

- Contract Damages  
- Intangible/Tangible

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE  
SOUTHERN DISTRICT OF GEORGIA  
Augusta Division

In the matter of: )  
C-SYSTEMS, INC., )  
d/b/a Comcon Systems, )  
d/b/a Supermicro Distributors )  
(Chapter 11 Case 186-00549) )

Debtor )

C-SYSTEMS, INC., )  
d/b/a Comcon Systems, )  
d/b/a Supermicro Distributors, )  
WILLIAM A. SCHWEITZER )  
and )  
BETTY A. SCHWEITZER )

Plaintiffs )

v. )

OMNETIC INCORPORATED )  
and )  
GLENN FOLSOM, JR. )

Defendants )

Adversary Proceeding  
Number 186-0051

**FILED**

at 9 O'clock & 10 min. AM

Date 12/14/81

MARY C. BECTON, CLERK  
United States Bankruptcy Court  
Savannah, Georgia

MEMORANDUM AND ORDER

FINDINGS OF FACT

The parties agree that a sales contract was entered into on October 24, 1985, for the sale to Glenn Folsom, Jr., of all of the assets of C-Systems, Inc., d/b/a Comcon

Systems and d/b/a Supermicro Distributors ("C-Systems"), which is the debtor in the underlying Chapter 11 case and the closely-held corporation of Betty and William A. Schweitzer.

1) The sales contract specified that "all existing assets" except accounts receivable of Plaintiffs' were to be sold (Exhibit P-4). These assets included various items of computer hardware located in the Atlanta residence of Barry Weinstein, an employee of C-Systems, a computer software package designed for use in physicians' offices known as Medi-Manage, and so-called source code used for programming changes in the Medi-Manage software which was located in the Maryland home of Karen Romeo, another C-Systems employee.

2) Also included among C-Systems' assets involved in the sale was the intangible right to reproduce and distribute Medi-Manage. C-Systems had acquired this right from Medi-Manage's developer, Solution Business Software, Inc. ("SBSI").

3) The contract obliged Folsom to pay C-Systems and the Schweitzers \$50,000 for assets. Deducted from this \$50,000 price were a pre-payment of \$5,868 by Fain Enterprises, Inc., ("Fain") for computer hardware and a payment of \$32 from Folsom made at the time of the signing. Folsom agreed to arrange

financing for the remaining \$44,100 as soon as possible (Exhibit P-4). The price was not divided into portions to reflect separately the costs of C-Systems tangible and intangible assets.

4) Both Folsom and the Schweitzers understood at the time of the October 24, 1985, agreement that C-Systems would transfer the intangible reproduction and distribution rights, and evidence their agreement in a subsequent writing to be executed at closing. Based on the agreement, Folsom took delivery of the assets and began to market the software purchased from Plaintiffs.

5) The contract made the Plaintiffs responsible for all the debts of C-Systems existing at the time of the signing, except one debt of \$560 owed to Cathy Mayo, which was to be Folsom's responsibility.

6) Folsom maintains that several items of computer hardware were not at Weinstein's residence when he and Weinstein made an inventory of the assets. Weinstein disputes this, and no formal demand was ever made on C-Systems to turnover the supposedly missing assets. Folsom's main interest and motivation in the C-Systems asset acquisition appears to have been the Medi-Manage software system. Folsom was indifferent to the hardware since his intentions were almost exclusively

centered around the marketing of Medi-Manage to health professionals.

7) In anticipation of marketing the software system, Folsom formed Omnetic, Inc. ("Omnetic"), a South Carolina corporation authorized to do business in Georgia, and transferred the C-Systems assets to the corporation. Initially Omnetic operated its affairs from Weinstein's residence. Weinstein continued to work on the Medi-Manage software as an employee of Omnetic. Karen Romeo continued to program changes in the software, using the source code at her Maryland home and transmitting the changes to Atlanta via telephone. At all times prior to C-Systems' Chapter 11 filing and Omnetic's decision to abandon his attempts to sell Medi-Manage, Folsom was able to use the source code in Romeo's possession. Folsom and Omnetic considered the source code the property of Omnetic at all times.

8) Despite their contractual obligation to pay all of C-Systems debts prior to the transfer of the assets, C-Systems and the Schweitzers failed to pay several bills for utilities used by C-Systems at Weinstein's residence. In order to avoid the costly consequence of interrupted utility services, Folsom was compelled to pay these bills. They included \$873.24 for a telephone bill, \$378.75 for an electric bill, and \$29.36 for a natural gas bill.

