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UNITED STATES BANKRUPTCY COURT

9

Southern District of California

10 In re:) CASE NO. 04-05832-LA11
) (Jointly Administered with
11 XÉLAN, INC., a California) Case Nos. 04-05833-LA11,
Corporation, PYRAMIDAL) 04-05834-LA11, and
12 FUNDING SYSTEMS, INC., a) 04-05835-LA11)
California corporation dba) (This Pleading applies to
13 XELAN INSURANCE SERVICES,) all cases)
INC., XELAN FINANCIAL)
14 PLANNING, INC., a California) MOTION FOR ORDER DIRECTING THE
Corporation, XELAN PENSION) APPOINTMENT OF A CHAPTER 11
15 SERVICES, INC., a California) TRUSTEE
corporation,)
16)
) Date: December 2, 2004
17) Time: 10:00 a.m.
) Debtors.) Dept.: Two
18) Room 118

19 COMES NOW, the United States Trustee, by and through
20 counsel, and requests that the Court direct the appointment of a
21 chapter 11 trustee. In support thereof, the United States
22 Trustee alleges the following:

23 STATEMENT OF FACTS

24 Xelan, Inc., Xelan Insurance Services, Inc. dba Pyramidal
25 Funding Systems, Inc. ("Xelan Insurance"), Xelan Pension
26 Services, Inc. ("Xelan Pension") and Xelan Financial Planning,
27 Inc. ("Xelan Planning") (collectively referred to as "Debtors")

28

1 each filed chapter 11 petitions on June 30, 2004.^{1/} On July 1,
2 2004, the Court granted the Debtors' motion for joint
3 administration of the estates.^{2/} These cases have not been
4 substantively consolidated; however, the Debtors have filed a
5 Motion for (1) Substantive Consolidation, or Alternatively, (2)
6 Approval of Cash Management System on October 19, 2004.^{3/} It is
7 scheduled for hearing at 2:00 p.m. on November 17, 2004.

8 The four Debtors are affiliates and are part of a larger
9 group of companies. These other companies include XIS, Doctor's
10 Benefit Insurance Company, Ltd., Xelan Administrative Services,
11 Xelan of Texas, Xelan Foundation, Inc. and perhaps more.^{4/}

12 Xelan, Inc.:

13 Xelan, Inc. prepares financial plans for doctors who are
14 members of Economic Association of Health Professionals
15 ("Association") and focuses on marketing and business development
16 for other Xelan entities. [See Declaration of John M. Farrington
17 in Support of Motion for: (1) Substantive Consolidation , or
18 Alternatively, (2) Approval of Cash Management System

19 _____
20 ^{1/}The United States Trustee requests that the Court take judicial
21 notice, pursuant to Federal Rule of Evidence ("FRE") 201, of the
22 Petitions filed in each case. The Request for Judicial Notice is
23 filed concurrently with this motion.

24 ^{2/}The United States Trustee requests that the Court take judicial
25 notice, pursuant to FRE 201, of the Order for Joint
26 Administration of the Debtors' cases. The Request for Judicial
27 Notice is filed concurrently with this motion.

28 ^{3/}The United States Trustee requests that the Court take judicial
notice, pursuant to FRE 201, of the Motion for (1) Substantive
Consolidation, or Alternatively, (2) Approval of Cash Management
System. The Request for Judicial Notice is filed concurrently
with this motion.

^{4/}Id.

1 ("Farrington Declaration") at page 2, lines 14 - 17.^{5/}] Xelan,
2 Inc. derives revenue from the members of the Association in two
3 ways: (1) membership fees; and (ii) consulting fees. [Id. at page
4 2, lines 17 - 24 and page 3, lines 1 - 9.] Xelan, Inc. received
5 gross revenue of \$318,642.00 in 2004 through June 30, 2004, gross
6 revenues of \$6,096,677.00 in 2003 and gross revenues of
7 \$7,217,163.00 in 2002. [See Xelan, Inc.'s Statement of Financial
8 Affairs, Question No. 1.^{6/}]

9 L. Donald Guess, DMD ("Dr. Guess") serves as President,
10 Secretary and Treasurer and is also the 100% shareholder of
11 Xelan, Inc. [See Xelan, Inc. Statement of Financial Affairs, No.
12 21(b).]

13 There were pre-petition intercompany transactions, which
14 resulted in amounts due from non-debtor affiliates. Schedule B
15 for Xelan, Inc. reveals that Xelan Investment Services, Inc.
16 ("XIS") owes Xelan, Inc. \$1,617,118.00 and the Association owes
17 Xelan, Inc. \$260,169.00.^{7/} XIS and the Association are
18 affiliates of Xelan, Inc. [See Farrington Declaration.]

20 ^{5/}The United States Trustee requests that the Court take judicial
21 notice, pursuant to FRE 201, of the Declaration of John M.
22 Farrington in Support of the Motion for (1) Substantive
23 Consolidation, or Alternatively, (2) Approval of Cash Management
System ("Farrington Declaration"). The Request for Judicial
Notice is filed concurrently with this motion.

24 ^{6/}The United States Trustee requests that the Court take judicial
25 notice, pursuant to FRE 201, of the relevant parts of the Xelan,
26 Inc. Statement of Financial Affairs. The Request for Judicial
Notice is filed concurrently with this motion.

