

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:)	Case No. 03-25461
)	
DEACONESS HOSPITAL, LLC, <i>et al.</i> ,)	Chapter 11
)	(jointly administered)
Debtors.)	
)	Judge Pat E. Morgenstern-Clarren
)	
)	<u>MEMORANDUM OF OPINION</u>

The official committee of unsecured creditors, JP Morgan Chase Bank, N.A. (successor to Bank One N.A.),¹ and GE HFS Holdings, Inc. jointly move to appoint a trustee in these liquidating chapter 11 cases.² The debtors Deaconess Hospital, LLC, Pearlview Square, Inc., and Indoga, Inc. oppose that request.³ For the reasons stated below, the motion is granted. The debtors moved at hearing for judgment on the pleadings, which motion is denied, also for the reasons stated below.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A).

¹ The JP Morgan/Bank One transaction took place during the chapter 11 case. For ease of reference, the court will continue to refer to the creditor as Bank One in this memorandum of opinion.

² Docket 864, 886.

³ Docket 888.

FACTS⁴

The debtors filed their chapter 11 reorganization cases on November 21, 2003. Within a week or so, the cases turned into liquidating chapter 11s. Most of the assets were sold in April 2004 and the debtors have about \$1.1 million in cash. The only funds coming into the estates are from accounts receivable, which are being collected by a third party at a rate of about \$5-10,000.00 a month.

A. Claims

Creditor GE HFS asserts a secured claim of more than \$4.6 million.⁵ Creditor Bank One filed a secured claim for \$3,043,134.99 as of the date the cases were filed.⁶ The debtors have not formally objected to the amount of either claim. There are about \$13 million in unsecured claims, as well as priority claims and administrative claims. With respect to the latter, the court has approved several fee applications from professionals. Some fees have been paid and others have not been paid. GE HFS will no longer consent to the use of its cash collateral to pay the fees, and the court declined to order the fees paid from GE HFS's cash collateral because the creditor is not adequately protected and the debtors did not show that the estates have unencumbered funds to draw on for this purpose.⁷

⁴ The court held an evidentiary hearing on April 5, 2005. George Saad, M.D. was the only witness.

⁵ With court approval, the debtors paid GE HFS \$3.5 million on October 1, 2004 as a non-indefeasible payment on this claim.

⁶ Exh. 8.

⁷ Docket 787, 788.

These fee applications have been approved and paid:

Administrative Claimant	Order Date	Fees	Expenses
Hahn Loeser & Parks (Debtors' counsel)	9/15/04 12/17/04	\$456,624.60	\$28,279.48 \$ 5,095.92
Brouse McDowell (Committee counsel)	10/19/04	\$136,320.00	\$ 1,297.47
McLaughlin & McCaffrey, LLP (Debtors' special counsel)	9/9/2004	\$ 13,782.50	\$ 26.47
MelCap Partners, LLC (Debtors' investment banker)	4/28/04 6/29/04	\$255,000.00	\$ 3,858.40 \$ 3,954.92
Klinc & Associates (Debtors' accountants)	6/17/04 10/18/04	\$ 22,500.50 \$ 30,708.50	\$ 160.00
	Subtotal	\$914,936.10	\$42,672.66

These fee applications have been approved but not paid:

Hahn Loeser & Parks	12/17/04	\$183,648.00	\$21,080.95
Klinc & Associates	2/23/05	\$ 16,504.05	\$ 38.08
	Subtotal	\$200,152.05	\$21,119.03

This part of a fee application was heard and deferred to see if the services benefitted the estates:

Hahn Loeser & Parks	12/17/04	\$ 77,749.00	
	Subtotal	\$ 77,749.00	

These fee applications have been filed but not yet heard:

Applicant	Date Filed	Fees Requested	Expenses Requested
Brouse & McDowell	2/11/05	\$185,635.00	\$ 7,842.69
	Subtotal	\$185,635.00	\$ 7,842.69