9) Fain Enterprises, one of the primary customers for the Medi-Manage software system, claimed that it had pre-paid C-Systems for more computer hardware than the Schweitzers had told Folsom that Fain was due. Omnetic and Folsom disputed their liability on any such pre-payment. At the urging of Weinstein, however, Omnetic and Folsom ultimately delivered approximately \$20,000 worth of additional hardware and computer services to Fain to satisfy his demands..

10) From October 1985 until June 1986, Omnetic marketed the Medi-Manage software. The sales figures were as follows:

December 1985:		
Fain Enterprises	2 systems at \$2,500 each	\$5,000
Matrix Group	1 system at \$2,500	\$2,500
Computerized Doctor Systems	2 systems at \$1,000 each	\$2,000
January 1986:		
Computerized Doctor Systems	1 system at \$1,000	\$1,000
February 1986:		
Computerized Doctor Systems	2 systems at \$1,000 each	\$2,000
March 1986:		
Fain Enterprises	1 system at \$2,500	\$2,500
April 1986:		
Executone	1 system at \$2,500	\$2,500
May 1986:		
Comdex	1 system at \$2,500	\$2,500
Fain Enterprises	2 systems at \$2,500 each	\$5,000

Total Sales

\$25,000

From January 1, 1986, to June 30, 1986, Omnetic also sold hardware worth \$126,408.25 (Exhibit D-10).

11) Some of Omnetic's customers complained of difficulties with the Medi-Manage software and refused payment. The evidence shows that Medi-Manage was less attractive to potential customers than were competing software systems.

12) While Omnetic was having trouble selling Medi-Manage, it had extensive start up costs. Omnetic entered into a 5 year lease for office space with monthly rent of \$2,200. Additionally, there were numerous other overhead expenses, including salaries, consulting and managing fees, and office expenses. (Exhibit D-10).

13) As Omnetic began its operation, the Schweitzers and Folsom, through their respective attorneys, began an exchange of correspondence which ostensibly was to lay the groundwork for the final closing of the October 24, 1985 deal. (Exhibits D-2, D-4, D-5, D-8, P-16 and P-17). Evidently, the Schweitzers' and C-Systems' attorney believed, notwithstanding the clear language of the agreement, that the source code

Romeo's possession was not included among the assets of C-Systems. As a result, he demanded an additional \$125,000 from Folsom (D-4, D-5). Folsom, understandably enough, refused to pay the additional amount, having previously tendered performance (Exhibit D-2) and awaited further action from the Schweitzers who never agreed to close the transaction at that price (Exhibit P-17).

14) On June 12, 1986, C-Systems filed a Chapter 11 petition in the United States Bankruptcy Court for the Southern District of Georgia. The schedule of assets of the estate listed a claim against Folsom for the conversion of C-Systems assets.

15) Almost contemporaneously with the filing of C-Systems' Chapter 11 petition, Folsom decided to cease his and Omnetic's efforts to sell the Medi-Manage system.

#### CONCLUSIONS OF LAW

##### I. Applicable Body of Law

Plaintiffs have argued that the sales contract is one for the sale of goods within the scope of Article 2 of the

Commercial Code. (O.C.G.A. §13-2-101 et seq.), and, therefore, the Commercial Code's provisions on contract performances and remedies should apply. This position is inaccurate.

In a sale of the assets of a business where the sales contract does not allocate the sales price among the physical assets, which would indisputedly be goods, and the intangible assets, which are not goods, the contract will be treated as indivisible, and general contract law as codified in Title 13 of the O.C.G.A. applies, not the Commercial Code. Flo-Mor, Inc. v. Birmingham, 176 Ga.App. 375, 336 S.E.2d 264 (1985). The sales contract here mentions only a single price for the assets of C-Systems. Those assets included both the intangible rights C-Systems had acquired from Medi-Manage's developer and various items of computer hardware. Since there was no allocation of price between the physical assets and the intangible rights, the rule of Flo-Mor requires that general contract law apply.

