain and/or re-negotiate customer relationships in a difficult environment, among other endeavors. In addition to the Key Employees' operational duties, they are tasked with attending meetings with (and potentially providing presentations to) multiple potential bidders. They are also responsible for coordinating responses to interested parties' extensive diligence requests.

17. The Key Employees also have assumed incremental duties in connection with the filing of these cases, which require extensive coordination with the Debtors' bankruptcy counsel

and other advisors with respect to various issues that arise in bankruptcy. Such issues, if not handled promptly and skillfully, threaten to erode the value of the Debtors' assets.

18. Even if additional outside professionals could be found and retained to perform these tasks with the same level of skill as the Key Employees — which would be highly unlikely in light of the Key Employees' experience, expertise, and knowledge of the Debtors' businesses and assets — the associated costs would be far greater than the bonuses that may be awarded under the KEIP. Moreover, all payments under the KEIP will be in lieu of any prior policies, plans and other bonus, severance or change of control arrangements for the Key Employees.

19. Given the expedited sale process, the Key Employees have been required to take on considerable additional responsibilities in connection with the Debtors' chapter 11 cases. Yet, as a result of the chapter 11 filing, absent the relief requested herein, such employees cannot be awarded bonuses to compensate them for their enhanced responsibilities. Further, thus far the Key Employees have continued to work knowing that there is a possibility that they will be employed only for a short time, to effectuate the Sale Process. By this Motion, the Debtors are seeking authority to provide incentives to those individuals that are essential to navigating the Debtors through this challenging, and critical, period. The efforts of the Key Employees have been and will continue to be instrumental in the success of that Sale Process and the maximization of value for the Debtors' stakeholders.

**I. The KEIP Should Be Approved Pursuant to Sections 105(a), 363(b)(1) and 503(c)(3) of the Bankruptcy Code.**

**A. Section 363(b) of the Bankruptcy Code.**

20. Section 363(b)(1) of the Bankruptcy Code permits a debtor in possession to use property of the estate “other than in the ordinary course of business” after notice and a hearing 11 U.S.C. § 363(b)(1). Uses of estate property outside the ordinary course of business may be

authorized if the debtor demonstrates a “sound business purpose” for it. *See In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983) (“The rule we adopt requires that a judge determining a 363(b) application expressly find from the evidence presented before him . . . a good business reason to grant the application.”); *In re Delaware & Hudson Ry., Co.*, 124 B.R. 169, 179 (D. Del. 1991). Here, the KEIP serves a sound business purpose. As detailed above, the KEIP is designed to incentivize the Key Employees to run an efficient Sale Process for the benefit of all creditors. As such, the KEIP is tailored to increase the value of the Debtors’ estates.

21. The Debtors’ business judgment is generally insulated from judicial second-guessing once a sound business purpose has been articulated. *See id.*; *see also Myers v. Martin (In re Martin)*, 91 F.3d 389, 395 (3d Cir. 1996) (noting that under normal circumstances, courts defer to a trustee’s judgment concerning use of property under Bankruptcy Code section 363(b) when there is a legitimate business justification); *In re Montgomery Ward Holding Corp.*, 242 B.R. 147, 153 (D. Del. 1999) (affirming bankruptcy court approval of key employee retention program, stating that “in determining whether to authorize the use, sale or lease of property of the estate under [section 363(b)], courts require the debtors to show that a sound business purpose justifies such actions.”); *In re Johns-Manville Corp.*, 60 B.R. 612, 615-616 (Bankr. S.D.N.Y. 1986) (a “presumption of reasonableness attaches to a Debtor’s management decisions” and courts will generally not entertain objections to the debtor’s conduct after a reasonable basis is set forth).

**B. The KEIP Also Should Be Evaluated Under Section 503(c)(3) of the Bankruptcy Code, Applying the Same Standard as Under Section 363(b).**

22. Section 503(c) of the Bankruptcy Code provides criteria for courts to use in approving certain types of payments to insiders and “other transfers or obligations that are outside the ordinary course of business.” Section 503(c) of the Bankruptcy Code is comprised

by three subsections: (1) a general prohibition against retention plans for insiders; (2) limitations on severance payments; and (3) standards governing other transfers to certain officers, employees and consultants, among others, that are outside of the ordinary course of business. For the reasons set forth herein, neither section 503(c)(1) nor section 503(c)(2) of the Bankruptcy Code are applicable to evaluating the KEIP.

