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THE APPOINTMENT OF A TRUSTEE IN A FARMER

CHAPTER 11 CASE AND THE RELATED DISCOVERY

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THE APPOINTMENT OF A TRUSTEE IN A FARMER CHAPTER 11 CASE AND THE RELATED DISCOVERY

I. <u>INTRODUCTION</u>

A Debtor-in-Possession in a Chapter 11 bankruptcy proceeding owes the creditors and the Bankruptcy Estate the same fiduciary duties as a trustee appointed over a case. In a non-farmer case, if the debtor-in-possession fails to perform his fiduciary duties, the Creditors may exercise their right to convert the Chapter 11 case to a Chapter 7 case pursuant to 11 U.S.C. § 1112. However, a unique situation arises when the Debtor-in-Possession is a farmer. 11 U.S.C. § 1112 forbids the Bankruptcy Court from converting a farmer's Chapter 11 case to a case under Chapter 7. If the case is dismissed, the creditor may be in a worse position, because the Debtor will be beyond the controls imposed by the Bankruptcy Code. Furthermore, actions to avoid insider preferential and fraudulent transfers will be lost if the case is dismissed. Thus, when the Debtor-in-Possession is a farmer, the only remedy available to the creditor is to seek the appointment a trustee pursuant to 11 U.S.C. § 1104. However, Bankruptcy Courts consider the removal of the Debtor in Possession and the concurrent appointment of a trustee to be an "extreme remedy." Any attempts to pursue the appointment of a trustee must be preceded by careful consideration of the pros and cons. The purpose of these materials is to discuss

the practicalities of dispossessing the debtor-in-possession and appointing a trustee, along with the discovery necessary to present sufficient evidence to support a motion.

II. THE LIKELY CANDIDATE TO PURSUE A MOTION TO APPOINT A TRUSTEE

Pursuing the appointment of trustee is not practical or even in the best interest of every creditor even if the Debtor's actions are sufficient to justify such an appointment. The first and foremost consideration in whether to pursue the appointment of a trustee is the additional drain on limited, unencumbered assets as compared to the likelihood that the appointment of a trustee will increase the size of the bankruptcy estate. The most likely candidate to pursue the appointment of a trustee is a large undersecured or unsecured creditor whose only chance of recovering its claim is for strict controls to be placed upon the Estate assets through a change in management of the Estate and for the Debtor-in-Possession to pursue certain actions against insiders or non-insiders who have a close relationship to the Debtor. If the Bankruptcy Estate is administratively insolvent (insufficient assets to pay administrative claims much less unsecured claims), this remedy is impracticable for these creditors even if cause exists. Additionally, a creditor secured by crops and crop proceeds should consider the appointment of a trustee when it feels insecure about the debtor's current year farming practices or its ability to monitor its cash collateral while the debtor remains in possession of the Bankruptcy Estate. Generally, smaller creditors or over-secured creditors with sufficient control of their collateral are unable to justify the cost of pursuing the appointment of trustee.

III. THE STANDARD FOR THE APPOINTMENT OF A TRUSTEE

As stated above, the Bankruptcy Code imposes the same fiduciary duties upon a debtor-in-possession as a trustee in a Chapter 11 case. These fiduciary duties include the obligation to protect and conserve the property in its possession and the obligation to refrain from acting in a manner which could damage the estate or hinder the successful reorganization of the business. *Commodity Futures Trading Comm'n v. Weintraub,* 471 U.S. 343, 355; 105 S.Ct. 1986, 1994; 85 L. Ed. 2d 372 (1985); *In re Ionosphere Clubs, Inc,* 113 B.R. 164, 169 (Bankr. E.D.N.Y. 1989); *Petit v. New England Mortgage Serv., Inc.,* 182 B.R. 64, 69 (Bankr. D. Me. 1995). "...One of the most fundamental and crucial duties of a debtor-in-possession is to keep the Court and creditors informed about the nature, status and condition of the business undergoing reorganization..." *Petit,* at 69.

Finally, the hallmark of a trustee is accountability and segregation of funds, and the debtor-in-possession is held to the same standards. *In re Nugelt, Inc.,* 142 B.R. 661, 666 (Bankr. D. Del. 1992). The appointment of a trustee pursuant to 11 U.S.C. § 1104 often arises from the Debtor's breach of these or other fiduciary duties.

11 U.S.C. § 1104 provides two separate grounds for the appointment of a trustee; (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the Debtor by current management, either before or after the commencement of the case or similar cause [11 U.S.C. § 1104(a)(1)]; or (2) if the appointment is in the "best interest" of the creditors [11U.S.C. § 1104(a)(2)]. A strong presumption arises in favor of the Debtor to remain in possession. *In re Macon Prestressed Concrete Co.,* 61 B.R. 432, 439 (Bankr. M.D.Ga. 1986). Due to this strong presumption, Courts are very hesitant to appoint a trustee under the 'best interest' standard without a showing of additional misconduct on the part of the Debtor.

