

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
LOCKWOOD CORPORATION,) CASE NO. BK93-80133
)
DEBTOR) CH. 11

MEMORANDUM

Hearing was held on November 9, 1995, on Amended and Supplemental Motion for Appointment of Trustee and Renewed Request for Expedited Hearing filed by the Official Committee of Unsecured Creditors; Objection by the Debtor. Appearances: Special Counsel for the debtor, Thomas Stalnaker and Robert Becker; Atty. for USA, Henry Carriger; Atty. for Norwest Bank, William Schonberg; Atty. for the Pension Benefit Guaranty Corp., Tracy Ricketts; Atty. for Pro Ag Equipment Inc., Michael Whaley; Atty. for Potato Equipment Corp., Michael Whaley; Atty. for the Unsec. Cr. Comm., Harry Dixon & Randall Wright; Atty. for Firstier Bank, Steve Turner; Atty. for the UST, Sam King; Atty. for Agromac International, William Biggs; Atty. for Mconnell, Robert Ginn.

This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A) and (N).

Background

By separate order filed November 13, 1995, the motion for appointment of trustee was denied. This memorandum contains the required findings of fact and conclusions of law supporting such denial.

Decision

The motion to appoint a Chapter 11 trustee pursuant to 11 U.S.C. § is denied. The appointment of a Chapter 11 trustee is not in the best interests of the unsecured creditors and other interested parties of the estate.

Facts

The debtor, a manufacturing company, proposes to sell certain real and personal property which, together, form a division of the company that can be severed and sold as a going concern. An offer to purchase has been received from an entity

which is owned by the president of the debtor and another person who, until very recently, was an officer of the debtor.

Prior to the debtor's receipt of such offer, the Official Unsecured Creditors' Committee (OUCC) filed a motion to appoint a trustee. The motion was renewed and supplemented after the purchase offer was made. The OUCC claims that the officers of the debtor are acting adversely to the debtor and the interest of creditors and that the trustee must be appointed to protect those interests.

Discussion

The Official Unsecured Creditors Committee (OUCC) seeks to have a Chapter 11 trustee appointed pursuant to Section 1104(a)(2) of the Bankruptcy Code, which provides:

(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--

(2) if such appointment is in the interests of creditors, and equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a)(2).

Section 1104(a)(2) requires an examination of whether appointing a trustee is in the best interests of the creditors and other interests of the estate. In re Microwave Prods. of Am., Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989). The appointment of a trustee in a Chapter 11 case is an extraordinary remedy and is the exception, rather than the rule under Chapter 11. In re Ionosphere Clubs, Inc., 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); In re Tahkenitch Tree Farm Partnership, 156 B.R. 525, 527 (Bankr. E.D. La. 1993); In re Nautilus of New Mexico, Inc., 83 B.R. 784, 788 (Bankr. D.N.M. 1988); In re North Star Contracting Corp., 128 B.R. 66, 70 (Bankr. S.D.N.Y. 1991) ("[T]he appointment of a trustee is an extraordinary remedy which will cause additional expense to the estate." (citations omitted)). In re Madison Management Group, Inc., 137 B.R. 275, 281 (Bankr. N.D. Ill. 1992) (quoting In re Sharon Steel Corp., 871 F.2d 1217, 1225 (3d Cir. 1989)). A full evidentiary hearing must be held on a motion for the appointment of a trustee. Madison Management

Group, 137 B.R. at 281. (contra Ionosphere Clubs, 113 B.R. at 167 (holding that even though court conducted full evidentiary hearing, one was not required). The burden of proof is on the OUCG to show that the appointment of a trustee is necessary in this case under Section 1104(a)(2) by clear and convincing evidence. Nautilus, 83 B.R. at 788; Tahkenitch Tree Farm, 156 B.R. at 527; In re Bellevue Place Assocs., 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994).

A decision to appoint a Chapter 11 trustee pursuant to Section 1104(a)(2) is discretionary. Bellevue Place Assocs., 171 B.R. at 623. In In re V. Savino Oil & Heating Co., Inc., the bankruptcy court discussed how to determine whether the appointment of a Chapter 11 trustee is appropriate under Section 1104(a)(2):

Unlike subsection (a)(1), § 1104(a)(2) may well entail the exercise of a spectrum of discretionary powers and equitable considerations, including a cost-benefit analysis, to determine whether the appointment of a reorganization trustee would be in the interests of creditors, equity security holders and other interests of the estate.

99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989)(citations omitted); accord In re Clinton Centrifuge, Inc., 85 B.R. 980, 983 (Bankr. E.D. Pa. 1988) ("[S]ection 1104(a)(2) leaves the court with broad discretion to determine whether the interests of all constituencies would benefit from the appointment of a disinterested trustee."); Microwave Prods., 102 B.R. at 675 ("11 U.S.C. § 1104(a)(2) provides a flexible standard for the appointment of a trustee. Section 1104(a)(2) allows the court to engage in a cost-benefit analysis in order to determine whether the appointment of a trustee would be in the best interest of creditors, equity security holders, and other interests of the estate." (citation omitted)).

The OUCG argues that the debtor-in-possession may grant potential purchaser Agromac, a company owned by the president of the debtor, favorable terms over other potential purchasers when the assets of the estate are sold through a competitive bidding process pursuant to 11 U.S.C. § 363(b), and that such a sale could be to the detriment of the unsecured creditors if the debtor fails to accept better bids from other potential buyers. In the alternative, the OUCG argues that the debtor will withhold financial information from potential buyers. The OUCG did not submit evidence to show that the debtor-in-possession has already engaged in conduct preferential to Agromac.