23. By the statute's plain language, section 503(c)(1) of the Bankruptcy Code pertains solely to retention plans of insiders and section 503(c)(2) of the Bankruptcy Code addresses only the requirements for severance plans, and neither provision applies to performance-based incentive plans. *See, e.g., In re Nobex Corp.*, Case No. 05-20050, January 12, 2006, Hearing Tr. at 67 (MFW) (Bankr. D. Del. 2006); *In re Calpine Corp.*, Case No. 05-60200, April 26, 2006 Hearing Tr. at 87 (BRL) (Bankr. S.D.N.Y. 2006). Indeed, one court has held that:

If sections 503(c)(1) and (c)(2) are not operative, a court may consider whether the payments are permissible under section 503(c)(3), which limits payments made to management and employees, among others, outside the ordinary course, unless such payments are shown to be justified under the facts and circumstances of chapter 11 case. As one treatise points out, the test appears to be no more stringent a test than the one courts must apply in approving any administrative expense under 503(b)(1)(A).

*In re Dana Corporation*, 358 B.R. 567, 576 (Bankr. S.D.N.Y. 2006).

24. For the avoidance of doubt, the KEIP is not intended to provide stay bonuses, nor severance pay. In particular, the KEIP is comprised of only incentive payments to management employees who currently play, and will continue to play, critical roles in the Debtors' Sale Process and overall chapter 11 efforts. The Key Employees are directly involved with either the implementation of the Sale Process or the preservation of the Debtors' assets so as to ensure that the assets of these estates, as a whole, retain value. These incentive payments are based upon the successful achievement of the Sale Process – which is the linchpin of these bankruptcy cases and

providing recoveries to creditors. Consequently, the KEIP is properly characterized as a performance-based management incentive plan, not a retention plan for insiders subject to the requirements of section 503(c)(1) of the Bankruptcy Code. Although certain of the Key Employees may be deemed “insiders” within the meaning of the Bankruptcy Code, the KEIP has been crafted with great care to ensure that it directly incentivizes all Key Employees to conduct the Sale Process in a manner beneficial to all creditors, rather than serving primarily a retentive purpose or to compensate the Key Employees in connection with their likely near-term departure from the Debtors.<sup>3</sup>

25. The KEIP is not in place to retain the Key Employees, but to motivate them. The preparations the Debtors made for these cases required tremendous effort from the Key Employees, and such efforts positioned the Debtors to conduct a robust Sale Process, yielding benefits to these estates. The ongoing dedication and commitment of the Key Employees will be essential to the success of the Sale Process and these chapter 11 cases. Accordingly, the KEIP exists to incentivize the Key Employees to put forth such dedication and commitment.

26. Finally, the KEIP does not constitute severance for insiders subject to the provisions of section 503(c)(2) of the Bankruptcy Code, because it does not provide benefits to Key Employees based upon termination of their employment with the Debtors. *See* 11 U.S.C.

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<sup>3</sup> Some may argue that the KEIP will have the added benefit of curbing potential attrition among Key Employees; however, any such effect would be a mere byproduct of the KEIP. This does not make the KEIP a “retention” plan, nor does it detract from the primary purpose of the plan, which is to provide incentives to participants to help the Debtors maximize the value of these estates for the benefit of their creditors. *See In re Nellson Nutraceutical*, 369 B.R. 787, 802 (Bankr. D. Del. 2007) (stating that section 503(c)(1) must necessarily be interpreted only to prohibit “a transfer . . . to an insider of the debtor for the [primary] purpose of inducing such person to remain with the Debtors’ business.”); *In re Borders Group, Inc.*, 453 B.R. 459, 471 (Bankr. S.D.N.Y. 2011) (“any payment made to an employee, including wages, has at least a partial retentive effect.”).