## II. C-Systems' Right to the Contract Price

The sales contract obliged Folsom to pay the Plaintiffs the remaining \$44,100 of the contract price and obliged the Plaintiffs to transfer all assets, including their intangible rights in the Medi-Manage software system to Folsom in order to complete the transaction. Thus, the contract imposed

concurrent obligations on the parties. Section 13-4-22 of the O.C.G.A. provides:

"Where the conditions as to performances of a contract are concurrent, if one party offers to perform and the other refuses to perform, the first shall be discharged from the performance of his part of the contract and may maintain an action against the other."

Here, Folsom offered and was prepared to pay C-Systems and the Schweitzers the remaining \$44,100 up until the filing of the Chapter 11 petition. This position was a sufficient tender of performance under Georgia Law. O.C.G.A. Section 13-4-24.

The Plaintiffs refusal to close and attempts to increase the purchase price constitute a breach of contract and as a result Folsom was entitled to avail himself of several remedies, including rescission, O.C.G.A. §13-4-62, damages, O.C.G.A. §13-6-1 and specific performance, O.C.G.A. §23-2-130, and perhaps others. Folsom, however, did not follow any of these courses of action. Nevertheless, he retained the assets and continued to sell Medi-Manage, albeit with indifferent results, through Omnetic, his closely-held corporation.

At all times until he abandoned his efforts to market Medi-Manage, Folsom had access to the source code in Romeo's possession, and through Omnetic, he took advantage of

that access. Romeo made periodic changes in the Medi-Manage software throughout the time that Folsom and the Schweitzers were disputing ownership of the source code. Omnetic used these changes to improve the quality of Medi-Manage, and despite the problems with the software, Omnetic sold 13 Medi-Manage packages from October 1985 to June 1986. Enjoying the use of the Medi-Manage software's earning's potential without paying the \$44,100 contract price is not one of the remedies available to Folsom, regardless of the Schweitzers' initial refusal to accept tender of payment. While the Schweitzers' refusal of the tender constituted a breach, the remedy for Folsom is a counter-claim in the nature of a recoupment, not nonpayment. Sasser & Co. v. Griffin, 133 Ga.App. 83, 210 S.E.2d 34 (1974).

C-Systems, accordingly, is entitled to the remaining \$44,100 of the contract price, less any recoverable damages Folsom incurred through C-Systems and the Schweitzers failure to perform.

### III. No Fraud on the Schweitzers' and C-Systems' Part is Shown

Folsom and Omnetic have counterclaimed against the Schweitzers and C-Systems, alleging fraud in the sale of C-Systems' assets. Of course, the record shows that Medi-Manage was not a particularly valuable computer software system. There

is, however, no evidence to show that the Schweitzers fraudulently misrepresented the quality of Medi-Manage.

The closest Folsom can come to showing fraud is the possibility that the Schweitzers misrepresented the amount of computer hardware items owned by C-Systems. Conceivably, such an inference would be possible since Folsom maintains that some items he understood to be assets of C-Systems were missing. In Georgia fraud is a "[w]illful misrepresentation of a material fact, made to induce another to act, upon which such person acts to his injury . . . ". O.C.G.A. §51-6-2. This definition of fraud has been construed to require reliance upon the misrepresentation by the injured party. Eckerd's Columbia, Inc. v. Moore, 155 Ga.App. 4, 270 S.E.2d 249 (1980). In this case, however, Folsom was not particularly interested in the computer hardware; his principal purpose in entering the contract was to acquire the computer software. His action in agreeing to purchase the assets of C-Systems was not induced by the presence of the hardware in the deal. Moreover, there was ample evidence that, in fact, all the tangible assets of C-Systems were delivered or made available to Folsom. Accordingly, the allegation of fraud is without merit.

IV. Folsom's Damages Resulting from the Schweitzers' as C-Systems' Breach

While C-Systems is entitled to the remainder of the contract price, Folsom is entitled to some deduction in the nature of a recoupment from the \$44,100 for damages he sustained from the Schweitzers' failure to close the deal. See, Griffin, cited supra. Section 13-7-2 of the O.C.G.A. states:

"Recoupment is a right of the defendant to have a deduction from the amount of the Plaintiff's damages for the reason that Plaintiff has not complied with the cross-obligations or independent covenants arising under the contract upon which suit is brought."

Folsom and Omnetic have requested damages for several items. The general rule in contract actions is that damages are recoverable to the extent that they arise naturally and according to the usual course of things from the breach of the contract and are within the contemplation of the parties when the contract was made. O.C.G.A. §13-6-2. In light of this principle, the merits of Folsom's claims will be considered.