27 ^{7/}The United States Trustee requests that the Court take judicial
28 notice, pursuant to FRE 201, of the relevant parts of the Xelan,
Inc. Schedules. The Request for Judicial Notice is filed
concurrently with this motion.

1 There were pre-petition intercompany transactions, which
2 resulted in pre-petition unsecured debt between Xelan, Inc. and
3 its debtor and non-debtor affiliates. Schedule F for Xelan, Inc.
4 reveals that Xelan, Inc. owes Xelan Administrative Services
5 \$83,643.00, Xelan Insurance Services \$3,414,195.00, Xelan of
6 Texas \$633,476.00 and Xelan Pension Services \$333,537.00. [See
7 Xelan, Inc. Schedule F.]

8 There are possible preference payments to non-debtor
9 affiliates, which should be investigated and pursued if
10 appropriate. For example, Xelan, Inc.'s Statement of Financial
11 Affairs Question No. 3b, Exhibit D, shows that Xelan
12 Administrative Services received two payments from Xelan, Inc. on
13 May 7, 2004: \$155,000.00 and \$59,239.00. [See Xelan, Inc.
14 Statement of Financial Affairs Question No. 3b at Exhibit D.]
15 There may be more preference payments to affiliates or insiders,
16 which will need investigation, set forth in the Statement of
17 Financial Affairs Question No. 3b at Exhibit D. The United
18 States Trustee has requested that the Debtor file an amendment to
19 this question as Exhibit D fails to provide sufficient
20 information to answer the question. To date, no amendment has
21 been filed.

22 There are possible preference payments to others, which
23 should be investigated and pursued, if appropriate. For example,
24 Keith H. Rutman, APC, non-bankruptcy attorneys for the Debtors,
25 received several payments in the 90 days before the bankruptcy
26 filing as follows:

3/26/04	\$25,378.85
4/05/04	\$ 690.00
4/27/04	\$25,391.62

1	5/26/04	\$23,017.77
2	6/08/04	<u>\$ 120.00</u>
3	Total	\$74,598.43

4 [See Statement of Financial Affairs Question 3a, Exhibit "C" at
 5 page 18.] Michael R. Suverkrubbe, APC, non-bankruptcy attorneys
 6 for the Debtors, also received several payments in the 90 days
 7 before the bankruptcy filing as follows:

8	3/31/03	\$ 6,892.61
9	4/03/04	\$75,000.00
	4/09/04	<u>\$52,744.84</u>
	Total	\$134,637.45

10 [See Statement of Financial Affairs Question 3a, Exhibit "C" at
 11 page 21.]

12 Xelan Pension:

13 Xelan Pension is a wholly owned subsidiary of Xelan, Inc.
 14 and it provides Association members with individual pension plan
 15 designs and annual administration. Xelan Pension receives its
 16 revenues from set up and administrative fees paid by Association
 17 members. [See Farrington Declaration at page 4, lines 2 - 8.]
 18 According to Xelan Pension Statement of Financial Affairs
 19 Question No. 1, Xelan Pension received gross revenues of
 20 \$671,000.00 for its year to date operations in 2004, gross
 21 revenues of \$624,403.00 for its 2003 operations and \$633,041.00
 22 for its 2002 operations.^{B/}

23 Dr. Guess serves as President of Xelan Pension. Xelan, Inc.,
 24 controlled by Dr. Guess, is the 100 % shareholder of Xelan
 25 Pension. Patricia De La Torre serves as the Secretary of Xelan

26
 27 ^{B/}The United States Trustee requests that the Court take judicial
 28 notice, pursuant to FRE 201, of the relevant parts of the Xelan
 Pension Statement of Financial Affairs. The Request for Judicial
 Notice is filed concurrently with this motion.

1 Pension. [See Xelan Pension Statement of Financial Affairs No.
2 21(b).] Patricia De La Torre is currently employed by Greenbook
3 Financial Services, Inc. ("Greenbook"). [See Declaration of
4 Kenneth Dennis in support of the United States Trustee's Motion
5 for Order Directing the Appointment of a Chapter 11 Trustee
6 ("Dennis Declaration") regarding the testimony of Patricia De La
7 Torre at 11 U.S.C. § 341(a) Meeting of Creditors held on October
8 12, 2004.]

9 Pre-petition intercompany transactions exist between Xelan
10 Pension and its debtor and non-debtor affiliates. Schedule B for
11 Xelan Pension states that there is \$333,537.00 due from Xelan,
12 Inc.^{2/} Schedule F for Xelan Pension shows the Association as an
13 unsecured creditor in the amount of \$275.00 and XIS as an
14 unsecured creditor in the amount of \$44,966.00.

15 Potential preference payments were made by Xelan Pension to
16 its debtor and non-debtor affiliates. Xelan Pension Statement
17 of Financial Affairs Question No. 3a, Exhibit C, shows that Xelan
18 Administrative Services received two payments in the 90 days
19 before the bankruptcy filing: \$40,730.00 and \$100.00 and Xelan,
20 Inc. received two payments in the 90 days before the bankruptcy
21 filing: \$75,000.00 and \$53,000.00. It is unclear from Xelan
22 Pension Statement of Financial Affairs Question No. 3b, Exhibit
23 D, what other payments were made to affiliates in the year before
24 the bankruptcy filing. The United States Trustee has requested
25 that Exhibit D to the Statement of Financial Affairs be amended

26 _____
27 ^{2/}The United States Trustee requests that the Court take judicial
28 notice, pursuant to FRE 201, of the relevant parts of the Xelan
Pension Schedules. The Request for Judicial Notice is filed
concurrently with this motion.