§ 503(c)(2). Therefore, the KEIP is a management incentive plan, not a severance plan for insiders subject to the requirements of section 503(c)(2) of the Bankruptcy Code.

27. To the extent that distributions under the KEIP are payments “outside the ordinary course of business,” they should be evaluated under section 503(c)(3). *See, e.g., Nobex Corp.*, Case No. 05-20050, January 12, 2006, Hearing Tr. at 67; *In re Musicland Holding Corp.*, Case No. 06-10064 (SMB) (Bankr. S.D.N.Y. Feb. 1, 2006) (debtor continuing to provide incentive bonuses under management incentive plan did not violate section 503(c) of the Bankruptcy Code); *Dana*, 358 B.R. at 581.

28. Section 503(c)(3) of the Bankruptcy Code states, in relevant part, that “there shall be neither allowed nor paid . . . other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case. . . .” For so long as courts have analyzed payments under section 503(c)(3) of the Bankruptcy Code, they have been unanimous in holding that they must use the “business judgment” standard as the proper standard for determining whether incentive programs and the payments thereunder are justified.

29. Indeed, in the *Nobex* case, Judge Walrath stated that:

“[Section 503] (c)(3) was meant to provide a standard, albeit not as clear, for any other transfers or obligations outside the ordinary course of business . . . . I read (c)(3) to be the catch-all and the standard under (c)(3) for any transfers or obligations made outside the ordinary course of business are those that are justified by the facts and circumstances of the case . . . . I find it quite frankly nothing more than a reiteration of the standard under 363 . . . under which courts had previously authorized transfers outside the ordinary course of business and that [are], based on the business judgment of the debtor . . . .”

*In re Nobex Corp.*, Case No. 05-20050, Jan. 12, 2006, Hearing Tr. at 86-87 (an order approving the management incentive plan at issue was entered Jan. 20, 2006). *See also Dana*, 358 B.R. at 576 (management incentive programs should be evaluated under the business judgment

standard). Thus, the Debtors submit that the standard for evaluating the KEIP pursuant to section 503(c)(3) of the Bankruptcy Code is the same as the standard pursuant to section 363(b) of the Bankruptcy Code, discussed herein.

**C. The KEIP Has a Sound Business Purpose, and Should Be Authorized by this Court Pursuant to Sections 363(b)(1) and 503(c)(3) of the Bankruptcy Code.**

30. The KEIP satisfies the business judgment standard of section 363(b)(1) and 503(c)(3) of the Bankruptcy Code, in that it is: (a) precisely calibrated to achieve the desired performance; (b) fair and reasonable in scope; and (c) does not discriminate unfairly.

31. The KEIP will reward participants for their significant efforts since the Petition Date and their increased responsibilities and burdens over the upcoming weeks as the Debtors pursue the Sale Process. As outlined above, the KEIP is structured to maximize value for the Debtors' estates and creditors.

32. Secondly, the Debtors' ability to preserve the value of their assets would be substantially hindered if the Debtors are unable to properly incentivize their Key Employees, many of whom have already had to sacrifice components of their compensation as a result of the Debtors' circumstances. Authorization to implement the KEIP will provide the Debtors' Key Employees with a greater sense of financial security, thereby eliminating a potential distraction that could adversely affect their performance. There would be a substantial negative impact on the Sale Process if the Key Employees' focus shifted significantly to matters unrelated to the Sale Process, including but not limited to future employment prospects. Providing incentives to encourage employees to focus on the Debtors' objectives, and to motivate them to provide optimal levels of performance, is necessary to successfully maintain the Debtors' business.

33. Third, the overall cost of the KEIP is reasonable. The value to these estates from the minimal percentage of the total proceeds realized from sales that would fund the KEIP

payments is outweighed by the tremendous value added to the Sale Process by the motivated participation of the Key Employees.