These parties have accrued fees that have not yet been the subject of fee applications:

Party	Accrued Fees	Accrued Expenses	Source of alleged obligation
GE HFS	\$475,460.85 as of 10/1/04; plus fees after that date	\$32,905.45	Financing documents; stipulated cash collateral orders
Brouse & McDowell	Fees after 01/19/05	Expenses after 01/19/05	
Hahn Loeser & Parks	Fees after 12/17/04	Expenses after 12/17/04	

The administrative costs, therefore, total about \$1,378,472.10 in fees plus \$71,634.38 in expenses, without including GE HFS's fees or fees incurred by debtors' counsel or the committee counsel for the last several months, a time of high activity.

B. George Saad, M.D.

Dr. George Saad is the debtors' only equity holder and sole decision maker. He also owns and controls these related companies: Nour Management, Inc., Deaconess Radiological Services, Inc., and Deaconess Emergency Room Services, Inc. Dr. Saad's finances are connected to the debtors in this fashion:

GE HFS

The debtors borrowed money from GE HFS both pre and postpetition. Dr. Saad guaranteed these debts personally.⁸ He also caused Deaconess Radiological and Deaconess Emergency to pledge certain accounts receivable to GE HFS. Together with Nour, Deaconess Radiological, and Deaconess Emergency, Dr. Saad personally filed a state court lawsuit⁹ against GE HFS alleging that GE HFS breached its obligation to fund the debtors' operations postpetition. The claims are for fraud in the inducement, promissory estoppel, breach of implied duty of good faith, intentional and malicious conduct, breach of contract, and injunctive relief to prevent GE HFS from exercising a warrant of attorney given to GE HFS by some or all of the plaintiffs.¹⁰ The plaintiffs' attorney withdrew from the representation and they have been without counsel for some time.

The debtors filed an equitable subordination complaint against GE HFS in this court that raises allegations substantially similar to those in the district court action.¹¹ The debtors retained special counsel to represent them in the adversary proceeding because their chapter 11 counsel is a material witness in that dispute and, therefore, has a conflict.

⁸ Exh. 22.

⁹ The complaint was removed to the United States District Court for the Northern District of Ohio.

¹⁰ Exh. 20.

¹¹ Exh. 21.

Based on the amount of the secured claims, the unsecured creditors will not receive any distribution from the liquidating estates unless the GE HFS claim is subordinated or settled for less than the full claim amount.

Bank One

Dr. Saad is personally indebted to Bank One for \$3,043,134.99.¹² He caused the debtors to guarantee his personal obligations to Bank One. While the debtors do not agree that this results in a conflict of interest, they do not intend to prosecute any actions relating to Bank One and agreed that the committee may do so.

Postpetition, Dr. Saad, Joyce Saad, Deaconess Hospital, LLC, Indoga, Inc., Pearlview Square, Medab, Inc., and Parma Day Medical, Inc. sued Bank One in state court asking that Bank One be enjoined from exercising warrants of attorney in the debt instruments to obtain cognovit judgments and be compelled to arbitrate the disputes.¹³

The debtors

The debtors acknowledge they have potential avoidance claims against Dr. Saad and related entities that the committee is pursuing. They also state that Dr. Saad has claims against the debtors.¹⁴

Based on the amount of unsecured debt (about \$13 million), there is no scenario under which Dr. Saad, the debtors' equity owner, will have any interest left. At this point, therefore, the debtors do not have an economic interest in the case.

¹² Exh. 8.

¹³ Exh. 26.

¹⁴ Exh. 15 at ¶ 9.

C. Efforts to resolve the issues consensually

On August 9, 2004, the debtors filed a proposed disclosure statement and plan. The United States trustee, the committee, GE HFS, and Bank One objected. The court denied the request to approve the disclosure statement on September 9, 2004. The debtors have not filed any other plan and have not described or suggested what such a plan might entail.