1 to specifically provide the information requested by Statement of
2 Financial Affairs Question 3b. To date, no amendment has been
3 filed.

4 Xelan Insurance:

5 Xelan Insurance derives its revenues in the form of
6 insurance and annuity commissions from products it sells through
7 financial counselors members of the Association. [See Farrington
8 Declaration at page 3, lines 10 - 20.] Xelan Insurance received
9 gross revenues from January 1, 2004 through the commencement of
10 the bankruptcy filing in the amount of \$8,274,000.00. It also
11 received revenues in 2003 in the amount of \$14,769,934.00 and in
12 2002 in the amount of \$19,869,241.00. [See Xelan Insurance
13 Statement of Financial Affairs Question No. 1.^{10/}]

14 The **sole** officer of Xelan Insurance is Patricia De La Torre.
15 She serves as the Secretary and Treasurer. [See Statement of
16 Financial Affairs. No. 21b.] She is currently employed by
17 Greenbook. [See Dennis Declaration.] (Although the Statement of
18 Financial Affairs No. 21b states that Graham S. Guess serves as
19 President, L. Donald Guess, M.D. testified at the October 12,
20 2004 Meeting of Creditors that Graham S. Guess does not serve as
21 President.) The Xelan Insurance Statement of Financial Affairs
22 shows Graham Guess holding 1 share of stock, L. Donald Guess
23 holding 67,000 shares of stock and Xelan Foundation holding
24 33,000 shares of stock. Evidently, Steve Locko resigned as
25 President of the Xelan Insurance on or about May 26, 2004 and now

26 _____
27 ^{10/}The United States Trustee requests that the Court take judicial
28 notice, pursuant to FRE 201, of the relevant parts of the Xelan
Insurance Statement of Financial Affairs. The Request for
Judicial Notice is filed concurrently with this motion.

1 works for Greenbook. [See Xelan Insurance Statement of Financial
2 Affairs Question No. 22b and the Dennis Declaration.]

3 There are pre-petition intercompany and insider
4 transactions, which need to be investigated. Schedule B^{11/} for
5 Xelan Insurance shows that Dr. Guess owes \$2,000 to the estate^{12/};
6 Xelan of Texas (a non-debtor affiliate of Xelan Insurance) owes
7 \$481,748.00 to Xelan Insurance; Xelan, Inc. owes \$3,414,195.00 to
8 Xelan Insurance; Xelan Pension owes \$207,510.00 to Xelan
9 Insurance; the Association owes \$31,000.00 to Xelan Insurance.

10 Schedule F for Xelan Insurance sets forth Dr. Guess as an
11 unsecured creditor in an unknown amount, Xelan Administrative
12 Services as an unsecured creditor in the amount of \$52,377.00 and
13 XIS as an unsecured creditor in the amount of \$2,474,192.00. In
14 addition, Schedule F for Xelan Insurance reveals that
15 Indianapolis Life Ins. Co. is owed \$480,000.00 for "Agency loan
16 to L. Donald Guess secured by renewed account agency" dated
17 September 2001. At the Meeting of Creditors held July 27, 2004,
18 Dr. Guess testified that he received \$400,000 from Indianapolis
19 Life Ins. Co. and used it to pay personal taxes. [See Declaration
20 Dennis.] It is unclear whether Dr. Guess has made any payments to
21

22 ^{11/}The United States Trustee requests that the Court take judicial
23 notice, pursuant to FRE 201, of the relevant parts of the Xelan
24 Insurance Schedules. The Request for Judicial Notice is filed
concurrently with this motion.

25 ^{12/}According to Dr. Guess' testimony at the July 27, 2004 Meeting
26 of Creditors, this obligation arose when Xelan Insurance paid off
27 Dr. Guess' obligation to the Bankruptcy Estate of XF Enterprises
in the amount of \$615,904.23. Dr. Guess testified that he had
28 paid back all but \$2,000.00 of the obligation by refinancing his
home. Xelan Insurance Statement of Financial Affairs Question
3a, Exhibit C shows a payment of \$615,904.23 to XF Enterprises,
Inc. on May 7, 2004.

1 reduce this debt since its inception and since the bankruptcy
2 filings.

3 Xelan Insurance Statement of Financial Affairs, Question No.
4 3a at page 7 of Exhibit D shows payments to Viatical Liquidity,
5 LLC^{13/} in the total amount of \$437,445.03 in the 90 days before
6 the bankruptcy filing. In the 90 days before the bankruptcy
7 filing, Statement of Financial Affairs Question No. 3a also
8 shows: five payments to Xelan Administrative Services in the
9 total amount of \$860,000.00, which includes a single payment of
10 \$685,000.00 on May 7, 2004; ten payments to Xelan, Inc. in the
11 total amount of \$1,022,500.00; one payment to Xelan Pension in
12 the amount of \$150,000.00; two payments to "Xelan Economic
13 Association of" in the amount of \$31,000.00. There could be
14 additional transactions including affiliates set forth in
15 response to Statement of Financial Affairs No. 3b at Exhibit E;
16 however, this Exhibit is difficult to understand. The Debtor was
17 asked to clarify this Exhibit and the responses to Statement of
18 Financial Affairs Question No. 3b; however, an Amendment has yet
19 to be filed.