a. <u>Appointment of a Trustee For Cause</u>

11 U.S.C. § 1104(a)(1) provides a non-exclusive list of conduct which qualifies as cause for the appointment of a trustee. This list includes fraud, dishonesty, incompetence, and gross mismanagement of the affairs of the Debtor. Furthermore, evidence of this conduct occurring pre-petition is sufficient to appoint a trustee. 11 U.S.C. § 1104(a)(1). Factors which a Court should consider in deciding whether to appoint a trustee include: (1) materiality of the misconduct; (2) evenhandedness or lack of same in dealings with insiders or affiliated entities vis-a-vis other creditors or customers; (3) the existence of pre-petition voidable preferences and fraudulent transfers; (4) unwillingness or inability of management to pursue Estate causes of actions; (5) conflicts of interest on the part of management which interfere with its ability to fulfill fiduciary duties to Debtor; (6) self-dealing by management; and (7) waste or squandering of corporate assets. *In re Intercat, Inc.* 247 B.R. 911 (Bankr. S.D.Ga. 2000);

A good starting point in determining whether the appointment of a trustee is appropriate is to determine whether the Debtor has complied with the reporting requirements imposed by Bankruptcy Rule 1007 and Bankruptcy Rule 2015. Bankruptcy Rule 2015 requires the debtor-in-possession to file inventory reports and monthly operating reports, to notify any entity holding money on behalf of Debtor of the Debtor's bankruptcy and to pay U.S. Trustee Fees. Bankruptcy Rule 1007 requires the

Debtor to file a schedule of assets and liabilities, statement of financial affairs and to report its income, expenditures, unexpired executory contracts and leases. Debtor's failure to fully and correctly comply with these requirements, or Debtor's persistent tardiness in complying with these requirements constitutes sufficient grounds to appoint a trustee. *In re Nugelt, Inc.,* 142 B.R. 661, 666 (Bankr. D. Del. 1992). Similarly, Debtor's failure to close pre-petition bank accounts and to open DIP bank accounts is cause for the appointment of a Trustee.

"The most common basis for appointing a Trustee under Section 1104 (a)(1) is for gross mismanagement and incompetence." *In re Ionosphere,* 113 B.R. 164, 169 (Bankr. S.D. N.Y. 1990). By Congress' use of the word "gross" in describing what mismanagement and incompetence is sufficient to appoint a trustee, Congress recognized that some degree of mismanagement exists in all insolvency cases. *id.* at 169. "While a certain amount of the mismanagement of the Debtor's affairs prior to the filing date may not be sufficient grounds for the appointment of a Trustee, continued mismanagement of the affairs of a Debtor after the filing date is evidence of the need to appoint a Trustee." *id.* In the context of a farm bankruptcy, post-petition management practices which justify the appointment of a trustee include the following: (1) The farmer continues to use poor farming practices such as the failure to apply pesticides, herbicides or fungicides when necessary or failure to irrigate when necessary; (2) The farmer continues to co-mingle his personal funds with those of the farming operation, if it is a separate entity; (3) The farmer overdraws the DIP accounts; or (4) The farmer keeps poor records of income and expenses.

One of the most important functions of the debtor-in-possession is to keep its creditors and the Court informed of the status of the business undergoing reorganization. *In re Paolino,* 53 B.R. 399 (Bankr. E.D. Pa. 1985). Very few farmers comply with Generally Accepted Accounting Principles. However, this does not relieve a farmer from the duties imposed upon all debtors-in-possession. The Debtor's books and records must be sufficient to give the creditors and the Court enough information to determine the nature, status and condition of the business undergoing the reorganization. *Petit v. New England Mortgage Serv., Inc.,* 182 B.R. 64, 69 (Bankr. D. Me. 1995). Ordinarily, the Debtor's failure to keep adequate records justifies the appointment of a trustee. *In re Oklahoma Refinancing Co.,* 838 F.2d 1133, 1136 (10th Cir. 1988). The necessary degree of sophistication of Debtor's records depends upon the size and complexity of Debtor's operation. By

creating a complicated business structure to avoid the payment limitations imposed in most government programs (discussed below), a Debtor increases the necessary degree of sophistication of his books and records. Farmers who have farming operations that exceed the debt limits for Chapter 12 bankruptcies should expect to maintain more records than a single checkbook. Farmers running large operations should keep sufficient records to compare the current year's revenues and expenses to the prior year's revenues and expenses and to make projections of future operations in a manner which is more than speculative.

In an effort to avoid the payment limitations imposed by most government payment programs, many farmers create more than one entity to conduct their farming operations to spread the payment limitations among the entities. This allows the farmer to collect payments for each entity up to the payment limitation. While the system often benefits the farmer's creditors in a non-bankruptcy context, it creates unique problems in a bankruptcy setting. If the farmer fails to maintain the separateness of each entity, the farmer may inadvertently create voidable preferences and fraudulent conveyances. The Debtor's incentive to refrain from pursuing these insider fraudulent conveyances and preferential transfers conflicts with the debtor-in-possession's duty to pursue and recover property of the estate. The inherent conflict of interest in recovering insider transfers for the benefit of the estate is also a common and well-accepted ground for the appointment of a trustee. *In re Sharon Shell Corp.,* 871 F.2d 1217, 1220-1221 (3rd Cir. 1989). When coupled with the one year "reach back" period for avoidable insider transfers, the recovery of insider transfers are often lucrative prospects for the undersecured and unsecured creditors.