At the debtors' request, the court referred the matter to mediation because the debtors felt that the other parties were not negotiating with them. The mediation did not result in any material agreements. The debtors entered into a series of agreed (albeit heavily negotiated) interim cash collateral orders with GE HFS and Bank One through March 1, 2005.¹⁵ After that date, the secured creditors refused to enter into any other such agreements. The debtors filed a motion to approve use of cash collateral which GE HFS and Bank One opposed.¹⁶ After a hearing, the court denied the motion because GE HFS was not adequately protected.¹⁷

On February 15, 2005, the committee, GE HFS, and Bank One moved the court to approve a global settlement that would resolve the GE HFS and Bank One claims, pay part of the committee's counsel fees, and create the possibility that other administrative claimants and priority and general unsecured creditors might receive a distribution.¹⁸ They invited the debtors to join in, but they declined. The debtors denied that the settlement was fair and reasonable and

¹⁵ Docket 809.

¹⁶ Docket 838, 848, 850, 853.

¹⁷ Docket 858 (order denying the debtors' motion for further use of cash collateral and granting in part the debtors' request to surcharge GE HFS for collection of accounts receivable).

¹⁸ Exh. 1 and 16.

challenged the movants' standing to ask the court to approve the settlement. They argued that it was in the interest of creditors to pursue extensive litigation rather than to settle under the proposed terms.¹⁹ The court denied the motion as procedurally defective.²⁰

The moving parties now ask the court to appoint a chapter 11 trustee to take over from the debtors in possession. The debtors oppose the motion.

THE POSITIONS OF THE PARTIES

The committee, GE HFS, and Bank One ask that a chapter 11 trustee be appointed for two purposes. The first purpose is to have an impartial party evaluate the global settlement proposal. If the trustee concludes it would be in the best interest of the estates to join in the settlement, then the trustee would move for court approval of the settlement.²¹ Notice would be given and the issue would proceed from there. If the trustee does not conclude that the settlement would be in the estates' best interest, then the second purpose would be to have an independent person resolve (either through settlement or litigation) the remaining issues with GE HFS, Bank One, and Dr. Saad, individually. The movants argue that the debtors no longer have an economic interest in the case and that they have conflicts of interest that will prevent them from prosecuting the remaining issues, even if the settlement does not go forward. Far better, the movants argue, that an independent decision maker come in and do whatever needs to be done to bring this case to a close.

¹⁹ Exh. 17.

²⁰ Docket 859. The essential problem was that the movants did not have standing to settle the claims under the terms proposed.

²¹ *See* FED. R. BANKR. P. 9019.

The debtors respond that the movants have not established cause to appoint a trustee. They contend the movants did not show the extreme circumstances that warrant appointment of the trustee, they deny that Dr. Saad's multiple interests create conflicts that prevent him from exercising appropriate judgment as a fiduciary, and they claim that other parties in interest who have not come forward are entitled to have the case administered without the expense of a chapter 11 trustee.

DISCUSSION

11 U.S.C. § 1104(a)

Bankruptcy code § 1104(a) provides for the appointment of a chapter 11 trustee. "In a Chapter 11 case, a trustee replaces the debtor in possession and takes immediate control of the business and the reorganization effort." *United States v. Schilling (In re Big Rivers Elec. Corp.)*, 355 F.3d 415, 422 (6th Cir. 2004). *See also* 11 U.S.C. §§ 1106(a), 1108. There is a strong presumption, however, that a chapter 11 debtor should be permitted to remain in control of its affairs. *See In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 471 (3d Cir. 1998). The creditors cite both subsections of bankruptcy code § 1104(a) as a basis for the appointment of a trustee in these cases:

- (a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee –
 - (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, . . . or
 - (2) if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate[.]