20 Xelan Planning:

21 Xelan Planning "was never operational." [See Declaration of
22 L. Donald Guess, D.M.D. in Support of Motion for Substantive
23 Consolidation, Xelan, Inc. Docket No. 164.]] No officers or
24 _____

25 ^{13/}Viatical Liquidity, LLC was set up to fund a settlement members
26 of the Association who bought "viatical settlement contracts". It
27 filed a chapter 11 bankruptcy case on June 21, 2004 in the
28 Souther District of California, Case Number 04-05472-JH11. A more
detailed description of the settlement and Viatical Liquidity,
LLC can be found in the Declaration of L. Donald Guess, D.M.D. in
Support of Emergency First Day Motions, Docket No. 3 for Xelan,
Inc.

1 directors are set forth in the Xelan Planning Statement of
2 Financial Affairs, Question 21b.^{14/} It appears there was a former
3 president, Charles F. Wachendorfer, who resigned in February
4 2004. [See Xelan Planning Statement of Financial Affairs,
5 Question 22b.] Charles Wachendorfer received a payment of
6 \$105,056.99 from Xelan, Inc. on March 31, 2004. [See Xelan, Inc.
7 Statement of Financial Affairs 3a, Exhibit "C".] Evidently, Mr.
8 Wachendorfer was also an employee of Xelan, Inc. and had an
9 employment contract. His salary was guaranteed by Dr. Guess. [See
10 Xelan, Inc. Schedule H.] Dr. Guess signed the Petition, Schedules
11 and Statement of Financial Affairs on behalf of Xelan Planning as
12 a director.^{15/} No assets or liabilities are set forth and no
13 amendments to the Schedules have yet been filed.

14 Greenbook Financial Services, Inc. ("Greenbook"):

15 _____ Greenbook was formed by Robert Holcomb. Mr. Holcomb was an
16 employee of Xelan, Inc. and received a payment of \$5,025.00 on
17 May 19, 2004. [See Xelan, Inc., Statement of Financial Affairs,
18 Question 3a, Exhibit C at page 12.] Greenbook currently employs
19 Steven Locko, former president of Xelan Insurance, and Patricia
20 De La Torre, the sole officer of Xelan Insurance, and the
21 Secretary of Xelan Pension. The United States Trustee believes
22 that Greenbook also employs former in-house attorneys for the
23 _____

24 ^{14/}The United States Trustee requests that the Court take judicial
25 notice, pursuant to FRE 201, of the relevant parts of the Xelan
26 Planning Statement of Financial Affairs. The Request for Judicial
Notice is filed concurrently with this motion.

27 ^{15/}The United States Trustee requests that the Court take judicial
28 notice, pursuant to FRE 201, of the relevant parts of the Xelan
Planning Petition and Schedules. The Request for Judicial Notice
is filed concurrently with this motion.

1 Debtors, Daniel Jenkins and Silas Harrington. While the United
2 States Trustee understands that it is not unusual for a potential
3 buyer to have relationships with Debtors, the United States
4 Trustee is concerned about the Debtors' ability to negotiate with
5 Greenbook at arms' length in these cases. This concern is
6 elevated by the fact that Ms. De La Torre is an employee of
7 Greenbook and is also the sole officer of Xelan Insurance.

8 Pre-Petition Intercompany Debt is Written Off Post-Petition:

9 Schedule B for Xelan, Inc. lists a claim due from non-debtor
10 Xelan Investment Services ("XIS") in the amount of \$1,617,118.00.
11 [See Schedule B for Xelan, Inc. or Dennis Declaration at Exhibit
12 "A" incorporated herein by reference.] On the balance sheet in
13 Xelan Inc.'s July 2004 Operating Report the balance of this claim
14 has been reduced to \$55,520.00. [See Dennis Declaration at
15 Exhibit "B" - Section VIII, Balance Sheet, from July 2004
16 Operating Report incorporated herein by reference.] In response
17 to the inquiry of the United States Trustee, the Debtor provided
18 the United States Trustee with a copy of the journal entries that
19 were made to adjust the balance of the claim from \$1,617,118.00
20 to \$55,520.00. [See Dennis Declaration at Exhibit "C"
21 incorporated herein by reference.] Xelan Inc.'s July 2004
22 Operating Report shows that Xelan, Inc. received \$10,000.00 from
23 XIS during July 2004. [See Dennis Declaration at Exhibit "D"
24 incorporated herein by reference.]