If the debtor-in-possession grants Agromac favorable buying terms or withholds information from potential buyers of the debtor's assets, the debtor-in-possession will breach its fiduciary duty to the bankruptcy estate, and in that instance, the appointment of a Chapter 11 trustee will be necessary: "A debtor in possession has the fiduciary duty to preserve estate assets for the benefit of creditors. When a debtor in possession is incapable of performing these duties a trustee is properly appointed." Nautilus, 83 B.R. at 789 (citations omitted).

The fiduciary duty of the debtor-in-possession requires the debtor to act on behalf of the creditors of the estate, as well as the shareholders and management of the debtor. The fiduciary duty of the debtor should not be taken lightly, as the court in Microwave Prods. noted, self-dealing harms unsecured creditors:

The duty of loyalty and good faith forbids directors and other business operators from using their position of trust and control over the rights of other parties to further their own private interest either by usurping opportunities, holding undisclosed conflicts, or otherwise exploiting their position.

Therefore, in the instant case, any attempt by the individual board members to structure deals that would benefit them privately to the detriment of other creditors would contravene the fiduciary relationship. Clearly, these actions could reek devastation to unsecured creditors.

102 B.R. at 672.

Several cases have held that it is appropriate to appoint a Chapter 11 trustee in instances where the officials of the debtor are also officials of related entities and where questions regarding the propriety of the officials' conduct have been raised. See In re McCorhill Publishing, Inc., 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987); In re L.S. Good & Co., 8 B.R. 312, 314-15 (Bankr. N.D. W. Va. 1980). However, until there is an allegation of impropriety and evidence supporting the allegation, there is no prohibition against a debtor-in-possession dealing with a related entity:

A trustee may be appointed for misconduct or self-dealing, such as questionable business dealings between a debtor corporation, and related entities. In re Oklahoma Refining Co., 838 F.2d 1133, 1136 (10th Cir. 1988); In re McCorhill Publishing, Inc., 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1982). 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.

Clinton Centrifuge, 85 B.R. at 980; see also Id. at 674 ("The fact that a corporation engages in business with subsidiaries or related corporations does not dejure establish a conflict of interest." (quotation omitted)); accord Madison Management, 137 B.R. at 282 (holding that while the mere appearance of impropriety may not be sufficient cause for the appointment of a full trustee under §1104(a)(2), it was appropriate to appoint a trustee under subsection (a)(2) where it was necessary to investigate related entities of the debtor for possible causes of action to recover assets of the estate); In re Tyler, 18 B.R. 574, 578 (Bankr. S.D. Fla. 1982) (holding that existence of several related corporate entities does not constitute factual predicate for appointment of trustee).

As mentioned above, no evidence of impropriety has been presented. In addition, the appointment of a Chapter 11 trustee would add an additional burdensome administrative expense in a case that is already burdened with excessive administrative expenses. See Official Creditors Comm. v. Liberal Market, Inc. (In re Liberal Market, Inc.), 13 B.R. 748, 751 (Bankr. S.D. Ohio 1981) (noting that the appointment of a Chapter 11 trustee will add "exorbitant expenses" to case administration in case where debtor already ceased operations). Even though the purchase price received by the debtor may determine whether the unsecured creditors will receive any payments, a possible scenario in this case is that the unsecured creditors will not receive any distribution from the estate. It makes no sense to create an additional administrative expense which will be paid ahead of the unsecured creditors, especially when the unsecured creditors already risk not receiving any payout in this case.

To determine if the sale of assets should be accomplished only by a trustee, it is necessary to examine how the unsecured creditors are harmed if the debtor-in-possession conducts the sale pursuant to Section 363(b). There is no evidence that any harm will result. There is a potential for a conflict of interest to arise because certain officers of the debtor are also either officers, shareholders or directors of Agromac, a potential buyer. However, the case law discussed, supra at 4-5, indicates that the mere potential for a conflict of interest does not necessitate the immediate appointment of a Chapter 11 trustee.

If the debtor-in-possession is permitted to proceed with the sale pursuant to Section 363(b), this court can review the debtor-in-possession's conduct for impropriety at the time the debtor reappears before the court to have the purchase approved.

If the winning bid under the debtor-in-possession's proposed sale is Agromac, this Court will examine the transaction very closely to determine that no self-dealing took place between the debtor and Agromac and that Agromac did in fact make the best bid. Interested parties may challenge whether the winning purchase offer is truly in the best interest of the estate. The debtor-in-possession will not be permitted to sell the estate assets to Agromac, or any other party, unless proper disclosures have been made to all legitimate potential buyers. If the debtor-in-possession or its representatives withhold financial data, the debtor-in-possession and its officers will be violating a fiduciary duty and will become liable for such conduct.

Dealing with an insider or a related entity is not a basis to appoint a trustee in the absence of evidence to indicate that the debtor-in-possession acted improperly. Generally, this inquiry is made after evidence is presented that the debtor failed to act in a fiduciary capacity to the estate, not in anticipation that the debtor-in-possession may act improperly. See, e.g., In re Calvary Temple Evangelistic Assoc., 47 B.R. 520, 525 (Bankr. D. Minn. 1984) (stating that a trustee may be appointed to sell real estate of debtor under § 1104(a)(2) if creditors committee can show that debtor failed to exercise due diligence with real estate sale because lack of due diligence would satisfy best interest of creditors inquiry).

In conclusion, the motion to approve the appointment of a Chapter 11 trustee by the OUCC is denied.

DATED: November 16, 1995

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.