**D. The Relief Requested Herein Is Also Warranted Under Section 105(a) to Protect the Value of the Debtors' Estates.**

34. Approval of the KEIP also is warranted under section 105(a) of the Bankruptcy Code, which allows the Court to enter any order “that is necessary to carry out the provisions of [the Bankruptcy Code].” 11 U.S.C. § 105(a). This includes an order designed to preserve the value of the debtor’s estate. *See, e.g., In re Adelphia Communications Corp.*, 2003 WL 21297258, at \*4 (S.D.N.Y. June 4, 2003) (“Section 105 of Title 11 provides the bankruptcy courts with a broad range of equitable powers over cases within its jurisdiction.”). As explained above, the KEIP is designed to maximize assets available for distribution to creditors by providing incentives to the Key Employees to drive as quickly and efficiently as possible a value-maximizing sale or sales of all or certain of the Debtors’ assets. Again, however, this Court need not even resort to section 105(a), as the relief requested herein is fully authorized by sections 363(b) and 503(c)(3) of the Bankruptcy Code.

35. Finally, targeted incentive programs have repeatedly been recognized by this and other courts as having particular value in motivating management teams to effectuate the sales of debtors’ assets. *See, e.g., In re Eddie Bauer, Inc.*, Case No. 09-12099 (MFW) (Bankr. D. Del. July 22, 2009) (granting incentive plan motion in connection with a sale process); *In re Boscov’s, Inc.*, Case No. 08-11637 (KG) (Bankr. D. Del. Sept. 5, 2008) (approving incentive plan featuring bonuses payable only upon the confirmation of a plan or the consummation of a sale of the debtors’ assets).

36. The Debtors strongly and reasonably believe that the KEIP is critical to their ability to maximize creditor recoveries. The payments are structured to focus the Key



Employees on the execution of their duties efficiently and expeditiously. Simply stated, the KEIP is necessary and appropriate, because it rewards the Key Employees for maximizing and preserving the value of the estates for the benefit of the Debtors' creditors under very difficult circumstances.

37. The Debtors respectfully submit that the implementation of the KEIP is an appropriate exercise of the Debtors' business judgment; is necessary and in the best interest of the Debtors, their creditors, and their estates; and should be approved under sections 105(a), 363(b) and 503(c)(3) of the Bankruptcy Code.

**NOTICE**

38. Notice of the hearing on this Motion has been given to: (a) the Office of the United States Trustee for the District of Delaware; (b) proposed counsel to the Committee; (c) counsel to the Debtors' postpetition lender and prepetition lenders; and (d) those parties that have properly requested notice in these cases. The Debtors respectfully submit that no further notice of this Motion is required.

**NO PRIOR REQUEST**

39. No previous motion for the relief sought herein has been made to this or to any other Court.

**CONCLUSION**

WHEREFORE, the Debtors respectfully request that the Court enter an order, substantially in the form annexed hereto as **Exhibit B**, granting the relief requested in the Motion and such other and further relief as may be just and proper.