25 These documents indicate that the following transactions
26 were posted to the XIS account:

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<u>Description</u>	<u>Amount</u>
Schedule B amount due to Xelan, Inc. from XIS	\$1,617,118.00
Marketing fees from June 30, 2004 journal entry	871,014.25
Amount reclassified to Accounts Receivable due from Xelan Pension "to settle intercompany loans" in June 30, 2004 journal entry posted post petition	<44,966.21>
Amount reclassified to Accounts Receivable due from Xelan Insurance "to settle intercompany loans" in June 30, 2004 journal entry posted post petition	<2,409,968.26>
Received from XIS during July 2004	<10,000.00>
Net undocumented transactions	<u>32,322.22</u>
Amount due to Xelan, Inc. from XIS from July 30, 2004 balance sheet	<u>\$ 55,520.00</u>

13 The journal entry, which reduced the balance due to Xelan, Inc.
14 by \$2,409,968.26, fails to include any supporting calculations to
15 justify this large adjustment. The balance sheet in the September
16 2004 Operating Report shows that the amount due from XIS had been
17 reduced to \$50,503.00 as of September 30, 2004. [See Dennis
18 Declaration at Exhibit "E" - Section VIII, Balance Sheet, from
19 September 2004 Operating Report - incorporated herein by
20 reference.]

21 Schedule B for Xelan Insurance lists a claim due from non-
22 debtor Xelan of Texas in the amount of \$481,748.00. [See Xelan
23 Insurance Schedule B or Dennis Declaration at Exhibit "F"
24 incorporated herein by reference.] On the balance sheet in Xelan
25 Inc.'s July 2004 Operating Report the balance of this claim has
26 been reduced to \$2,971.00. [See, Dennis Declaration at Exhibit
27 "G" - Section VIII, Balance Sheet, from July 2004 Operating
28 Report - incorporated herein by reference.] The July 2004

1 Operating Report does not report the receipt of any funds from
2 Xelan of Texas. [See Dennis Declaration at Exhibit "H" - Section
3 I, Cash Receipts and Disbursements from July 2004 Operating
4 Report - incorporated herein by reference.] In response to the
5 inquiry of the United States Trustee, the Debtor provided the
6 United States Trustee with a copy of the journal entry that was
7 made to adjust the balance of the claim from \$481,748.00 to
8 \$2,971.00. [See Dennis Declaration at Exhibit "I" incorporated
9 herein by reference.]

10 These documents indicate that the following transactions
11 were posted to the Xelan of Texas account:

<u>Description</u>	<u>Amount</u>
Schedule B amount due to Xelan Insurance from Xelan of Texas	\$481,748.00
Amount reclassified due from Xelan, Inc. "to settle intercompany loans" in June 30, 2004 journal entry posted post petition	<487,511.36>
Net undocumented transactions	<u>8,734.36</u>
Amount due to Insurance Services from Xelan of Texas from July 30, 2004 balance sheet	<u>\$ 2,971.00</u>

19 The journal entry which reduced the balance due to Xelan
20 Insurance by \$481,748.00 fails to include any supporting
21 calculations to justify this large adjustment. The balance
22 sheet in the September 2004 Operating Report shows that the
23 amount due from Xelan of Texas was \$20,236.00 as of September 30,
24 2004. [See Dennis Declaration at Exhibit "J" - Section VIII,
25 Balance Sheet, from September 2004 Operating Report -
26 incorporated herein by reference.]

27 In addition to effectively writing off amounts due from XIS
28 and Xelan of Texas, the documents provided by the Debtors

1 indicate that the Debtors made material adjustments to the
2 amounts the various Debtors owe each other. [See Dennis
3 Declaration incorporated herein by reference.]

4 Unauthorized Post-Petition Intercompany Transactions:

5 In the Farrington Declaration at Exhibit C, Mr. Farrington
6 identifies amounts transferred by the Debtors to Non-Debtors and
7 between Debtors. Mr. Farrington identifies transfers made
8 without proper court authorization as follows:

9

July 2004 Transfers Without Court Approval		
Transferred from	Transferred to	Amount Transferred
Xelan Insurance	Xelan, Inc.	77,336.60
Xelan Pension	Xelan, Inc.	45,445.21
Total July 2004 Transfers Without Court Approval		122,781.81

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August 2004 Transfers Without Court Approval		
Transferred from	Transferred to	Amount Transferred
Xelan, Inc.	Xelan Pension	4,970.00
Xelan, Inc.	Xelan Administrative Services	27,400.00
Xelan, Inc.	Xelan Insurance	2,096.00
Xelan Insurance	Xelan, Inc.	5,250.00
Xelan Insurance	Xelan Administrative Services	37,000.00
Xelan Pension	Xelan, Inc.	38,288.69
Xelan Pension	Xelan Administrative Services	5,000.00
Total August 2004 Transfers Without Court Approval		120,004.69

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25 There were also similar transfers noted in the September
26 Operating Reports.

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1 Post-Petition Payments for Pre-petition Debt without Court
2 Authorization and Unaccounted for Cash:

3 In addition, it appears that the Debtors may have made post-
4 petition payments to pre-petition creditors. On or about July
5 15, 2004, Kenneth Dennis received a telephone call from Everett
6 G. Barry, Jr., Esq., attorney for First National Bank. The
7 Debtors maintained their pre-petition bank accounts at First
8 National Bank. Mr. Barry provided the United States Trustee's
9 Office with a copy of a letter he sent to Martin Eliopoulos. [See
10 Letter attached to the Dennis Declaration as Exhibit "K" and
11 incorporated herein by reference.] This letter indicates on July
12 15, that the "Bank was not previously made aware of the
13 bankruptcy filings". The Debtors July and August 2004 Operating
14 Reports fail to disclose transactions in First National Bank
15 accounts.