11 U.S.C. § 1104(a). The creditors must prove their case by clear and convincing evidence. *Marvel*, 140 F.3d at 471.

A. 11 U.S.C. § 1104(a)(1)

Section 1104(a)(1) requires the court to appoint a trustee when a moving party proves that cause exists. The statute specifies that fraud, dishonesty, incompetence, and gross mismanagement are cause, but those factors are not exclusive. *See* 11 U.S.C. § 102(3) (the term “including” in § 1104(a)(1) is not limiting). Additional relevant factors include:

- (1) Materiality of the conduct;
- (2) Evenhandedness or lack of same in the dealings with insiders or affiliated entities vis-a-vis other creditors or customers;
- (3) The existence of prepetition voidable preferences or fraudulent transfers;
- (4) Unwillingness or inability of management to pursue estate causes of action;
- (5) Conflicts of interest on the part of management interfering with its ability to fulfill fiduciary duties to the debtor; [and]
- (6) Self-dealing by management or waste or squandering of corporate assets.

In re Intercat, Inc., 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000). Conflicts of interest which prevent a debtor in possession from fulfilling its fiduciary duties may constitute cause for the appointment of a chapter 11 trustee. *See, for example, In re SunCruz Casinos, LLC*, 298 B.R. 821, 830-32 (Bankr. S.D. Fla. 2003).

The debtors in this case have multiple conflicts of interest stemming from Dr. Saad’s role as the debtors’ sole decision maker. The documents show that he is personally liable to the

estates' two secured creditors, GE HFS and Bank One, although in testimony he refused to admit this.²² Dr. Saad personally initiated litigation postpetition against both creditors for his own benefit in an attempt to release himself from whatever obligations he may have to those lenders. The Bank One litigation is particularly curious because Dr. Saad caused the debtors to be plaintiffs, but he did so without court authority. Also, all of the plaintiffs in that case were represented by attorney Robert Kracht, who represented Dr. Saad personally in the bankruptcy cases. This was not only unauthorized, but a clear conflict of interest. The debtors have agreed they will not pursue the Bank One claim in this court, which means that issue is already in other hands, although the debtors have not ceded their right to object to any settlement of that claim. The GE HFS situation also features a conflict. Dr. Saad has personal litigation against GE HFS that is not being prosecuted; at the same time, he wants the debtors' cause of action against GE HFS pursued vigorously in the bankruptcy court. Additionally, the debtors have claims against Dr. Saad and Dr. Saad states that he has claims against the debtors. In resolving those issues, Dr. Saad would be negotiating with himself, an obvious conflict. The court also notes that the debtors have some conflict between their interests and those of Nour, one of the companies wholly owned by Dr. Saad. The debtors moved to pay Nour for management services rendered that allegedly went beyond those the debtors were obligated to provide as fiduciaries. The motion was strongly opposed and the court denied it. The debtors then filed a motion to hire a third party, threatening that Nour would no longer provide services after a certain date without

²² Dr. Saad did not explain the basis for contradicting the documents that he himself signed, including a cash collateral order entered by this court.

the requested compensation and that the matter was an emergency. That threat turned out to be an empty one, but not until considerable time had been spent by all concerned on the issue. Given all of the circumstances, the court concludes based on clear and convincing evidence that Dr. Saad's conflicts of interest interfere with his fiduciary responsibilities.

The debtors argue that it is not unusual for an individual to have guaranteed the debts of a corporate debtor and if the movants prevail in their argument that this constitutes a disabling conflict, every such debtor will end up with a trustee. That is not so. The trustee is warranted in this case because of Dr. Saad's specific conflicts of interest as described above that interfere with his responsibilities as the debtors' sole decision maker, not simply because he is personally liable to some of the same creditors.²³

B. 11 U.S.C. § 1104(a)(2)

Additionally, and alternatively, the movants proved by clear and convincing evidence that a trustee should be appointed under § 1104(a)(2). That section "creates a flexible standard, instructing the court to appoint a trustee when doing so addresses 'the interests of the creditors, equity security holders, and other interests of the estate'." *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989). The appointment of a trustee under § 1104(a)(2) is left to the bankruptcy court's discretion. *See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 501 (6th Cir. 1990).