Dated: November 13, 2013  
Wilmington, Delaware

MORRIS, NICHOLS, ARSHT & TUNNELL LLP

/s/ Erin R. Fay

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**EXHIBIT A**

**Key Employee Incentive Plan**

### Key Employee Incentive Plan

#### In re Laboratory Partners, Inc., Case No. 13-12769 (PJW)

<b>A. Purpose</b>	<p>To provide incentives to the Debtors' Key Employees to maximize the value of the Debtors' assets by effectuating sales of the Debtors' assets at the highest possible value.</p> <p>For purposes of the KEIP, "Debtors" shall mean Laboratory Partners, Inc., Kilbourne Medical Laboratories, Inc., MedLab Ohio, Inc., Suburban Medical Laboratory, Inc., Biological Technology Laboratory, Inc., Terre Haute Medical Laboratory, Inc., and Pathology Associates of Terre Haute, Inc.</p>
<b>B. Administrator</b>	The Debtors' Chief Executive Officer, at the direction of the Debtors' Board of Directors.
<b>C. Eligibility</b>	Employees of the Debtors who are identified on Exhibit 1 hereto (the "Key Employees") shall be eligible to participate in the KEIP.
<b>D. Bonus Opportunities</b>	<p>The Key Employees shall be eligible for certain cash bonus opportunities identified on Exhibit 2 hereto under the terms and conditions set forth in the KEIP, provided that, except as otherwise provided in Section G of this KEIP, the Key Employee is employed by the Debtors on the closing of the sale of all or a significant portion of the assets related to the Debtors' Long-Term Care Division (the "LTC Division Sale") or the Talon Division (the "Talon Division Sale"), as applicable.</p> <p>The maximum aggregate cash bonus payments to all Key Employees under the KEIP shall not exceed \$785,104.</p>
<b>E. Milestones</b>	<p>(1) <i>Long-Term Care Division:</i> Within 30 days following the LTC Division Sale:</p> <p>(a) <u>Fixed LTC Bonus:</u> Certain Key Employees shall receive the Fixed LTC Bonus, as identified on Exhibit 2 hereto, in an aggregate amount not to exceed \$313,873; <u>provided, however</u>, that no Key Employee shall be entitled to the Fixed LTC Bonus if the Net Asset Sale Proceeds from the LTC Division Sale are not sufficient to repay in full all amounts then due and owing under the Debtors' postpetition financing facility. Notwithstanding the foregoing, to the extent that the aggregate amount of Net Asset Sale Proceeds available to pay the Fixed LTC Bonuses under this subsection 1(a) is less than \$313,873, each Key Employee eligible for a Fixed LTC Bonus shall be entitled to receive a pro rata portion of such available amount.</p> <p>(b) <u>Variable LTC Bonus Pool:</u> Certain Key Employees as</p>

identified on Exhibit 2 hereto shall receive equal shares of the Variable LTC Bonus Pool, but only to the extent that the Net Asset Sale Proceeds from the LTC Division Sale exceed \$5.0 million. For purposes of this KEIP, "Variable LTC Bonus Pool" shall mean 8% of any Net Asset Sale Proceeds from the LTC Division Sale that exceed \$5.0 million, but in no event shall the Variable LTC Bonus Pool under this KEIP exceed \$120,000.

(2) *Talon Division:* Within 30 days following the Talon Division Sale:

(a) Fixed Talon Bonus: Certain Key Employees shall receive the Fixed Talon Bonus, as identified on Exhibit 2 hereto, in an aggregate amount not to exceed \$251,231; provided, however, that no Key Employee shall be entitled to the Fixed Talon Bonus if the Net Asset Sale Proceeds from the Talon Division Sale are not sufficient to repay in full all amounts then due and owing under the Debtors' postpetition financing facility. Notwithstanding the foregoing, to the extent that the aggregate amount of Net Asset Sale Proceeds available to pay the Fixed Talon Bonuses under this subsection 2(a) is less than \$251,231, each Key Employee eligible for a Fixed Talon Bonus shall be entitled to receive a pro rata portion of such available amount.

(b) Variable Talon Bonus Pool: Certain Key Employees as identified on Exhibit 2 hereto shall receive equal shares of the Variable Talon Bonus Pool, but only to the extent that the Net Asset Sale Proceeds from the Talon Division Sale exceed \$6.0 million. For purposes of this KEIP, "Variable Talon Bonus Pool" shall mean 5% of any Net Asset Sale Proceeds from the Talon Division Sale that exceed \$6.0 million, but in no event shall the Variable Talon Bonus Pool under this KEIP exceed \$100,000.

(3) *Definitions:* For purposes of this KEIP, the following definitions shall apply:

(a) "Long-Term Care Division" shall mean the Debtors' clinical laboratory and anatomic pathology services to skilled nursing facilities in Illinois, Indiana, Kentucky, Maryland, Michigan, Missouri, Ohio, Virginia and Washington DC.

(b) "Talon Division" shall mean the Debtors' clinical laboratory and anatomic pathology services to physicians, physician offices and medical groups in Indiana and Illinois, and, to the extent such assets are included in such division sale transaction, the Debtors' clinical laboratory, anatomic pathology and nuclear imaging services to Union Hospital in Terre Haute and Clinton, Indiana.