16 The United States Trustee's Office sent John Morrell a
17 letter dated October 5, 2004, which listed a number of
18 deficiencies in the case. Included in the letter was a request
19 for the Debtors to provide evidence of the closing of the
20 Debtors' pre-petition bank accounts including copies of the
21 closing bank statements. [See Letter attached to the Dennis
22 Declaration as Exhibit "L" and incorporated herein by reference.]
23 At the continued 11 U.S.C. § 341(a) meeting held October 13,
24 2004, the Debtor provided the United States Trustee's Office with
25 a document from First National Bank for each account that was
26 closed. The documents are not closing bank statements but
27 indicate that the accounts reported on have been closed. Each
28 document lists the date and amount for the last deposit and check

1 for each account which is summarized as follows:

2

3

First National Bank - Prepetition Accounts					
Debtor	Account #	Date of Last Deposit	Amount of Last Deposit	Date of Last Check	Amount of Last Check
Xelan Inc	105041556	7/13/04	2,142.10	7/19/04	24,545.00
Xelan Inc	105041637	7/14/04	24,014.22	7/20/04	26,441.55
Xelan Inc	90116039	7/2/04	1,281.46	7/2/04	1,281.46
Xelan Insurance	105041718	7/9/04	218,657.58	7/19/04	1,019,177.68
Xelan Insurance	90113648	7/14/04	1,449.34	7/20/04	857.11
Xelan Insurance	105041750	7/14/04	173.06	7/14/04	173.06
Xelan Pension	105041831	7/9/04	12,097.50	7/30/04	80,187.03

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15 [See Bank notices attached to the Dennis Declaration as Exhibit
16 "M" and incorporated herein by reference.]

17 At the October 13, 2004 Meeting of Creditors, the United
18 States Trustee's Office again requested closing bank statements.
19 In addition, the Debtors were asked to provide the June 2004 bank
20 statements. To date, these bank statements have not been
21 provided.

22 It appears that Xelan Insurance closed bank account
23 105041718 on July 19, 2004 and was issued a check in the amount
24 of \$1,019,177.68. The July Operating Report; however, states that
25 only \$768,633.67 was transferred to the DIP account at Torrey
26 Pines Bank to open the account, and Xelan Insurance fails to
27 account for these funds in the July Operating Report. [See Dennis
28 Declaration at Exhibit "H" - Section I, Cash Receipts and

1 Disbursements from July 2004 Operating Report - incorporated
2 herein by reference.]

3 The fact that these funds are unaccounted for is of great
4 concern.

5 Operations Under Asset Preservation Agreement are
6 Problematic:

7 The Debtors are not monitoring their own revenues and
8 expenses closely enough. Greenbook is operating the Debtors'
9 businesses pursuant to an Order Approving the Asset Preservation
10 Agreement. [See Order at Docket 74 entered August 4, 2004 in the
11 Xelan, Inc. case.] It was contemplated that the Debtors would
12 only be operating under this order a short time while they
13 attempted to sell assets quickly to preserve the estates;
14 however, after two plus months, the Debtors continue to operate
15 under the Order. In Paragraph 33 of the Farrington Declaration,
16 Mr. Farrington states:

17 Greenbook has not yet provided an accounting to the
18 Debtors and as a result, the August operating report is
19 based on estimates of certain revenues and expenses of
20 Greenbook relating to its operations of the Debtors.
21 Debtors reserve the right to restate the August
22 operating report once actual financial information is
23 obtained from Greenbook.

24 This statement is an example of the Debtors not acting in the
25 best interest of creditors of the estates. The Debtors should be
26 receiving this information regularly from Greenbook, not waiting
27 for Greenbook to provide it. Mr. Farrington is talking about the
28 Debtors' money so it is unclear why the Debtors would not have a
complete grasp of the Debtors' revenues and expenses.

The Operating Reports for Xelan Insurance show numerous
checks for commissions and payments to Greenbook. The Operating

1 Reports for Xelan Insurance report that numerous checks were paid
2 for commissions as follows:

Commissions Paid by Insurance Services		
Debtor	Operating Report Period	Total Commissions Paid
Insurance Services	July 2004	79,365.54
Insurance Services	August 2004	217,529.47
Total		296,895.01

10 The August and September 2004 Operating Reports for
11 Insurance Services report that the following checks were paid to
12 Greenbook:

Checks Paid to Greenbook by Insurance Services			
Date	Check Number	Purpose	Amount
8/13/03 (sic)	5014	Operating Agreement	215,545.72
8/24/04	5020	Operating Agreement	17,615.99
9/2/04	5028	Operating Agreement	578,000.79
9/9/04	5034	Operating Agreement	491,770.01
9/20/04	5044	Operating Agreement	193,366.57
9/24/04	5048	Operating Agreement	107,857.17
9/29/04	5050	Operating Agreement	203,038.74
Total			1,807,194.99

23 [See Dennis Declaration at Exhibit "N" - Disbursements listing
24 from Insurance Services August 2004 Operating Report - and
25 Exhibit "O" - Disbursements listing from Insurance Services
26 September 2004 Operating Report both incorporated herein by
27 reference.]