#### A. The Utility Expenditures

Folsom and Omnetic made payments of \$873.24 (telephone bill), \$378.75 (electric bill) and \$29.36 (gas bill) to clear up debts incurred by C-Systems at Weinstein's residence. Without these payments the utilities would have been disconnected, and since much of Omnetic's business depended on

its operations in Weinstein's home, the effect would have been devastating. The Schweitzers should have understood the consequences of this since they too had operated C-Systems from Weinstein's home. The utility bills, therefore, are recoverable by Folsom.

B. Payment to Cathy Mayo

Folsom claims damages of \$560 because of a payment to Cathy Mayo for money owed her by C-Systems prior to October 24, 1985. While the sales contract otherwise made the Schweitzers responsible for all existing debts, the debt to Mayo was specifically excepted and made Folsom's responsibility. Therefore, Folsom's claim is denied.

C. Start-up Costs and Lost Profits of Omnetic

These damages are consequential damages and are governed by O.C.G.A. Section 13-6-8. No evidence was given to substantiate a claim for lost profits. Nor do the financial statements introduced in evidence support a claim for expenses incurred in the start-up of the business. The expenses are not allocated between costs necessary to start any similar business and those which can be traced solely to Plaintiffs' breach. Nor are the expenses allocated between that part of the business devoted to sale of Medi-Manage software and sale of hardware

which apparently continued long after Folsom abandoned his efforts to sell hardware. Since this constituted more than 80% of the gross sales of Omnetic (Exhibit D-10) during the six months in question is it reasonable to assume that as much as 80% of the overhead is attributable to hardware sales and not to the failed software business. However, I cannot act on an assumption, and there was no evidence to quantify the damage sustained due to overhead devoted to software marketing. As such, it would error to award these damages. Department of Transportation v. Arapaho Construction, Inc., 180 Ga.App. 341, 345 (1986).

D. Goods and Services Delivered to Fain

Folsom claims his delivery of additional goods at no cost to Fain resulted from the Plaintiffs' breach. The Schweitzers alleged that Folsom's allowance of Fain's demand was a calculated move to retain Fain's goodwill as a steady customer, not because he felt he was obliged to do so. While the evidence was conflicting, I conclude that the \$20,000 in goods and services provided to Fain should be deducted against Folsom's liability for the balance due on the contract. Due to the Plaintiffs' breach in refusing to close and their failure to adhere to other contract provisions such as the utility payments, Folsom had every reason to doubt their veracity and the accuracy

of the figures provided by them as to Fain's rights. Thus, they must bear the risk that Folsom's reasonable action in responding to Fain's claim might ultimately cost them.

E. Exemplary Damages are Inappropriate

Defendants Folsom and Omnetic recognize that ordinarily exemplary damages are inappropriate in contract actions. O.C.G.A. §13-6-10. They maintain, correctly, however, that exemplary damages are available in contract actions where a claim of fraud is made and proven. Clark v. Aenchbacher, 143 Ga.App. 282, 238 S.E.2d 442 (1977). In this case, however, Folsom and Omnetic did not prove any fraud for the reasons discussed in Conclusions of Law III, supra, and no exemplary damages are recoverable.

O R D E R

Based on the foregoing discussion Plaintiff, C-Systems, Inc.,<sup>1</sup> is entitled to recover the agreed upon purchase

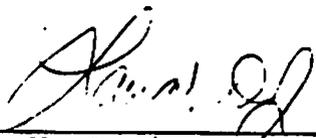
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<sup>1</sup> Although Mr. and Mrs. Schweitzer were also parties to the agreement, it is clear from Exhibits 1 - 4 that Folsom did not purchase their stock in C-Systems but rather, purchased C-Systems assets. As a result, the balance owed is owed to C-Systems only.

price less those credits awarded to Defendants as follows:

Gross Balance of Purchase Price		\$44,100.00
Less:		
Utility Payments	\$ 1,281.35	
Goods and Services to Fain	\$20,000.00	
	<u>\$21,281.35</u>	
		\$21,281.35
Net Balance		<u>\$22,818.65</u>

SO ORDERED.

  
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Lamar W. Davis, Jr.  
United States Bankruptcy Judge

Dated at Savannah, Georgia

This 10<sup>th</sup> day of December, 1987.