An additional red flag for a creditor is the Debtor's filing of numerous crop insurance claims in years which other farmers did not file many claims. In this type of case, the creditor should determine whether the Debtor had unusually high yields in some fields and unusually low yields in other fields compared to the county-wide average. If a farmer has unusually high yields in one field and unusually low yields in another field, the farmer may be reporting the crops grown in one field as crops grown in another field and filing an insurance claim to recover the difference in the field with the low yield. This fraudulent practice warrants the appointment of a trustee whether the conduct occurred pre-petition or post-petition. The best way to clarify whether this conduct exists is to obtain the Farm Service Agency records from the previous crop years and review the county

averages. *See* Section IX, *infra,* for a discussion on obtaining Farm Service Agency records.

Finally, other grounds which justify the appoint of a trustee include: (1) undocumented personal loans to the principals; (2) the Debtor's failure to file tax returns; (3) Debtor's inability to project income and basic expenses with any certainty based on the previous year's records; (4) the Debtor's misapplication of crop proceeds; (5) Debtor's transfer of assets out of the ordinary course of business without court authority ; and (6) the Debtor's use of cash collateral without the consent of the secured creditor or without the authority from the court. Any combination of the above represents cause for the appointment of a trustee. As stated above, any additional conduct which breaches the fiduciary duties imposed upon a trustee over the estate is sufficient cause to require the appointment of a trustee.

b. Appointment of A Trustee Due To The Best Interest of The Creditors or Of The Estate

11 U.S.C. § 1104 (a)(2) creates a flexible standard for the "best interest" test and allows the appointment of a Trustee even when no "cause" exists under Section 1104 (a)(1). *In re Sharon Steel Corp.,* 871 F. 2d 1217, 1226 (3rd Cir. 1989). However, as a practical matter, Courts are hesitant to dispossess a farmer debtor-in-possession despite the fact that it is in the best interest of the creditors or of the Bankruptcy Estate. Even though the court has this flexibility, courts typically require additional misconduct by the Debtor which may not rise to levels sufficient to appoint a trustee for cause. In determining whether it is in the "best interest" of the creditors or the Bankruptcy Estate to appoint a trustee, the Court may consider the following: (1) The trustworthiness of the Debtor; (2) The Debtor-in-Possession's past and present performance and prospects of the Debtor's rehabilitation; (3) The confidence or lack thereof of the business community and of creditors in present management; and (4) The benefits derived from the appointment of a trustee balanced against the cost of the appointment. *In re Ionosphere Clubs, Inc.,* 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990); *In re Cajun Elec. Power Coop., Inc.,* 191 B.R. 659, 661-662 (Bankr. M.D. La. 1995). In order to be successful, some public interest must be affected. *In re Ionosphere,* at 168. In the context of a Chapter 11 farm reorganization, the chances of having a trustee appointed without showing cause are "slim to none." In most cases, the case may not have enough impact on the

"public interest" to warrant the appointment of a trustee.

IV. <u>THE BURDEN OF PROOF</u>

Depending upon which District the case is pending, the burden of proof may vary. The courts in most reported cases impose a burden of "clear and convincing evidence" for the appointment of a trustee. However, none of the cases which impose a "clear and convincing evidence" burden has addressed the issues raised in *Grogan v. Garner,* 498 U.S. 279, 111 S.Ct. 654, 112 L. Ed.2d 755 (1991). In two recent unpublished decisions, the United States Bankruptcy Court for the Middle District of Georgia applied the *Grogan* decision in holding that the burden of proof for the appointment of a trustee should only be a "preponderance of the evidence."

In *Grogan*, the United States Supreme Court held that bankruptcy courts should not apply the "clear and convincing evidence" standard to establish fraud as the cause for excepting a claim from discharge under 11 U.S.C. § 523. Although the holding is not directly on point, the reasoning of the U.S. Supreme Court cannot be ignored. The U.S. Supreme Court found that Section 523 and its legislative history were silent concerning whether there should be a special heightened standard of proof for fraud as grounds for an exception to discharge. The Court further stated: "because the preponderance of evidence standard results in a roughly equal allocation of the risk of error between litigants, we presume that this standard is applicable in civil actions between private litigants unless particularly important individual interests or rights are at stake." *Grogan,* at 286 (*quoting Herman & MacClean v. Huddleston*, 459 U.S. 375, 389-90 (1982)). The U.S. Supreme Court stated that a Debtor had no constitutional or fundamental right to a discharge in bankruptcy which would heighten the standard of proof. *id.* The U.S. Supreme Court cited its earlier decisions that rejected a higher standard of proof in favor of a preponderance of the evidence standard for federal civil actions that did not involve constitutional or fundamental rights. *id*. at 286, 288-89; *see e.g. Herman & MacClean v. Huddleston*, 459 U.S. 375 (1982) (holding that a preponderance of the evidence standard was appropriate for fraud actions under the Securities Exchange Act.). Additionally, in *Vance v. Terrazas,* 444 U.S. 252 (1980), the U.S. Supreme Court held that the due process clause did not require proof beyond a preponderance of the evidence even in an expatriation proceeding. 44 U.S. at 266. Finally, in *U.S. v. Regan* 232 U.S. 37 (1914), the U.S. Supreme Court held that proof by "preponderance of the evidence" suffices in civil suits involving proof of acts that expose a party to

criminal prosecution. 232 U.S. at 48-49. Likewise, Section 1104 and the legislative history is silent concerning the standard of proof for the appointment of a trustee, and a debtor has no fundamental right to remain as debtor-in-possession. Therefore, even in a District in which the Court imposes the "clear and convincing" evidentiary standard, a viable argument exists to reduce the standard to "preponderance of the evidence."

