UNITED STATES BANKRUPTCY COURT

DISTRICT OF MINNESOTA

In re:

Petters Company, Inc., BKY No. 08-45257

Debtor.

BEFORE THE HONORABLE GREGORY F. KISHEL

United States Bankruptcy Judge

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TRANSCRIPT OF PROCEEDINGS

12/16/08

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A P P E A R A N C E S

MR. MICHAEL E. RIDGWAY, Attorney at Law, 1015 U.S. Courthouse, 300 South Fourth Street, Minneapolis, Minnesota 55415, appeared on behalf of Trustee.

MR. JAMES A. LODOEN, Attorney at Law, Suite 4200, 80 South Eighth Street, Minneapolis, Minnesota 55402, appeared on behalf of Debtor.

MR. DAVID E. RUNCK, Attorney at Law, Suite 400, 775 Prairie Center Drive, Eden Prairie, Minnesota 55344, appeared on behalf of Unsecured Creditors Committee.

MR. JAMES M. JORISSEN, Attorney at Law, Suite 2500, 100 South Fifth Street, Minneapolis, Minnesota 55402, appeared on behalf of creditors.

P R O C E E D I N G S

THE COURT: -- the record and the matter at bar is in the group of Chapter 11 cases presently jointly administered and being maintained under the case of Petters Company, Inc., file 08-45257. Two motions are on the calendar this afternoon, both relating to the request -- two requests for appointment of trustees under Chapter 11 in these cases.

Let's note appearances all around here, counsel.

MR. JORISSEN: Good afternoon, Your Honor. James Jorissen on behalf of Ritchie Special Credit Investments Limited; Rhone Holdings II, Limited; Yorkville Investment I, LLC; Ritchie Capital Structure Arbitrage, LLC; and Ritchie Capital Management Limited.

MR. RUNCK: Good afternoon, Your Honor. David Runck on behalf of the Unsecured Creditors Committee, and with me today is Mr. Ronald Peterson who is the chair of our committee and he is also the Chapter 7

Trustee for the Lancelot Funds.

MR. PETERSON: Good afternoon, Your Honor.

THE COURT: Very good.

MR. LODOEN: Your Honor, James Lodoen on behalf of the debtors.

MR. RIDGWAY: Good afternoon, Your Honor. Michael Ridgway and Bob Raschke on behalf of the United States Trustee.

THE COURT: All right. Appearances are as noted here. Well, let me see. What I'd like to do is hear the U.S. Trustee's motion first, the Ritchie Group's motion second, and then go around for respective responses here.

So from the U.S. Trustee, Mr. Ridgway.

MR. RIDGWAY: Good afternoon, Your Honor, counsel.

The United States Trustee has filed a motion for the appointment of a Chapter 11 trustee in these ten jointly administered cases. I believe the Court is very familiar with the facts that have led us here today. The concern that precipitated in large part the U.S. Trustee bringing this motion is the capacity of the receiver appointed by the District Court, Judge Montgomery, to continue as a debtor in possession.

As the Court knows, the Bankruptcy Code doesn't recognize a receiver as such, specifically under Section 105(B). I don't think that anybody here today would argue that the receiver, Mr. Kelly, actually had the authority, based upon Judge Montgomery's receivership order, to place these entities into Chapter 11. The concern is what is his capacity vis-a-vis the debtor.

The case law that we have in our memorandum in support of our motion suggests that many courts in the country recognize that once these entities were filed by the receiver, he becomes a custodian as that term is defined under the Bankruptcy Code. And as a custodian, he has the responsibility, indeed the obligation, to turn over the assets to the debtor in possession.

Well, the case here, the principal, Mr. Petters, was removed, indeed indicted, as several of the managers and key personnel in these affiliated entities. So there's no debtor for whom the receiver can turn the property over pursuant to Section 543.

Whether one looks at 1104(A)1, the appointment of a Chapter 11 Trustee for cause, or 1104(A)2 which is in the interests of creditors and equity shareholders, the U.S. Trustee respectfully submits that this case calls out and cries out for the appointment of a Chapter 11 trustee. It avoids the -- I believe the word I used in the memorandum was skirmishes -- with regard to procedural issues, regarding avoidance preference, transfers, fraudulent transfers and the like, standing issues, capacity issues and what have you.

An 11 trustee when viewed with the powers granted to him by Section 1106, and attendant thereto 1107 and 1108, would avoid all of those procedural and standing issues and would be able to prosecute those cases in his or her discretion to its fruition for the joint benefit of all of the estates.

The process contemplated by the Code, if this Court were to order the appointment of a Chapter 11 trustee, then falls upon the

United States Trustee pursuant to Rules 2007.1 and 2009 with regard to the appointment of one or more trustees in these jointly administered cases. From that and under our obligation under both 1104(D) and under Rule 2007.1, and after consultation with parties in interest, we look at the pool of applicants and the United States Trustee in his discretion, then, would select a qualified applicant or more than one trustee should that be warranted.

At that point that person selected then would have to become eligible under Section 322 of the Code which would include the posting of an appropriate bond and the filing of an appropriate affidavit of disinterestedness. After that point, any party in interest, should the need arise, could challenge that selection process based on a material conflict of interest that would otherwise disqualify a common trustee from being the trustee for these jointly administered cases.

