

**In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division**

FILED
at 2 O'clock & 49 min PM
Date 8/25/04

MICHAEL F. McHUGH, CLERK
United States Bankruptcy Court
Savannah, Georgia *MB*

In the matter of:)
)
SLEEP DIAGNOSTICS CENTERS)
OF COASTAL GEORGIA, INC.)
)
Debtor)
)
jointly administered with)
)
SLEEP DIAGNOSTICS CENTERS)
OF GEORGIA, INC.)
)
Debtor)

Chapter 11 Case
Number 03-42680

Chapter 11 Case
Number 03-42686

ORDER ON MOTIONS TO DISMISS OR CONVERT

Sleep Diagnostics Centers of Coastal Georgia, Inc. ("CG") and Sleep Diagnostics Centers of Georgia, Inc. ("GA") both filed bankruptcy on August 28, 2003. On September 9, 2003, this Court entered an order that the two cases be jointly administered. On February 18, 2004, the United States Trustee filed a Motion to Convert or Dismiss. On May 14, 2004, Francis B. Buda, M.D., filed a Motion to Set Date Certain to File Chapter 11 Plan, or, in Alternative, to Dismiss. On July 8, 2004, pursuant to notice, this Court conducted a hearing on both motions. This Court has jurisdiction over this matter under 28 U.S.C. § 157. This Court enters the following Findings of Fact and Conclusions of Law pursuant to Federal Rule of Bankruptcy Procedure 7052.

FINDINGS OF FACT

John and Beverly Jenkins serve as controlling shareholders and executive officers of the CG and GA ("Debtors"). Beverly Jenkins serves as president of GA and vice-president of CG. John Jenkins serves as president of CG and vice-president of GA. CG's operations are located in the Medical Arts Center in Savannah, Georgia, and GA's operations are located in Stockbridge, Georgia, near the Henry County Medical Center. Both corporations specialize in the diagnosis and treatment of sleep disorders.

Dr. Buda served as medical director of both Debtors until January 2003, under contracts that contained no restrictive covenants concerning his employment with other medical providers. At some point after the employment relationship ended, Dr. Buda allegedly competed with and interfered with the Debtors' ability to conduct business by contacting referring physicians, patients and other medical providers, referring them to his new employer, and using other methods to draw business away from the Debtors. In response, Debtors brought an action in the Superior Court of Chatham County alleging tortious interference and breach of contract and seeking to enjoin his activities. Dr. Buda filed a counterclaim for payment of services rendered. The parties were involved in discovery in the Superior Court when the case was stayed by the filing of this Chapter 11 case in August of 2003.

Dr. Buda is the largest unsecured creditor in the case holding a claim of approximately \$302,000.00 which the Debtors argue should be offset by losses they incurred after his resignation.

Dr. Buda's Motion alleges the following: (1) that transactions between the Debtors and certain insiders represent irreconcilable conflicts of interest; (2) that relevant factors such as failure to file tax returns demonstrate a lack of good faith and prejudice the unsecured creditors; (3) that no plan can be confirmed without his consent because his vote will control the unsecured class of creditors and he is unwilling to vote in favor of the plan that is presently proposed by the Debtors; and (4) that the Debtors' case has been pending nearly a year without progress causing prejudicial delay. As a result, he contends that the case should be converted to a Chapter 7 for administration by an independent Chapter 7 trustee.

Insider Transactions

Debtors employ the firm of Medical Claim Consultants ("MCC") to handle the processing of their medical claims. MCC is in turn owned by Debtors' principal owners, John and Beverly Jenkins. Debtors' Schedules list debt of \$23,000.00 to MCC. In addition, the Schedules list debt of almost \$30,000.00 to Excel Enterprises which sells sleep equipment to Debtors' patients. Dr. Buda asserts that John and Beverly Jenkins run Excel as evidenced

by the fact that have the same address as MCC. Furthermore, Dr. Buda contends that Debtors have paid more than \$110,000.00 to a charity known as Breaking Down the Walls Ministries ("BDWM") in the year prior to filing. BDWM shares the same address as the Debtors' principals, and John Jenkins is the director.

With regard to the payments to MCC, Beverly Jenkins testified that MCC processed all claims for the Debtors pre-petition and did so for the same price and under the same terms and conditions as it processes claims for other medical providers. Furthermore, there was no evidence that the debt owed to Excel was outside of the ordinary course of business of the Debtors. Similarly, payments to BDWM reflected a pre-existing pattern of conduct by Mr. and Mrs. Jenkins who have deeply held beliefs concerning their duty to tithe their earnings. There have been no post-petition payments made to BDWM, but historically the corporate Debtors remitted ten percent of their gross receipts to this charity.