Relevant considerations under § 1104(a)(2) include: (1) the debtor's trustworthiness; (2) the debtor's past and present performance and its prospects for rehabilitation; (3) the confidence

²³ This court has presided over many cases where an equity owner with personal obligations to the debtor's lender has nevertheless met his fiduciary obligations. It can be done.

of creditors and the business community in the debtor; (4) the benefits to be derived from the appointment of a trustee compared to the costs of the appointment; and (5) whether a trustee could accomplish the goals of a chapter 11 plan more efficiently and effectively than the debtor in possession. *See Schuster v. Dragone (In re Dragone)*, 266 B.R. 268, 273 (D. Conn. 2001); *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D. N.Y. 1990). The appointment of a trustee may be appropriate where it is “necessary to unfreeze [the] bankruptcy case and to permit and foster the negotiations between interested parties which generally occur in bankruptcy cases.” *In re Bellevue Place Assocs.*, 171 B.R. 615, 625 (Bankr. N.D. Ill. 1994). *See also Marvel*, 140 F.3d at 474-75 (discussing the appointment of chapter 11 trustee to address cases where there is gridlock based on parties’ inability to resolve the many issues on which they are sharply divided).

The facts unquestionably show that appointing a trustee addresses the interests of the creditors, equity holders, and other estate interests. These are liquidating estates with no prospect for reorganization. Dr. Saad admits he will not end up with any equity. At this point, and for the last several months, the debtors have simply been stakeholders for the creditors’ economic interests. The debtors and most of the creditors are at loggerheads on the remaining major issues: resolution of the GE HFS and Bank One claims, the continuing use of cash collateral, and payment of administrative claims. All creditors who appeared ask that a trustee be appointed to move this case to resolution without unduly incurring more professional fees. No creditor has asked that the debtors, acting through Dr. Saad, continue as fiduciaries. The committee and the secured creditors have proposed a settlement which the debtors will not allow to be presented for

comment by interested parties. They insist that extensive litigation is the better solution without articulating any sound reason for refusing to submit the settlement to the creditors.²⁴

As part of their argument, the debtors claim that the creditors' interest cannot really be analyzed because fewer than all creditors received notice of this motion. At the same time, the debtors concede that notice was given in accordance with the rules. They purport to be worried that notice was not given to *each* unsecured creditor, to administrative creditors owed professional fees, and to prepetition priority creditors (primarily former employees). The unsecured creditors are, however, represented by their committee and the committee's counsel and they are part of the moving force behind this motion to appoint a trustee. In response, the debtors argue that the committee really only speaks for the committee members, rather than for the unsecured creditors as a constituency. This is not only contrary to the committee's statutory duties, but it is not supported by any evidence whatsoever. On the issue of notice to administrative creditors, the main creditors in this category are debtors' counsel and the committee counsel, both of whom obviously had notice of the motion and neither of whom interposed an objection. As for the prepetition priority creditors, the debtors argue that those creditors are entitled to have the estates administered by Dr. Saad unless there is a showing of fraud or misconduct of a similar magnitude. This is not an accurate statement of the law. The debtors also contend that these creditors are entitled to have the estates administered without the

²⁴ The debtors argue that their contingency counsel is in the best position to say if the settlement should be seriously considered because that counsel will only be paid from a successful prosecution of the action. The debtors offer two letters from contingency counsel which opine that the court should ultimately rule in the debtors' favor. (Exhs. A, D). While the court respects each counsel's opinion, it sees no reason to give greater weight to one counsel's opinion than another's. In any event, the court is not making any decision about the merits of the litigation or the proposed settlement.

additional cost of a trustee. While the appointment of a trustee does involve expense, that increase is generally balanced by a decrease in fees incurred by debtors' counsel. In this case, it will most likely also be balanced by a decrease in fees devoted to wrangling between the parties. The legitimate interest of the priority creditors, and for that matter all creditors, is to have the estates administered according to law, not necessarily to have them administered by the original fiduciary. Finally, if the debtors truly thought the prepetition priority creditors should be heard on this issue, they could have asked the court to expand the notice provisions for the motion. They did not.