	<p>(c) “Net Asset Sale Proceeds” shall have the meaning assigned to such term in the Senior Secured, Super-Priority Debtor-In-Possession Credit Agreement dated as of October 30, 2013, as the same may be amended or modified from time to time.</p>
<p><b>F. Release</b></p>	<p>To be eligible to receive any bonus described under this KEIP, a Key Employee shall execute and deliver to the Debtors a release in the form provided by the Administrator in his sole discretion, which shall include a release by such Key Employee of all known and unknown claims by such employee against any of the Debtors, including, without limitation, (i) any claim against any of the Debtors with respect to the Key Employee’s employment by any of the Debtors; provided, however, that such release shall not extend to or affect any indemnification or advancement rights or claims otherwise available to Key Employees, and (ii) if applicable, any claim, right or interest to any amounts earned or accrued with respect to any other plans, agreements, obligations or policies relating to retention, change in control, severance, bonuses or incentives.</p>
<p><b>G. Termination of Employment; Resignation</b></p>	<p>(6) Other than as provided in provided in paragraph (3) below, if a Key Employee is terminated by the Debtors for cause or resigns prior to the date of the LTC Division Sale or Talon Division Sale, as applicable, such Key Employee shall not be eligible to receive any payments under this KEIP.</p> <p>(7) Other than as provided in paragraph (3) below, if a Key Employee is terminated by the Debtors without cause within thirty (30) days prior to the date of the LTC Division Sale or Talon Division Sale, as applicable, the Key Employee shall be eligible to receive such payments as the Key Employee would receive if the Key Employee was employed by the Debtors through the date of the LTC Division Sale or Talon Division Sale, as applicable.</p> <p>(8) If a Key Employee is terminated by the Debtors without cause or resigns prior to the date of the Talon Division Sale but, at the request of the Debtors, provides transition services to the Debtors pursuant to, and in accordance with, a written transition services agreement (as determined by the Administrator, in its sole discretion) through the date of the Talon Division Sale, such Key Employee shall be eligible to receive such payments under this KEIP as the Key Employee would receive if the Key Employee was employed by the Debtors through the date of the Talon Division Sale.</p> <p>(9) Notwithstanding anything in this Section G to the contrary, if upon a Key Employee’s termination by the Debtors without cause or resignation, (i) the Debtor requests that the Key Employee perform certain transition services to the Debtors (on terms and conditions established by the Debtors, in their sole discretion, pursuant to a written transition</p>

	<p>services agreement) and (ii) the Key Employee refuses to perform such services or otherwise fails to perform such services in accordance with the terms of the transition services agreement, the Key Employee shall not be eligible to receive any payments under this KEIP attributable to the applicable division sale.</p> <p>(10) <i>Definitions:</i> For purposes of this KEIP, the following definition shall apply:</p> <p>“Cause” shall mean the determination by the Administrator, in its sole discretion, that the Key Employee: (a) failed to substantially perform his or her duties and has not cured and corrected such failure within fifteen (15) days after notice thereof, other than due to such Participant’s disability; (b) engaged in gross misconduct, gross neglect, willful malfeasance or gross negligence in carrying out his or her duties (including, but not limited to, serious dereliction of any fiduciary obligation, abuse of alcohol or narcotics, or a violation of any law governing the workplace of any of the Debtors); (c) has breached any employment agreement or other agreement or obligation relating to employment between such Key Employee and any of the Debtors (other than an inadvertent and nonrecurring breach cured and corrected by such Key Employee within fifteen (15) days after notice thereof), and such breach causes, or is likely to cause, material harm to any of the Debtors; (d) engaged in any act or conduct of dishonesty involving fraud or embezzlement against any of the Debtors; or (e) acted or failed to act in a way that constitutes cause under the Key Employee’s employment agreement with any of the Debtors, if any, or any applicable policy handbook.</p>
<b>H. Taxes</b>	As required by applicable law, Debtors or their agent shall (i) withhold all applicable federal, state and local taxes from any payment made pursuant to this KEIP and (ii) remit any applicable federal, state or local taxes which are required to be paid by the Debtors under any applicable law.
<b>I. Governing Law</b>	The terms of this KEIP shall be governed by the laws of the State of Delaware.