Notwithstanding the above paragraph, courts continue to apply the "clear and convincing" standard of proof for the appointment of a trustee, including the Fifth Circuit Court of Appeals. *See e.g. In re Cajun Elec. Power Coop., Inc.,* 69 F.3d 746 (5th Cir. 1995). In *Cajun Electric*, the Fifth Circuit Court of Appeals applied the "clear and convincing" evidence standard without addressing the *Grogan* decision. Thus, to be successful, a creditor must convince the Bankruptcy Court to follow the *Grogan* decision rather than the *Cajun Electric* decision.

V. THE TIMING OF THE MOTION TO APPOINT A TRUSTEE

The timing of filing a motion to appoint a trustee in a farm reorganization creates unique issues depending upon whether the motion is filed prior to the harvest or after the harvest. In considering whether to file the motion pre-harvest, a creditor must be prepared to propose various solutions concerning the logistics and costs of maintaining and harvesting the crops. If the motion is brought post-harvest, the creditor must concern itself with safeguards for the crop proceeds and safeguards for the crops stored in a warehouse.

a. Pre-Harvest

A motion brought prior to the harvest creates numerous problems which must be addressed immediately. The obvious benefit of asserting a motion prior to harvest is to ensure adequate controls will be implemented over the crops and the proceeds of the crops. In certain cases, this may be the overriding concern of the creditor. If the creditor decides to file the motion pre-harvest, the creditor should file the motion so as to schedule the hearing at or near the time of harvest to minimize the maintenance cost. Additionally, if no other creditor joins in the motion, or if one of the creditors opposes the motion, the moving party should be prepared to share the burden of the excess cost of maintaining and harvesting the crops by the proposed Trustee. If the moving party is not the DIP Financer, the DIP Financer will probably oppose the use of its loan proceeds to fund the added

cost associated with a Trustee managing the crop. However, to the extent of the excess costs are actual and necessary costs of the Bankruptcy Estate, the cost should be recoverable by the creditor as an administrative expense priority claim.

In order to make an accurate assessment of whether to file a motion pre-harvest, the creditor should engage a crop consultant to appraise the expected yields of the crops and to project the expected cost of maintaining and harvesting the crops. The creditor should be conservative in its assessments and build in extra cushions to ensure that sufficient proceeds will be available to cover the cost of maintaining and harvesting the crops. Further, a crop consultant should also be prepared to testify at the hearing on the motion. The Court will be very interested in whether the present crop will yield sufficient funds to pay the crop lender and create a surplus to the unsecured creditors.

Many of the problems related to the pre-harvest logistics may be solved if the majority of the creditors join in the motion or if the DIP lender joins in the motion to appoint a trustee. If the DIP lender opposes the appointment of a Trustee, the chances of pre-harvest success can decrease significantly. The DIP financer has the most invested in the crop and the most to lose if the crop is improperly maintained and harvested by the Trustee. However, if the Debtor's misconduct is so egregious to create a clear need for a trustee, the creditor should be suspicious of a lender willing to support the Debtor. The DIP financer's willingness to turn a blind eye to the debtor-in-possession's misconduct may indicate that the DIP financer will benefit from the debtor-in-possession's continued misconduct. Any conflicts raised by the DIP financer's benefit from the debtor-in-possession's misconduct are valuable tools to discredit the DIP financer's opposition to the appointment of a trustee. If the DIP Financer's conduct contributed to the Debtor's breach of his fiduciary duties, the Court may be even more willing to appoint a trustee.

The fact that the DIP lender is opposed to the appointment of a trustee should not dissuade a creditor from seeking the appointment of a trustee. The threat of the removal of the debtor-in-possession can provide significant leverage to the moving creditors in a contested motion to appoint a trustee. By filing the motion and scheduling the hearing, a creditor may be able to negotiate safeguards related to the harvest and sale of the crops which are consistent with the creditor's and the DIP financer's best interest as consideration for the creditor consenting to the continuation of the hearing until after the harvest. In this case, the DIP financer may exert sufficient influence upon the Debtor to convince the Debtor to agree to these safeguards. If the creditor is unsuccessful in

negotiating satisfactory safeguards, the creditor still retains the options of obtaining a restraining order as will be discussed below. Potential safeguards include the following:

(1) Place an employee with a background in accounting and with knowledge and experience in agricultural practices on the site of the Debtor during the harvest of the crops. Each truckload or module, as the case may be, should be recorded, logged, and reported daily to the DIP financer and the creditors. The creditors should use the reports to keep a daily running total of the harvested crops to compare with estimated crop yields for each farm. If appreciable variations from the estimated crop yields occur, the monitoring plan should provide that such variation should be addressed immediately;