The creditors who have been heard from have repeatedly and emphatically stated that they do not have confidence in Dr. Saad. There is objective evidence—in addition to the conflict issues outlined above—supporting the lack of confidence. For example, Dr. Saad testified in July 2004 that the debtors would collect \$3 million in accounts receivable. The court rejected this testimony as unsupported and the debtors in fact have only collected in the range of \$5-10,000.00 a month since then. Dr. Saad also testified at that time that the debtors anticipated receiving \$1.2 million from HCAP. The debtors now say that the amount of this recovery is uncertain.²⁵

If a trustee steps in, that person can independently evaluate the proposed settlement free of conflicts and make a decision on how best to proceed. If the settlement is not adopted or ultimately approved, a trustee can decide how best to resolve the remaining major issues without the taint of self-interest. In either event, the only entities with an economic interest in this case will have the chance to move it forward. This is particularly critical in light of the professional fees that have accrued to date and continue to accrue in these insolvent estates. Thus, a trustee

²⁵ Docket 564, 798 at ¶ 13(iii).

can accomplish the goals of chapter 11 more efficiently than can the debtors in possession. The movants have proven that a trustee should be appointed under § 1104(a)(2).

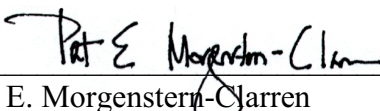
THE DEBTORS' MOTION FOR JUDGMENT ON THE PLEADINGS

At the hearing, the debtors orally moved for judgment on the pleadings on the ground that the movants did not state reasons sufficient to support appointment of a trustee. The court took the motion under advisement. Federal rule of civil procedure 12(c) states in part "after the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings." FED. R. CIV. P. 12(c) made applicable to adversary proceedings by FED. R. BANKR. P. 7012. A motion to appoint a trustee is a contested matter and this rule does not apply to contested matters. FED. R. BANKR. P. 9014(c). Even if it did apply, the movants' allegations sufficiently supported their request to appoint a trustee for the reasons discussed above. The motion is, therefore, denied.

CONCLUSION

For the reasons stated, the creditors' motion for the appointment of a chapter 11 trustee is granted and the debtors' motion for judgment on the pleadings is denied. A separate order will be entered reflecting this decision.

Date: 18 April 2005



Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:) Case No. 03-25461
)
DEACONESS HOSPITAL, LLC, *et al.*,) Chapter 11
) (jointly administered)
Debtors.)
) Judge Pat E. Morgenstern-Clarren
)
) **ORDER**

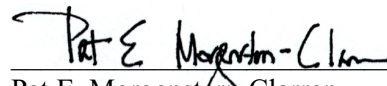
For the reasons stated in the memorandum of opinion filed this same date, the joint motion of the official committee of unsecured creditors, JP Morgan Chase Bank, N.A., and GE HFS Holdings, Inc. to appoint a chapter 11 trustee is granted, the debtors' opposition is overruled, and the debtors' oral motion for judgment on the pleadings is denied. (Docket 864).

IT IS, THEREFORE, ORDERED that a chapter 11 trustee is appointed and the United States trustee is authorized to exercise his duties in making the appointment of such trustee, subject to the court's approval;

IT IS FURTHER ORDERED that until such time as the chapter 11 trustee assumes his or her duties, the debtors and their principal, George Saad, M.D., are prohibited from using, transferring or otherwise taking control over any funds belonging to the debtors; and

IT IS FURTHER ORDERED that the debtors and their principal are to provide an accounting to the United States trustee for any funds collected and any transactions that occur from the date of this order until the chapter 11 trustee assumes his or her duties.

Date: 18 April 2005


Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center