**Key Employee Incentive Plan**

**Exhibit 1 - Key Employees**

Director of Information Technology, Laboratory Partners

Vice President of Sales, Laboratory Partners

Vice President of Operations, Laboratory Partners

General Manager, Talon

Vice President of Clinical Services, Long Term Care

Chief Financial Officer, Laboratory Partners

Director of Billing, Long-Term Care

General Manager, South, Long-Term Care

Director of Clinical Services, Long-Term Care

Manager of Finance, Laboratory Partners

Chief Technical Officer, Laboratory Partners

Supervisor of Phlebotomy, Long-Term Care

Regional Operations Manager, Long-Term Care

Director of Human Resources, Laboratory Partners

Chief Financial Officer, Talon



**Key Employee Incentive Plan**  
**Exhibit 2 - Maximum Bonus Opportunities**

**FILED UNDER SEAL**

**EXHIBIT B**

**Proposed Order**

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

-----X	:	
In re	:	Chapter 11
	:	
Laboratory Partners, Inc., <i>et al.</i> , <sup>1</sup>	:	Case No. 13-12769 (PJW)
	:	
Debtors.	:	(Jointly Administered)
	:	
	:	
-----X	:	<b>Re: D.I. _____</b>

**ORDER AUTHORIZING KEY EMPLOYEE INCENTIVE PLAN AND AUTHORIZING  
BUT NOT DIRECTING RELATED PAYMENTS PURSUANT TO BANKRUPTCY  
CODE SECTIONS 105(a), 363(b)(1) AND 503(c)(3)**

Upon consideration of the motion (the “Motion”)<sup>2</sup> of the debtors and debtors in possession in the above-captioned cases (collectively, the “Debtors”) for entry of an order, pursuant to sections 105(a), 363(b)(1) and 503(c)(3) of title 11 of the United States Code (the “Bankruptcy Code”), authorizing, but not directing, the Debtors to implement a key employee incentive plan and make related payments to key employees; and due and sufficient notice of the Motion having been given; and it appearing that the relief requested by this Motion is in the best interest of the Debtors, their estates and creditors, and other parties in interest; and after due deliberation and sufficient cause appearing therefor, it is hereby

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<sup>1</sup> The Debtors and the last four digits of their taxpayer identification numbers are as follows: Laboratory Partners, Inc. (3376), Kilbourne Medical Laboratories, Inc. (9849), MedLab Ohio, Inc. (9072), Suburban Medical Laboratory, Inc. (0859), Biological Technology Laboratory, Inc. (4370), Terre Haute Medical Laboratory, Inc. (1809), and Pathology Associates of Terre Haute, Inc. (6485). Certain of the Debtors do business as MEDLAB. The Debtors’ mailing address for notice in these cases is: 671 Ohio Pike, Suite K, Cincinnati, OH 45245.

<sup>2</sup> Capitalized terms not otherwise defined herein shall have the meanings ascribed to such terms in the Motion.

**ORDERED, ADJUDGED, and DECREED that:**

1. The Motion is granted.
2. The KEIP is approved in all respects.
3. Pursuant to sections 105(a), 363(b) and 503(c)(3) of the Bankruptcy Code, the Debtors are authorized, but not directed, to: (a) adopt and implement the KEIP; (b) make payments consistent with the KEIP; and (c) take such other actions as may be necessary to implement the KEIP, including, without limitation, designing and/or altering the KEIP (subject to the terms and conditions thereof), in any manner necessary to comply with applicable law.
4. The authorization granted hereby to make payments to the Key Employees under the KEIP shall not create any obligation on the part of the Debtors or their officers, directors, attorneys or agents to make payments under the KEIP and none of the foregoing persons shall have any liability on account of any decision by the Debtors not to honor the KEIP.
5. Compensation that the Debtors determine, in their sole discretion, to award to the Key Employees pursuant to the KEIP shall be treated in the Debtors' chapter 11 cases as allowed administrative expenses in accordance with section 503 of the Bankruptcy Code.
6. Neither this Order nor any payment or performance by the Debtors authorized hereunder shall be deemed an assumption of any executory contract or otherwise affect the Debtors' rights under section 365 of the Bankruptcy Code to assume or reject any executory contract.
7. Notwithstanding Bankruptcy Rule 6004(h), this Order shall be effective and enforceable immediately upon entry hereof.