28 It is unclear why Xelan Insurance is making these payments.

1 The Asset Preservation Agreement does not provide for Xelan
2 Insurance to make payments to Greenbook or to pay pre-petition
3 commissions. It is unclear why the Debtor continues to operate
4 under the Asset Preservation Agreement. It is unclear how the
5 Debtors are benefitted under the Asset Preservation Agreement at
6 this stage. As the Debtors are not intimately involved and
7 knowledgeable with regard to the revenues and expenses of the
8 ongoing operations and as Xelan Insurance is collecting insurance
9 renewal monies and then turning them over to Greenbook at an
10 expense, the United States Trustee believes the Asset
11 Preservation Agreement should be terminated. If a Chapter 11
12 Trustee were appointed, he or she, acting as an independent
13 fiduciary on the Debtors behalf, could terminate the Asset
14 Preservation Agreement or keep a closer eye on the Debtors'
15 operations and assets.

16 Employment of Professionals:

17 Currently, Higgs, Fletcher & Mack, proposed general counsel
18 to the Debtors, have yet to be employed due to their attempt to
19 represent all four Debtors when there are intercompany claims
20 between some of the Debtors. Barros & Farrington have yet to be
21 employed due to their attempt to work for all four Debtors as
22 well as non-debtor affiliates where intercompany transactions
23 have occurred. Other professionals who have been working for the
24 estate since the bankruptcy filings have yet to be employed.

25 MEMORANDUM OF POINTS AND AUTHORITIES

26 An Independent Trustee is necessary due to Conflicts of
27 Interest

28 Section 1104(a) of the Bankruptcy Code provides that this

1 Court shall appoint a Chapter 11 Trustee:

2 (1) for cause, including fraud, dishonesty,
3 incompetence or gross mismanagement of affairs of the
4 debtor by current management, either before or after
5 the commencement of the case, or similar cause. . . ;
6 or

7 (2) if such appointment is in the interest of
8 creditors, any equity security holders, and other
9 interests of the estate. . .

10 11 U.S.C. § 1104. If the conflicts of interest described above
11 go unchecked and/or the estates are substantively consolidated
12 the United States Trustee believes that unsecured creditors will
13 almost certainly receive less on their claims. Appointment of a
14 Chapter 11 Trustee to discharge the fiduciary duties the Debtors
15 are incapable of fulfilling clearly is in the best interests of
16 the Debtors' creditors, if not mandated by Section 1104(a) of the
17 Bankruptcy Code and cases construing it.

18 Determinations made pursuant to Section 1104(a) of the
19 Bankruptcy Code are fact intensive and decisions must be made on
20 a case-by-case basis. See In re: Sharon Steel Corp., 871 F.2d
21 1217, 1226 (3d Cir. 1989). A Bankruptcy Court is required to
22 order the appointment of a Chapter 11 Trustee where "cause"
23 exists. The list of factors in subsection (a)(1) constituting
24 "cause" warranting the appointment of a Chapter 11 Trustee is
25 illustrative, not exclusive. See, e.g., In re: Madison
26 Management Group, Inc., 137 B.R. 275, 281 (Bankr. N.D. Ill.
27 1992). A determination of cause, therefore, is within the
28 discretion of this Court and due consideration must be given to
the various interests involved in the bankruptcy proceeding.
Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc.,
828 F.2d 239, 240 (4th Cir. 1987).

1 Bankruptcy Code Section 1104(a)(2), on the other hand,
2 enables this Court to appoint a Chapter 11 Trustee even when no
3 "cause" exists. Under subsection (a)(2), this Court is required
4 to appoint a trustee when doing so is in "the interest of
5 creditors, equity security holders and other interests of the
6 estate." See, e.g., Committee of Dalkon Shield Claimants, 828
7 F.2d at 240 . See also In re: V. Salvino Oil & Hearing Co.,
8 Inc., 99 B.R. 518, 527, n.11 (Bankr. E.D. N.Y. 1989) ("factors
9 constituting a basis for appointment of a trustee under §
10 1104(a)(2) are amorphous, diverse and necessarily involve a great
11 deal of judicial discretion"). 11 U.S.C. § 1104(a)(2) reflects
12 "the practical reality that a trustee is needed." In re: Sharon
13 Steel Corp., 86 B.R. 455, 458 (Bankr.W.D. Pa. 1988).

14 The pre-petition and post-petition intercompany
15 transactions, the pre-petition transactions between Dr. Guess and
16 the Debtors as well as the structure of current management, i.e.,
17 Dr. Guess is in control of all the Debtor's expect Xelan
18 Insurance and Patricia De La Torre, an employee of Greenbook, is
19 the sole officer of Xelan Insurance, shows that current
20 management is not capable of discharging its fiduciary duties for
21 the benefit of all creditors. One court aptly summarized the law
22 as follows:

23 The underlying assumption of Chapter 11 is that
24 debtor-in-possession governance is to be the norm.
25 This assumption arises from a belief that current
26 management is generally best suited to orchestrate the
27 process of rehabilitation for the benefit of creditors
28 and other interests of the estate . . . The filing of a
Chapter 11 petition does, however, cause a fundamental
legal change in the entity. The filing entity is
legally different from what it was the moment before
filing, as it now assumes the mantle of a new judicial
entity, a debtor-in-possession. As such it becomes an

1 officer of the Court subject to the supervision and
2 control of the Bankruptcy Court and the provisions of
3 the Bankruptcy Code. A debtor-in-possession in a
4 Chapter 11 case has the same fiduciary duties as a
5 trustee appointed by the court . . . The willingness of
6 Congress to leave a debtor-in-possession is premised on
7 an expectation that current management can be depended
8 upon to carry out the fiduciary responsibilities of a
9 trustee. And if the debtor-in-possession defaults in
10 this respect, Section 1104(a)(1) commands that the
11 stewardship for the reorganization effort must be
12 turned over to the independent trustee.