John Jenkins also testified at the hearing. Mr. Jenkins is a trained sleep technician; however, his testimony centered on BDWM. Evidence revealed that BDWM is not incorporated nor is it a qualified charitable organization recognized under the Internal Revenue Code. The organization was founded in 1999, had an annual budget of approximately \$100,000.00 in at least one year, and receives 99% or more of its contributions from the Debtors. Thus, BDWM bears many of the characteristics of a private

charity or a private foundation and not those of a qualified charitable organization. Mr. Jenkins produced copies of the checking account register for the organization for the years 2001 through 2003 which reveal numerous payments to charitable organizations. In addition to the contributions to qualified charitable organizations, BDWM has also acted as a conduit for payments to members of the Jenkins family and other individuals who are in need.

The Debtors concede that at least \$36,000.00 was paid to BDWM during a period of time when Dr. Buda's earnings under his contracts with the Debtors were not being paid in full and that an additional \$70,000.00 was being paid to BDWM at a time when Debtors owed outstanding bills to the law firm that it employed to prosecute the state court litigation. As of the time of the hearing, the Debtors had not considered investigating whether the payments to BDWM constituted fraudulent transfers under 11 U.S.C. § 548.

Good Faith

At the hearing, Beverly Jenkins testified in support of the Debtors' contentions that these cases were filed in good faith. She traces the filing of the cases to early 2003 when a former office manager/marketing employee, Angela Ward, was terminated because she was not performing up to expectations. In addition, Dr. Buda resigned in January 2003, and sent letters to patients of the Debtor corporations advising them that they could seek treatment with a competitor of the Debtors for whom Dr. Buda had

gone to work. The evidence revealed that following these two events there was a decline in the patient load of CG, coupled with employee morale problems. At the same time, Debtors suffered reimbursement delays, sometimes in excess of six to twelve months after the time services were billed. In response to these developments, Mrs. Jenkins became more actively involved in managing the business and marketing it to prospective clients.

Although business has been sluggish for more than a year, Mrs. Jenkins expects it to improve substantially. The former GA office was improperly constructed with inadequate soundproofing which impaired patients' ability to sleep comfortably and be monitored as needed in order to diagnose their problems. This in turn cost GA valuable referrals. In addition, nearby highway construction by the Georgia Department of Transportation made access to their facility more difficult. GA was scheduled to relocate its offices to a more suitable facility closer to the Henry County Medical Center at some time in July. Furthermore, Mrs. Jenkins testified that she has developed several new, valuable business opportunities for the corporations.

Debtors' balance sheet shows approximately \$480,000.00 in accounts receivable at book value. However, this amount must be discounted based on the discounting that insurance companies and other payors impose based on what they believe is the reasonable and customary rate for services rendered. Mrs. Jenkins estimated that the

receivables will net only 60% of face value or approximately \$288,000.00 after the discount.

The Debtors have not filed federal or state income tax returns since 1996 or 1997.¹ They recently provided the data for the preparation and filing of such returns to Henry W. Harvey, CPA. At the hearing, I gave Debtors thirty days to file the tax returns. However, I recognized the difficulty in completing the task within the prescribed period, and I noted that I would consider any returns filed in that period and any evidence of the likelihood of further tax liability. On August 4, 2004, both Debtors submitted to the Court their U.S. Corporate Income Tax Returns for 1998 and 1999. In addition, Debtors submitted a copy of a letter from Mr. Harvey advising that although his firm would be unable to complete all twenty-four outstanding tax returns in the thirty days given by the Court, Beverly Jenkins was being "cooperative and expeditious in providing [the firm] information to prepare the returns." He also stressed that, based on his review thus far, both companies have operating and tax losses each year since 1998.

Monthly reports filed by the Debtors with the Office of the United States Trustee indicate that the Debtors have not shown any profitability in the post-petition period. Based upon this lack of profitability, together with the CPA's belief that there is no tax liability and therefore presumably no taxable income for the past seven to eight years, the

¹Although they are not debtors, Mr. and Mrs. Jenkins individually have failed to file tax returns for the years in question.

United States Trustee joins in urging conversion of the case so that a trustee can investigate the allegedly preferential or fraudulent transfers, collect the accounts receivable, and pay claims to the maximum extent possible in an orderly liquidation.

Debtors urge the Court to leave the businesses in place as a going concern because of the efforts which have been underway for several months to rebuild the businesses following the withdrawal of Dr. Buda. Debtors would like an opportunity to rehabilitate and propose to pay Dr. Buda's claim to the extent it is finally allowed and the claims of other unsecured creditors one hundred cents on the dollar over the length of the plan..