8. This Court shall retain jurisdiction with respect to all matters relating to the interpretation or implementation of this Order.

Dated: \_\_\_\_\_, 2013  
Wilmington, Delaware

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THE HONORABLE PETER J. WALSH  
UNITED STATES BANKRUPTCY JUDGE

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

-----X

In re	:	Chapter 11
	:	
Laboratory Partners, Inc., <i>et al.</i> , <sup>1</sup>	:	Case No. 13-12769 (PJW)
	:	
Debtors.	:	(Jointly Administered)
	:	
	:	<b>Hearing Date: November 26, 2013 at 2:00 p.m. (ET)</b>
	:	<b>(REQUESTED)</b>
	:	<b>Obj. Deadline: As Set By the Court</b>

-----X

**NOTICE OF DEBTORS' MOTION FOR ORDER AUTHORIZING KEY  
EMPLOYEE INCENTIVE PLAN AND AUTHORIZING BUT NOT DIRECTING  
RELATED PAYMENTS PURSUANT TO BANKRUPTCY CODE  
SECTIONS 105(a), 363(b)(1) AND 503(c)(3)**

PLEASE TAKE NOTICE that on November 13, 2013, the above-captioned debtors and debtors-in-possession (the "Debtors") in the above-captioned cases, filed the **Debtors' Motion For Order Authorizing Key Employee Incentive Plan And Authorizing But Not Directing Related Payments Pursuant To Bankruptcy Code Sections 105(a), 363(b)(1) And 503(c)(3) ("Motion")**.

PLEASE TAKE FURTHER NOTICE that any party wishing to oppose the entry of an order approving the Motion must file a response or an objection to the Motion ("Objection") with the Clerk of the United States Bankruptcy Court for the District of Delaware, 824 North Market Street, 3rd Floor, Wilmington, Delaware 19801 **or before the date and time set by the Court in connection with the motion to shorten notice filed concurrently with the Motion** (the "Objection Deadline"). At the same time, you must serve such Objection upon the undersigned counsel so as to be received by the Objection Deadline.

**PLEASE TAKE FURTHER NOTICE THAT THE DEBTORS HAVE  
REQUESTED THAT A HEARING ON THE MOTION BE SCHEDULED FOR**

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<sup>1</sup> The Debtors and the last four digits of their taxpayer identification numbers are as follows: Laboratory Partners, Inc. (3376), Kilbourne Medical Laboratories, Inc. (9849), MedLab Ohio, Inc.(9072), Suburban Medical Laboratory, Inc. (0859), Biological Technology Laboratory, Inc. (4370), Terre Haute Medical Laboratory, Inc. (1809), and Pathology Associates of Terre Haute, Inc. (6485). Certain of the Debtors do business as MEDLAB. The Debtors' mailing address for notice in these cases is: 671 Ohio Pike, Suite K, Cincinnati, OH 45245.

**NOVEMBER 26, 2013 AT 2:00 P.M. (ET)** BEFORE THE HONORABLE PETER J. WALSH,  
AT THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE,  
824 MARKET STREET, 6TH FLOOR, COURTROOM #2, WILMINGTON, DELAWARE  
19801.

**IF YOU FAIL TO RESPOND IN ACCORDANCE WITH THIS NOTICE,  
THE COURT MAY GRANT THE RELIEF REQUESTED IN THE MOTION WITHOUT  
FURTHER NOTICE OR HEARING.**

Dated: November 13, 2013  
Wilmington, Delaware

MORRIS, NICHOLS, ARSHT & TUNNELL LLP

/s/ Erin R. Fay

Robert J. Dehney (No. 3578)  
Derek C. Abbott (No. 3376)  
Andrew R. Remming (No. 5120)  
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- and -

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*Proposed Counsel to Debtors  
and Debtors in Possession*