13 V. Salvino Oil and Heating, 99 B.R. at 524-26.

14 A Chapter 11 trustee is in the best interest of creditors
15 and equity holders where ". . . the continuation of current
16 management will result in serious potential conflict. In re:
17 L.S. Good & Co., 8 B.R. 312, 315 (Bankr. N.D. W. Va. 1980). See
18 also Matter of Fiesta Homes of Georgia, Inc., 125 B.R. 321, 325
19 (Bankr. S.D. Ga. 1990) citing In re: Graf Bros., Inc., 19 B.R.
20 269 (Bankr. D. Me. 1982) (conflict of interest constitutes
21 independent cause for conversion of case to chapter 7 where a
22 trustee can scrutinize and collect insider transfers); In re:
23 William H. Vaughan & Co., Inc., 40 B.R. 524 (Bankr. E.D. Pa.
24 1984) (appointing chapter 11 trustee due to debtor's failure to
25 commence proceedings for avoidance of transfer to its president);
26 In re: Nautilus of New Mexico, Inc., 83 B.R. 784 (Bankr. N.M.
27 1988) (concluding that co-owner president's conflict of interest
28 made him incapable of dealing with debtor as a fiduciary and
appointing Chapter 11 trustee); In re: Microwave Products of
America, Inc., 102 B.R. 666 (Bankr. W.D. Tenn 1989)(appointing
chapter 11 trustee due to failure of a debtor to investigate
potentially avoidable or preferential transfers, or to attempt to
collect substantial dormant receivables from parent company, had

1 resulted in considerable and continued erosion of confidence in
2 debtor and its board of directors to operate the company.)

3 Even without clear proof of fraud, dishonesty, or gross
4 mismanagement had been presented, intercompany transactions
5 exceeding \$1 Million Dollars justified appointment of a trustee
6 under section 1104(a)(2) because the size and number of
7 transactions "places current . . . management . . . in a position
8 of having grave conflict of interest, and the presumption arises
9 that the current management . . . will be unable to make the
10 important investigation and decision demands." In re: L.S. Good
11 & Co., 8 B.R. 312, 315 (Bankr. N.D. W. Va. 1980).

12 Similarly, in the instant case, the facts compel the
13 appointment of a disinterested third party to act on behalf of
14 the Debtors and their separate creditors. The integrity of the
15 bankruptcy system is challenged where, in the instant case, the
16 Debtors have pre-petition and post-petition intercompany
17 transactions between themselves and between themselves and non-
18 debtor affiliates, which must be investigation and pursued, pre-
19 petition transactions between the Debtors and the person in
20 control of all but one of the Debtors, which must be
21 investigation and pursued, and one company's sole officer is an
22 employee of the buyer seeking to purchase company assets.

23 Debtors have failed to comply with the Bankruptcy Code

24 Additional grounds exist to appoint a chapter 11 trustee in
25 these cases as the Debtors have failed to comply with certain
26 Bankruptcy Code Sections and Operating and Reporting
27 Requirements. While any one may be *de minimis* and by itself does
28 not justify appointment of a trustee, together they amount to

1 "cause" as required by 11 U.S.C. § 1104(a)(1). In re: Nautilus of
2 New Mexico, Inc., 83 B.R. 790.

3 11 U.S.C. § 327(a) provides:

4 Except as otherwise provided in this section , the trustee,
5 *with the court's approval*, may employ one or more attorneys,
6 accountants, appraisers, auctioneers, or other professional
7 persons, that do not hold or represent an interest adverse to the
8 estate, and that are disinterested persons, to represent or
9 assist the trustee in carrying out the trustee's duties under
10 this title. . .

11 (Emphasis added.) Undisputed facts exist that the Debtors
12 continue to use their pre-petition accountants after filing these
13 cases even though the accountants also provide professional
14 services to affiliates of the Debtors. In fact, these same
15 accountants are evidently involved in writing off substantial
16 debt to non-debtor affiliates, XIS and Xelan of Texas. The pre-
17 petition accounts fail to comply with the requirements of 11
18 U.S.C. § 327(a) and yet the Debtors continue to use their
19 services on a post-petition basis.

20 In addition, the Debtors have failed to employ Robert K.
21 Athy, certified public accountant, who provide a declarations
22 (Xelan, Inc., Docket Nos. 66 and 102) and testimony concerning
23 the insurance renewal income stream of Xelan Insurance.
24 According the Internal Revenue Service's Opposition to the
25 Applications to Employ Higgs Fletcher & Mack, the Debtors are
26 also being represented by special counsel with regard to third
27 party litigation who have yet to be employed by the Debtors. [See
28 Opposition by Internal Revenue Service to Motion to Employ
General Bankruptcy Counsel at Xelan, Inc., Docket No. 134.]

Based on these failures, 11 U.S.C. § 327 is being violated.

The Debtors may have paid pre-petition creditors without