CONCLUSIONS OF LAW

A court may convert or dismiss a Chapter 11 case pursuant to 11 U.S.C. § 1112(b) which provides in part:

[O]n request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause

Cause includes the ten factors listed in § 1112(b), and it is generally considered to include

bad faith as well. See Albany Partners Ltd. v. Westbrook (In re Albany Partners, Ltd.), 749 F.2d 670, 674 (11th Cir. 1984). Bad faith does not require a showing of actual fraud, malice or scienter. Shell Oil Co. v. Waldron (In re Waldron), 785 F.2d 936, 941 (11th Cir. 1986). The Eleventh Circuit held that “the courts may consider any factors which evidence ‘an intent to abuse the judicial process and the purposes of the reorganization provisions’ or, in particular, factors which evidence that the petition was filed ‘to delay or frustrate the legitimate efforts of secured creditors to enforce their rights.’” Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1394 (11th Cir. 1988)(quoting In re Albany Partners, Ltd., 749 F.2d at 674). As I noted, “[Section] 1112(b) gives this Court wide discretion to make an appropriate disposition of each case and the ability ‘to consider other factors as they arise, and use its equitable powers to reach an appropriate result in individual cases.’” In re Barnhill Genomics, Inc., Ch. 11 Case No. 02-40426, slip op. at 2 (Bankr. S.D. Ga. Nov. 25, 2003)(Davis, J.)(citing In re Albany Partners, Ltd., 749 F.2d at 674).

Dr. Buda asserts that the Debtors’ cases should be converted to a Chapter 7 because they were filed in bad faith. He alleges that Debtors filed this case in order to avoid complying with discovery in the Superior Court of Chatham County.² Dr. Buda contends that turning the Superior Court dispute into a bankruptcy action demonstrates a lack

²The Court notes that Dr. Buda has not filed a Motion for Relief from Stay in order to continue to prosecute the action in Superior Court. If he does so, a hearing will be promptly scheduled to determine whether this Court should abstain pursuant to 28 U.S.C. § 1334 and grant said motion.

of good faith. See In re Phoenix Piccadilly, Ltd., 849 F.2d 1393, 1394 (11th Cir. 1988). Despite these *indicia* of bad faith, I hold that in light of other problems plaguing the two corporations that led to the filings, including location and structural problems with the building in Atlanta, the poor performance of an office manager in Savannah, delays in the receipt of payment, and a loss of business resulting from Dr. Buda's departure and alleged subsequent misconduct, this is far more than a single-creditor case.

Nor do I find, at this point, an irreconcilable conflict of interest. No evidence was presented that the Debtors have refused to pursue potential claims against BDWM or that a viable cause of action is present. Debtors have a fiduciary duty to examine all payments and decide, as a fiduciary, whether to pursue them. See Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 355, 105 S.Ct. 1986, 1994, 85 L.Ed.2d 372 (1985). At this point it is not clear that Debtors and their counsel have failed to fulfill that duty.

Furthermore, Mrs. Jenkins' testimony about the other affiliated organizations such as MCC was undisputed. According to her testimony, MCC deals with the Debtors under the same terms and conditions as any other client. See In re Microwave Products of America, Inc., 102 B.R. 666, 672 (Bankr. W.D. Tenn. 1989) ("However, the mere fact that a corporate debtor engages in a business relationship with a subsidiary or a related company

does not automatically create a conflict of interest.”). In addition, the proposed Reorganization Plan provides that payments to all affiliated organizations would be deferred until all other claims have been paid in full. Without further evidence of an existing conflict of interest, Dr. Buda’s concerns are premature. *See Richter v. Klein/Ray Broad. (In re Klein/Ray Broad.)*, 100 B.R. 509, 511 (B.A.P. 9th Cir. 1987)(holding evidence asserting a conflict of interest insufficient as it consisted only of declaration of movant’s attorney and amounted only to predictions of possible conflicts of interest rather than evidence that such conflicts existed); *Ribkov Realty Corp. v. Neck Road One Realty, LLC (In re Ribkov Realty Corp.)*, Nos. 99-CV-984, 99-CV-985, 99-CV-987, 1999 WL 529557, at * 11 (E.D.N.Y. July 21, 1999)(“However, the reluctance of the debtor to pursue claims against its insider, taken alone, does not justify [the Judge’s] precipitous decision to convert the case and appoint a trustee.”); *In re Future Energy Corp.*, 83 B.R. 470, 487 (Bankr. S.D. Ohio 1988)(“[T]he good faith objection... is premised purely upon the objectors’ speculation as to the debtor-in-possession’s *future* conduct, *i.e.*, the presumption that [the debtor] will not pursue avoidance actions or object to insider claims. Accordingly, the Court rejects the objectors’ assertion that the plan has not been proposed in good faith.”). *See also Ad Hoc Comm. of Bondholders v. Citicorp Venture Capital Ltd. (In re Fairwood Corp.)*, No. 99 CIV. 3177, 2000 WL 264319, at * 3 (S.D.N.Y. 2000).