(2) The buying point should be selected with the approval of the DIP financer and the creditors. If the buying point is the same as the DIP financer, as in many cases, the DIP financer should provide trucks and drivers to deliver crops to a specific facility for weighing, sampling, cleaning and grading. Daily totals received at the buying point should be compared to the site representative's log of loads leaving the field;

(3) The on-site representative should make daily estimates of crop volumes remaining in the fields being harvested. In order to keep an accurate record of the harvest, estimates of crops remaining in the field should be added to the tally of loads leaving the field in order to produce the estimated crop yields for a particular field;

(4) For cotton, each module should be marked with the farmer name and number and should be tallied as it is located in the field. Cotton modules should be furnished by the gin and should be transported to and from the fields by specialized module trucks. Daily reports of module receipts from each gin should be tallied and compared to the number of modules loaded and removed from each farm in order to keep a running total of the volume removed from each farm;

(5) Additional personnel should make random inspections at the Debtor's farm during harvesting operations. These random checks serve the purpose of comparing total volume harvested and removed from each farm with estimated crop yields. A safeguard should be in place to address any appreciable variance between the harvest

volumes and estimated crop yields;

(6) All payments for all crops should be paid jointly to the DIP financer and the Debtor-in-Possession and disbursed only in accordance with any loan agreements approved by the Bankruptcy Court or as otherwise directed by the Bankruptcy Court. The Debtor-in-Possession should not be authorized to disburse funds other than as authorized by the monitoring agreement or by order of the court.

b. Post-Harvest

If after engaging the crop consultant, the creditor determines that the crop will not generate sufficient revenues to benefit the moving creditor, the creditor should file his motion post-harvest. Filing post-harvest may simplify the evidence which will be presented to the Court. Whether the yields will be sufficient to cover the costs and to benefit the estate will not be an issue at a post-harvest hearing. Furthermore, the likelihood of a creditor being harmed by the appointment of the trustee significantly decreases post-harvest. However, if an appointment of the Trustee is warranted, the obvious detriment to waiting is lack of control of the crops and crop proceeds. This may be prevented if the motion is filed pre-harvest with the hearing scheduled post-harvest. The same safeguards discussed above may be implemented. Furthermore, as discussed below, waiting decreases the risk and cost related to obtaining a restraining order against the Debtor.

VI. THE NECESSITY FOR A PRELIMINARY AND PERMANENT INJUNCTION AND A TEMPORARY RESTRAINING ORDER

In many cases, significant and valuable time may pass between the date the court enters an Order requiring the U.S. Trustee to appoint a Trustee and the date the Trustee is actually appointed and approved by the Court. In order to preserve the *status quo* during this period, a creditor should file an adversary proceeding seeking a preliminary and permanent injunction pursuant to Bankruptcy Rule 7065, prohibiting the Debtor's waste of the assets of the estate prior to the Court's appointment of a Trustee and prohibiting Debtor's use of the assets of the estate after the appointment of a Trustee. Additionally, the creditor should file a motion for a temporary restraining order on the date that the adversary proceeding is filed. The motion is an ex parte motion and should not require significant time to litigate.

If the motion to appoint a trustee is filed pre-harvest, the burden placed upon the creditor to obtain a temporary restraining order and preliminary injunction significantly increases. First, the Court may require a creditor to post a bond. Second, the creditor must tailor the Order to allow for the payment of certain necessary expenditures to maintain and or harvest the crops during the interim between the date the temporary restraining order is issued and the date of the hearing on the preliminary injunction. (As a matter of procedure, a court must conduct a hearing on the preliminary injunction within ten (10) days after the entry of the order granting the temporary restraining order.) Third, the creditor must tailor the Order for preliminary and/or permanent injunction to allow for the payment of necessary expenditures to maintain and harvest the crop, if necessary, before the appointment of a trustee. In order to tailor the Order, the creditor will be required to prepare a cash receipts and cash disbursement budget. Fourth, the creditor must convince the Court of the need and practicality of the safeguards discussed above. Unless the DIP lender is a party to the motion and adversary proceeding or unless it supports the motion, the creditor should consider waiting to file the adversary proceeding and motion on the date of the hearing for the appointment of the trustee. This may reduce the bonding requirements imposed by Bankruptcy Rule 7065. However, the adversary proceeding may be the only way to force the impositions of safeguards. Once again, the DIP Lender's failure to support the safeguards, should raise red flags to the creditor.

If the motion to appoint a trustee is filed post-harvest, the issues related to the adversary proceeding and the temporary restraining order are simplified. A temporary restraining order and the order for a preliminary injunction may be tailored to allow the Debtor to expend living expenses in an amount equal to those listed in Bankruptcy Schedule "J" during the time between the imposition of the temporary restraining order and the hearing on the appointment of trustees. Under these circumstances, the Court should not require a bond due to the lack of any potential damages which will be incurred during the interim. Additionally, a permanent order for injunction may be tailored to include the same limitations concerning expenditures until the trustee is appointed if necessary.

