

In the United States Bankruptcy Court

for the Northern District of Iowa

NATIONAL CATTLE CONGRESS
Debtors.

Bankruptcy No. 93-61986KW
Chapter 11

ORDER RE: MOTION FOR APPOINTMENT OF CHAPTER 11 TRUSTEE

On March 29, 1995, the above-captioned matter came on for hearing pursuant to assignment. Attorney John Titler and Elizabeth Jacobi appeared for Debtor National Cattle Congress, Inc.. Attorney Tom Fiegen represented the Unsecured Creditors Committee ("Committee"). Attorney Dave Mason appeared for Homeland Bank as trustee for bondholders. Attorney William Smith appeared for the City of Waterloo.

The matter before the Court is the Committee's Motion for Appointment of Chapter 11 Trustee and objections thereto. After presentation of evidence and arguments of counsel, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(A).

STATEMENT OF FACTS

The Committee requests appointment of a Chapter 11 Trustee pursuant to 11 U.S.C. 1104(a). Its motion sets out an extensive history of this case. It states that the Committee has had concerns regarding the Debtor's management for some time. In its post-trial brief, the Committee focuses on four main areas of concern: 1) loss of creditor confidence, 2) Debtor's political reputation, 3) transactions with insiders/secured creditors and 4) lack of a plan of reorganization.

At the hearing, creditors testified that they had no confidence that Debtor would be able to reorganize or that they would be repaid. A political analyst testified that, in his opinion, the failure of the gambling referendum is attributable to the public's distrust of Debtor's management, specifically General Manager August Masciotra. The Committee elicited testimony from an insurance agent, an attorney and board members regarding possible conflicts of interest. Debtor's representatives testified regarding current efforts at reorganization. The Committee's brief concedes that evidence regarding insider transactions and Debtor's reorganization efforts is mixed, and not as clear and convincing as evidence of loss of creditor confidence and of public distrust.

Debtor objects to appointment of a Trustee. It believes that existing management has the best experience to proceed in the best interests of creditors. Homeland Bank, trustee for the Bondholders, and the City of Waterloo also object.

CONCLUSIONS OF LAW

The standards used in determining whether to appoint a trustee under 1104(a) are well settled. There is a presumption that a Chapter 11 debtor is to continue in control and possession of its business. Appointment of a trustee is an extraordinary remedy and should be the exception rather than the rule. The moving party has the burden of proving the need for a trustee by clear and convincing evidence. See In re Jansma, No. C)94-4018, slip op. at 6-7 (N.D. Iowa November 29, 1994); In re Sharon Steel Corp., 871 F.2d 1217, 1225 (3d Cir. 1989); In re Madison Management Group, Inc., 137 B.R. 275, 281 (Bankr. N.D. Ill. 1992).

The Committee seeks appointment of a trustee both for "cause", 1104(a)(1), and "in the interests of creditors, any equity security holders, and other interests of the estate", 1104(a)(2). Determinations made pursuant to 1104(a) are fact intensive and must be made on a case by case basis. Sharon Steel, 871 F.2d at 1225. Subsection (a)(1) provides a nonexhaustive list of examples of "cause" including fraud, dishonesty, incompetence and gross mismanagement. In re Bellevue Place Assoc., 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994). A finding of gross mismanagement requires extreme ineptitude on Debtor's part as a certain amount of mismanagement is inherent in most Chapter 11 cases. In re Colorado-Ute Elec. Ass'n, Inc., 120 B.R. 164, 174 (Bankr. D. Colo. 1990).

The Court has particularly wide discretion under subsection (a)(2) which sets forth a flexible standard for appointment of a trustee even when no cause exists. Bellevue Place, 171 B.R. at 623. Courts have considered the following factors in determining whether appointment of a Chapter 11 trustee is in the best interests of creditors and the estate under 1104(a)(2):

(i) the trustworthiness of the debtor; (ii) the debtor in possession's past and present performance and prospects for the debtor's rehabilitation; (iii) the confidence -- or lack thereof -- of the business community and of the creditors in present management; and (iv) the benefits derived by the appointment of a trustee, balanced against the cost of appointment.

In re Madison Management Group, Inc., 137 B.R. 275, 282 (Bankr. N.D. Ill. 1992) (citations omitted); In re Ionosphere Clubs, Inc., 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990). The Court should look to practical realities and necessities in considering these factors. Madison Management, 137 B.R. at 282.