Both Dr. Buda and the United States Trustee urge the Court to convert

Debtors' cases to a Chapter 7 based on Debtors' failure to file tax returns. Both Movants rely on this Court's decision in In re Crayton, 169 B.R. 243 (Bankr. S.D. Ga. 1994)(Davis, J.). In Crayton, this Court held, "Debtor's failure to file his returns before filing his Chapter 13 plan, coupled with his failure for six months after filing to bring himself into compliance with federal law, constitute 'unmistakable manifestations of bad faith.'" Id. at 245. However, in Crayton, this Court specifically noted that there was no evidence that the debtor had gathered the information necessary to prepare the unfiled tax returns, that the debtor had obtained copies of his W-2 forms or other information from which his liability could be calculated, or that the debtor had contacted the IRS to obtain information from prior years. It was the debtor's failure to show a sense of responsibility to file his tax returns that demonstrated a lack of good faith and necessitated dismissal. Id. at 244.

In further support, the Movants rely on Eilertson v. United States (In re Eilertson), 211 B.R. 526 (D.S.C. 1997). In Eilertson, the court affirmed the bankruptcy court's dismissal for lack of good faith in filing based on the debtor's failure to file an income tax return. However, in Eilertson, the court found that the debtor had no intention of filing income tax returns despite the large claim the Internal Revenue Service filed in the case. Id. at 530. Dr. Buda also cites a number of other cases in which the courts dismissed a case or denied confirmation based on bad faith for failure to file a tax return; however, those cases are substantially different from the one at bar. *See, e.g.,* Hazel v. Internal

Revenue Service, 95 B.R. 481, 482 (E.D. Mich. 1988)(affirming bankruptcy court's dismissal upon finding that debtor was "tax protester" and had filed invalid income tax returns); In re Burrell, 186 B.R. 230, 236 (Bankr. E.D. Tenn. 1995)(finding that the debtor filed his bankruptcy petition to further his tax protest); In re Paulson, 170 B.R. 496, 497 (Bankr. D. Conn. 1994)(finding that the debtor believed the income tax laws were unconstitutional and debtor acknowledged he filed bankruptcy to stop IRS collection activities).

In this case, the Debtors have demonstrated a willingness to promptly file their tax returns. In fact, the CPA has all of the necessary documents and has indicated that the Jenkins have been cooperative. Furthermore, the CPA assured the Debtors that there will be little if any tax liability. Both Debtors have submitted two years of the unfiled tax returns, and based on this Court's review, it does not appear that there is any misconduct that should lead the court to conclude it was a bad faith failure to file tax returns. As further returns are prepared, the Court directs the Debtors to submit the returns to the Court.

Although Dr. Buda did not address this argument in his brief, counsel did assert at the hearing that Dr. Buda would not vote for the plan proposed by the Debtors and that no plan can be confirmed. This argument is premature until it is certain that Debtors have no ability to amend their plan in a such a way that the plan could be confirmed.

Finally, Dr. Buda asserts that pursuant to 11 U.S.C. §§ 1112 (b)(1) and (b)(3), there has been an unreasonable delay by the debtors that is prejudicial to creditors and that there has been a diminution to the estate assets. As I stated in the hearing, this case does not appear to be one of unreasonable delay. After filing, the Debtors were forced to make substantial organizational changes due to the departure of Dr. Buda and the office manager as well as the development of new business opportunities. Their failure to present a plan for reorganization during this period is excusable and not prejudicial. Dr. Buda presented no evidence regarding the diminution in the value of the estate other than the failure to pay tax returns; however, the CPA has preliminarily determined that no taxes are owed.

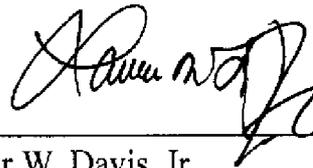
Based on the foregoing, this Court does not at this time find cause to dismiss or convert the Debtors' cases. However, this Court reserves the right to continue to review this matter in light of any new information including information appearing on the unfiled tax returns.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the Motions to Dismiss or Convert are DENIED on an INTERIM basis.

FURTHER ORDERED that the Debtors are directed to file their remaining unfiled tax returns in the next thirty (30) days or show cause why they have not done so.

FURTHER ORDERED that the Clerk shall set a final hearing to consider the Motions to Dismiss or Convert.



Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 20th day of August, 2004.

DEB: SLEEP DIAGNOSTICS CTCS.
Debtor's Atty. BUTLER
Creditor
Creditor's Atty. BOWEN
Trustee
U. S. Trustee JAMES

8/25/04
JB