VII. THE LOGISTICS OF THE APPOINTMENT OF THE TRUSTEE

Pursuant to 11 U.S.C. § 1104, and Bankruptcy Rule 2007.1, the actual selection of a trustee

is not made by the court. The creditor's motion should request the Court to issue an order requiring the U.S. Trustee to designate a trustee. Pursuant to 11 U.S.C. § 1104 and Bankruptcy Rule 2007.1, the U.S. Trustee's Office has two options: (1) Based on recommendations of the creditors, the U.S. Trustee may appoint a trustee, subject to the approval of the Court; or (2) the U.S. Trustee may convene a Meeting of Creditors for the purpose of electing a trustee, subject to the approval of the Court. Even if the U.S. Trustee appoints a trustee without a Meeting of Creditors, a party-in-interest may request the U.S. Trustee to convene a Meeting of Creditors to elect a trustee. However, this party-in-interest must request the Meeting of Creditors within thirty (30) days after the Court orders the appointment of the trustee. 11 U.S.C. § 1104 (b).

Once the trustee is selected, the U.S. Trustee must file an application with the Court for an order approving the appointment of the trustee by either method. Bankruptcy Rule 2007.1(c). The application must state the following: (1) the name of the person appointed and all of the proposed Trustee's connections with the Debtor, creditors, any other parties-in-interest, their respective attorneys and accountants, the U.S. Trustee, and persons employed in the office of the U.S. Trustee; and (2) Unless the person has been elected by the creditors, the application must state the names of the parties-in-interest with whom the U.S. Trustee consulted regarding the appointment. *id.* If the Trustee meets the bonding requirements of 11 U.S.C. § 322 and Bankruptcy Rule 2010 and is not disqualified by the restrictions imposed by Bankruptcy Rule 5002, the Court may approve the appointment.

Due to the U.S. Trustee's significant involvement in the selection process, the moving party should approach the U.S. Trustee either prior to filing the motion or immediately after filing the motion to apprise the U.S. Trustee of the information it deems to be sufficient cause for the appointment of a trustee and to introduce the proposed Trustee to the U.S. Trustee, if possible. In the experience of the author, the U.S. Trustee's office has been very cooperative with the process of appointing a trustee. Thus, it is important for the moving party to immediately locate a proposed trustee. The proposed trustee should be aggressive, with a farming background or have access to consultants with a farming background and who is either bonded or has the ability to obtain a bond in connection with the case. Usually, any panel Trustee for the District or another District will qualify to be appointed as a Chapter 11 trustee. Finally, any proposed trustee must be prepared to appear at the hearing on the appointment of a trustee and to testify concerning his qualifications and

willingness to serve as Trustee.

A creditor should do his homework before approaching a potential trustee. In order to persuade a party to serve as the trustee, the creditor should be prepared to show the proposed trustee that sufficient assets or potential assets exist for him to be paid. A trustee will not be willing to serve if the estate is administratively insolvent. The creditor should summarize all relevant information in a form which allows the trustee to make an informed decision. This summarization should be prepared prior to approaching the trustee, because this is the first information any party qualified to serve as Trustee will request. In addition to showing a summarization of the assets, the moving party should be prepared to provide the proposed trustee with sufficient information concerning the location of assets to allow the trustee to quickly obtain control of all assets of the estate. Finally, if the motion is filed prior to the harvest, the creditor should work out the logistics of maintaining and harvesting the crops prior to the appointment of the trustee to ensure a smooth transition. The creditor should locate a farmer or farmers who are willing to manage and harvest the crop if hired by the Trustee and approved by the Court. This farmer should be introduced to the potential Trustee as soon as possible. Obviously, this farmer may be a witness in the hearing on the Motion to provide the Court with the cost of maintaining and harvesting the crop.

VIII. THE RECOVERY OF ATTORNEYS' FEES AS AN ADMINISTRATIVE EXPENSE PRIORITY

If successful, the moving party should be entitled to recover it attorneys' fees related to pursuing the motion as an administrative expense priority claim pursuant to 11 U.S.C. § 503(b)(3)(D). *In re On Tour, LLC,* 276 B.R. 407 (Bankr. D. Md. 2002); *In re Stoecker,* 128 B.R. 205 (Bankr. N.D. Ill. 1991). Any entity who makes a substantial contribution to the bankruptcy estate may recover its expenses pursuant to 11 U.S.C. § 503(b)(3)(D). If the entity is entitled to an award under Section 503(b)(3), it may recover its professional fees pursuant to 11 U.S.C. § 503 (b)(4). *Speights & Runyon v. Celotex Corp.,* (*In re Celotex Corp.),* 227 F.3d 1336 (11th Cir. 2000). The authority to reimburse a Creditor who makes a substantial contribution to the appointment of a Trustee stems from the interplay between Section 503(b)(3)(D) and Section 503(b)(4). *In re On Tour, LLC,* 276 B.R. 407 (Bankr. D. Md. 2002); *In re Catalina Spa and RV Resort, Ltd.,* 97 B.R. 13 (Bankr. S.D.Ca. 1989). Substantial contributions are defined as a contributions to the bankruptcy

case that "foster and enhance, rather than retard or interrupt the process of reorganization." *In re On Tour, LLC,* 276 B.R. 407, 417-418 (Bankr. D. Md. 2002). A substantial contribution may be in the form of an increase in size of the estate or in the form of additional protection to the interest of the creditors. *In re W.G.S.C. Enterprises, Inc.,* 47 B.R. 53 (Bankr. N.D.Ga. 1985). The fact that the attorney was motivated to benefit his client is irrelevant where the services benefit the estate as a whole as well as all creditors. *Hall Fin. Group v. D.P. Partners, L.P. (In re D.P. Partners, L.P.),* 106 F.3d 667 (5th Cir. 1997); *Celotex,* at 1339. In every case where the author sought the appointment of a trustee, the judge has allowed our client to be reimbursed for its attorney's fees and expenses.