Lack of confidence in a debtor can constitute "cause" under subsection (a)(1) as well as being included in the factors for determination under subsection (a)(2). Id. at 281. In order for lack of confidence to support the appointment of a trustee, the moving party must prove the basis for the lack of confidence by clear and convincing evidence. Id. One court found "cause" for appointment of a trustee where many events in combination showed that the debtor was essentially out of control of its operations which "caused a loss of confidence of crisis proportions". In re Cardinal Indus., Inc., 109 B.R. 755, 766 (Bankr. S.D. Ohio 1990).

Other courts have appointed Chapter 11 trustees under subsection (a)(2) for the best interests of creditors and the estate based, in part, on a loss of confidence in the debtor. See In re U.S. Communications, 123 B.R. 491, 495 (Bankr. S.D.N.Y. 1991) (finding that sheer financial incompetence of current management led to a complete erosion of trust and confidence by creditors); Colorado-Ute Elec., 120 B.R. at 176 (finding that creditors had no confidence in debtor's ability to reorganize in light of conflicts within the board of directors and management's lack of sophistication); Ionosphere Clubs, 113 B.R. at 170 (appointing trustee because of magnitude of losses and management's inability to make reliable forecasts); Cardinal Indus., 109 B.R. at 766 (finding that loss of confidence resulted from management's failure to provide financial information, conflicts of interest and significant postpetition losses); In re Microwave Prods., 102 B.R. 666, 676 (Bankr. W.D.

Tenn. 1989) (finding that debtor's acknowledged need for outside operations management and questionable intercompany transactions eroded trust and confidence of creditors); In re Concord Coal Corp., 11 B.R. 552, 554 (Bankr. S.D.W. Va. 1981) (appointing trustee where competing business interests and intercompany transactions led to president's inability to borrow operating funds because of lack of lender confidence).

The Committee has focused its request for appointment of a trustee mainly on the lack of confidence of creditors and the community in Debtor's operations and ability to reorganize. It does not assert that any fraud, dishonest, incompetence or gross mismanagement exists as cause under 1104(a)(1). However, it asserts that this lack of confidence both constitutes cause under subsection (a)(1) and supports appointment in the best interests of creditors and the estate under subsection (a)(2). In order to succeed in this argument, the Committee must prove the basis for the lack of confidence by clear and convincing evidence.

The cases cited above which held that the lack of creditor confidence in the debtor supported the appointment of a trustee generally found supplemental factors present such as questionable transactions, conflicts of interest, large losses or lack of expertise by the management. The Committee has asserted that conflicts and questionable transactions are present in this case. However, the Court concludes that the Committee has failed in its burden to prove these facts by clear and convincing evidence. Much of the evidence presented regarding conflicts related to transactions and events which occurred in the mid-1980s. The Committee admits that the evidence was mixed. The Court cannot find that conflicts and questionable transactions clearly occurred.

The Committee focused a large portion of its testimony on the validity of Homeland Bank's mortgage and Debtor's failure to challenge the mortgage in state foreclosure proceedings. Debtor has asserted that it had legitimate reasons for not challenging the mortgage. The Committee will complete this challenge at a subsequent hearing. From the record presented, the Court cannot conclude that this issue compels the appointment of a trustee.

The Committee asks the court to find that the public's failure to vote for expanded gambling by referendum arose because of its lack of confidence in Mr. Masciotra. The testimony of the Committee's political analyst made this assertion. However, the Court need not accept that opinion as correct. The extensive efforts of an organized coalition of citizens opposed to passage of the referendum could be as much the cause of the referendum's failure as distrust of Mr. Masciotra.

Debtor has not incurred major postpetition losses. There are no allegations of dishonesty or fraud. Debtor asserts that it is searching for alternatives to expanded gambling in order to effectuate a reorganization. It is continuing to sponsor events to utilize the National Cattle Congress grounds. Two major creditors object to Debtor's management being ousted in favor of a trustee.

Based on the record as a whole, the Court concludes that the Committee has failed to prove that cause exists for appointment of a trustee or that appointment of a trustee is in the best interests of creditors and the estate under

1104(a)(1) or (2). Therefore, the Motion for Appointment of Chapter 11 Trustee should be denied. Debtor shall remain in possession of the bankruptcy estate as authorized by 1107.

WHEREFORE, the Committee's Motion for Appointment of Chapter 11 Trustee is DENIED.

SO ORDERED this 20th day of April, 1995.

Paul J. Kilburg
U.S. Bankruptcy Judge