In addition to alleging sufficient facts to show a substantial contribution to the bankruptcy estate, a motion requesting the allowance of attorney's fees as an administrative expense priority claim should contain the same information contained in a fee application filed by any other professional in the case. To be successful in the motion, the creditor must submit sufficient facts to address the lodestar rates and factors enumerated in *Johnson V. Georgia Highway Express,* 488 F.2d 714 (5th Cir. 1974); *In re First Colonial Court of America*, 544 F.2d 291 (5th Cir. 1997) and *Norman V. Housing Authority of The City of Montgomery,* 836 F. 2d 292 (11th Cir. 1988). Those cases require the attorney to discuss the following factors: (1) the actual time expended; (2) the nature and length of the professional relationship with the client; (3) the skill, experience, reputation, and hourly rate of the attorneys providing services; (4) the experience and reputation of the applicants; (5) novelty and difficulty of the questions addressed in bringing the motions; (6) the hours reasonably expended; and (7) the amount involved. Additionally, the application should contain a detailed breakdown of the time, charges and expenses.

IX. THE DISCOVERY RELATED TO OBTAINING AN ORDER REQUIRING THE APPOINTMENT OF A TRUSTEE

Discovery in a bankruptcy case may be conducted using three procedures: (1) A party may conduct an examination of any person and request related documents by means of a motion and order issued pursuant to Bankruptcy Rule 2004; (2) In the context of a contested matter as defined pursuant to Bankruptcy Rule 9014, certain types of discovery may be conducted while the motion is pending; (3) In the context of an adversary proceeding, all discovery may be conducted pursuant to

Bankruptcy Rule 7026, *et. seq*. If a contested matter and/or an adversary proceeding is not pending, no procedural avenue exists to conduct discovery except by means of Bankruptcy Rule 2004.

a. <u>A Bankruptcy Rule 2004 Examination</u>

Most discovery conducted to support the appointment a trustee occurs in the context of a Bankruptcy Rule 2004 motion and order. The party will not have sufficient information to support its motion to appoint a trustee until the party has at least conducted some preliminary discovery. The scope of the examination conducted pursuant to Bankruptcy Rule 2004 is much broader than depositions taken in a contested matter and in an adversary proceeding. The investigation of an examiner in bankruptcy, unlike civil discovery under Federal Rule of Civil Procedure No. 26(c), can be a "fishing expedition as exploratory and groping as appears proper to the examiner." *In re Ionosphere Clubs, Inc.* 156 B.R. 414, 432 (S.D.N.Y. 1993). Unlike discovery sought in a contested matter and in an adversary proceeding, the only limitation imposed upon the examiner is that the examination may not be conducted for the purpose of abuse and harassment of the party being examined. *In re Duratech Industries, Inc.,* 241 B.R. 283 (E.D.N.Y. 1999). Furthermore, a party may examine any entity pursuant to Bankruptcy Rule 2004. Once the Court issues the order permitting the examination, the attorney for the examining party may issue a subpoena which must be served personally upon the witness.

In establishing a case for the appointment of a trustee, the party anticipating the need for a trustee should, at a minimum, subpoena the following documents from the Debtor, and any entity who has an ownership interest in Debtor: (1) all bank statements, cancelled checks, records of deposits, and the like of all bank accounts maintained for a period of three years prior to the bankruptcy until the date of the issue of the subpoena; (2) copies of all Financial Statements prepared by or behalf of the person or entity within the prior three years; (3) copies of each tax return filed by or on behalf of the person for the three previous tax years; (4) each record of the disposition of real or personal property for the previous three years; (5) each document reflecting any and all statements of income and/or expenses prepared by or on behalf of the person or any entity for the previous three years; (6) copies of any appraisals of real or personal property owned by the person or entity prepared during the previous three years; (7) any document prepared and submitted to any buying point during the previous three crop years; (8) any document received from any buying point during the previous three crop years; and (9) any document prepared and/or

submitted to any government agency reflecting any crops grown by the Debtor during the previous three years.

If the creditor is suspicious of the crop yields reported by the Debtor in the previous year, the creditor may seek a Bankruptcy Rule 2004 examination of the Debtor's crop buying points, the Debtor's crop insurer, any crop insurance adjuster, if a claim has been made, and any crop lender. The following represents an example of the documents which should be obtained from crop buying points for the relevant crop years: Any and all documents of any type or description related to all crops, including, but not limited to, corn, cotton, wheat and peanuts delivered to, handled, stored or purchased by the buying point at any time during the relevant period which was produced or delivered by Debtor, or any affiliate of the Debtor, and/or any employee, spouse or immediate family member of any of the foregoing; including copies of all weight tickets, receipts, checks, drafts, warehouse receipts, records of production (both by name and farm serial number), seed checks, records of gin-direct cotton sales, records pertaining to loan deficiency payments and loan bales, warehouse rebate checks and backup; records relating to dealings with any broker (checks, refunds, rebates), copies of all FSA Form 1007s with weight tickets, copies of all FV-95s (including those that have been voided), copies of all corrective documents (whether related to voided FV-95s or otherwise), printouts of all pertinent marketing cards, documents related to drying charges (also cleaning and hauling), copies any other checks with backup documents for all production agents and any and all other documents of any type or description in anyway relating to such crops.

As to the Debtor's crop insurer, the following documents should be obtained for the relevant year or years: any and all documents or information in any way related to the crop, including but not limited to copies of any policy issued, reports of acreage to be produced, reports of actual production, crop loss claims, investigative reports relating to crop loss claims, yield data, and any and all other information in any way related to crop insured through the agency or its affiliate. As to the Debtor's crop lender, the following documents should be obtained for the relevant years: each and every document of any type or description related to any crops grown by the Debtor, any affiliate of the Debtor, employee, spouse, or immediate family member of any of the foregoing, including but not limited to each and every invoice, journal, ledger, check request, check, deposit slip, or any other document which relates to or reflects any amounts loaned to Debtor or any affiliated entity of Debtor.

The U.S.D.A.'s records of the Debtor's crop yields, acreage planted, entitlement to government payments, etc., are valuable sources of information regarding the Debtor's farming operation. However, special issues arise when a creditor seeks to obtain testimony and records from any U.S.D.A employee. Pursuant to 7 C.F.R. 1.210, *et. seq*., in order to subpoena U.S.D.A. testimony or records, the party must seek permission from the head of the agency, with the concurrence of the general counsel, which will only be granted on a determination that the appearance is in the interest of the U.S.D.A. In determinating whether the appearance is in the interest of the U.S.D.A., the U.S.D.A. will determine what interest would be promoted by its employee's testimony, whether an appearance would result in an unnecessary interference with the duties of the U.S.D.A. employee, and whether the employee's testimony would result in the appearance of the improper favor of one litigant over the other. As such, the USDA rarely authorizes its employees to testify for a litigant. The only alternative available to the creditor is to seek the Debtor's authorization to release its Farm Service Agency data. If the Debtor is not cooperative, the party should bring a motion to compel the Debtor to execute the release. By forcing a creditor to file a motion to compel the release of Farm Service Agency data, the Debtor puts itself in the untenable position of explaining to the Judge why he refuses to comply with his fiduciary duties to disclose all relevant documents and information related to the bankruptcy.

b. <u>Discovery in A Contested Matter and An Adversary Proceeding</u>

Pursuant to Bankruptcy Rule 2007.1, a motion to appoint a Trustee pursuant to 11 U.S.C. § 1104(a) is a contested matter, and the moving party may seek discovery within the scope of Bankruptcy Rule 7026 and 7028-7037. If the Debtor's crop yields are suspicious, all of the aforementioned discovery sought from the Debtor's crop buying point, crop insurer, crop adjuster and crop lender should fall within the scope of Bankruptcy Rule 7026. Although the scope may be narrower in this context, once the contested matter has been filed, there is no need for a motion pursuant to Bankruptcy Rule 2004. Furthermore, a creditor may file interrogatories and requests for the production of documents without the need for the service of a subpoena. Bankruptcy Rule 7033; Bankruptcy Rule 7034.

Pursuant to Bankruptcy Rule 7001, *et. seq*., a complaint asserting a claim for a preliminary and permanent injunction is an adversary proceeding. Part VII of the Bankruptcy Rules incorporates

all of the Federal Rules of Civil Procedure concerning discovery. Accordingly, once the adversary proceeding is filed, the creditor may serve interrogatories, requests for the production of documents, and requests for admissions upon the Debtor. Additionally, the creditor may conduct any depositions it deems appropriate to prove its case. As mentioned above, in order to obtain a temporary restraining order and a preliminary injunction against the Debtor prior to the harvest, the creditor will be required to tailor its order to allow the Debtor to expend funds necessary to maintain and harvest the crops. The information necessary to propose a cash receipts and cash disbursements budget during the relevant period may be obtained through each of the forms of discovery. Also, if a Debtor has retained accountants to prepare operating reports, this same type of discovery may be served on the accountants.

c. Information From Local Contacts

The client and other local contacts can provide a wealth of information needed to effectively represent the client's interest in a farm reorganization and to determine whether a trustee is needed. The farming community is often a small world and information about the Debtor's farming operation, the Debtor's reputation, and simple gossip is readily available to those who pursue it. The client or other local contacts who are members of the Debtor's community are better suited than an out-of-town attorney to pursue this information. In each of the cases in which the author obtained an order appointing a trustee, a local insider provided the information that ultimately led to the appointment of trustee. If the creditor does not have a local representative involved in the community or if the creditor is not represented by an attorney who lives in the same community as the Debtor, the creditor should consider hiring local counsel in addition to its current attorney. The information gained is worth the added cost.