And I believe the case law that has been submitted by both the debtor and the committee of the unsecured creditors suggests that a common trustee is favored over the appointment of more than one trustee for the efficiency of justice, saving costs and so forth. However, there is that provision that exists for a party in interest to challenge that upon a showing of the material conflict of interest which might necessitate the appointment of more than one trustee.

In looking at these cases, and I might suggest that we look at the record here, and the record does reflect that no party in interest has filed an objection per se to the request of the U.S. Trustee for the appointment of a Chapter 11 trustee in these cases. The debtor supports the motion. The committee supports the motion.

Ritchie Groups, and I'll collectively refer to all of those affiliated entities as the Ritchie Groups, say yes. We feel also that there's a need here for the appointment of a trustee. However, we want one for PGW and not necessarily one for all of these because in terms of what they're saying, they're unique or they're special because Ritchie is the primary creditor of PGW and that somehow distinguishes them from the rest of the affiliated entities.

The exhibit that was attached to Debtor's memorandum in support of our motion I think is very telling in that it shows with regard to the, put in quotations, loan from Ritchie Group to PGW, that the wire transfer came directly from Ritchie Brothers, not to PGW but to PCI and the PCI bank account and that's reflected on the exhibit.

Perhaps looking at this thing from the lens of the criminal side of things, and as we know, on December 1 the United States Attorney's Office and the grand jury returned an indictment against PGW, PCI, and Thomas Petters individually, Ritchie Group tries to minimize I guess would be the appropriate word, the recitation or the involvement of their client with regard to the criminal aspect of it. However, if one were to look at the criminal indictment itself, the counts involving mail fraud all allege that Thomas Petters, PCI, and PGW did together aid and abet and support the other parties named in those accounts with regard to the criminal allegations. Indeed, Count 11 under 18 U.S.C. Section 371 alleges a conspiracy with all of those entities together with Mr. Petters.

Count 12 also alleges a money laundering conspiracy. The point being that all of these affiliated entities are together in one. As I heard one attorney today indicate to me, one big bowl of spaghetti where the thing is so intertwined and interconnected that it is very difficult at this juncture to go in and to unwind or unravel those proceedings. All three of them were indeed into this together. The common scheme and artifice to defraud was alleged in the indictment. The complicity of these two companies together with Mr. Petters as the hub or the central point of this masterminded scheme and artifice to defraud I think is very evident.

We ask the Court's consideration for the appointment of the 11 trustee. And again, I would submit that cause exists under 1104(A)1 because of the fact that the receiver is kind of in limbo. What is his status vis-a-vis the debtor in possession. And unless and until this Court allows the U.S. Trustee to go forward and appoint that appropriate person, there is this limbo and any adversary proceeding could be held up because of skirmishes regarding standing and the ability to prosecute these individual cases.

Looking under 1104(A)2, in the interests of creditors and equity security holders, and it's interesting to note as the Court knows in other places of the Code, we have always heard the phrase in the best interests of creditors. That adjective is noticeably absent from 1104(A)2 and it says the interests of creditors and equity shareholders. Therefore, whatever prong -- we would submit they're both prongs and again our motion is unopposed to support this Court's order of the appointment of a Chapter 11 Trustee.

Unless the Court has any questions, that would conclude my main presentation.

THE COURT: No. I don't right now. Thank you.

MR. RIDGWAY: Thank you, Your

Honor.

THE COURT: All right.

Mr. Jorissen.

MR. JORISSEN: Thank you, Your Honor. I think, as a prefatory remark, everyone who's weighed in on the issue thus far is in agreement that the appointment of at least one trustee is appropriate in this case. The committee supports the appointment of a trustee. The debtor is not opposing the appointment of a trustee. We certainly support the appointment of a trustee, at least one. And of course, the U.S. Trustee's Office believes that a trustee should be appointed. So really the issues that are alive today it seems are, first, whether a separate trustee should be appointed for PGW and whether Mr. Kelly can serve as both trustee and as receiver.

Now, our clients are the single largest non-insider creditors of PGW. And according to the schedules, PGW owes the Ritchie Group over $250 million. No one in this proceeding has questioned the validity of the notes that PGW executed and delivered to Ritchie and instead their arguments focus on the fact that a wire or wires were directed to the account of PCI and not PGW as a result of this loan.

Now, a couple of things that aren't in the record are that there was no restriction when this loan was made on the use of those funds. And I would submit, Your Honor, that it is not at all uncommon for a borrower to direct the disposition of loan proceeds to a third party and certainly to an affiliated company. So in February of 2008 when the funds are transferred, there's really nothing remarkable at all about the fact that PGW requested and the funds were wired to an affiliate.

PGW is different than PCI. The pleadings that have been put into the record in the federal court case indicate that PCI was a funding vehicle through which this Ponzi scheme was orchestrated. PCI has few employees. It has no legitimate operating businesses to speak of. In contrast, PGW has several operating wholly-owned subsidiaries including Polaroid. And unlike PCI, PGW has thus far been identified by name in only one count set out in the indictment which was handed down recently by the United States and that's Count 20 which alleges a single count of money laundering based on a wire transfer from PGW to Mr. Petters.

The FBI affidavit which has been referred to avers that Petters and PCI engaged in the Ponzi scheme. There's no mention in that search warrant, or in the affidavit, excuse me, of any suggestion that PGW was part of that scheme. And in the pleadings which we've summarized in the attachment to our response I think you will find, Your Honor, that there is really not much at all in the way of factual averments pled with particularity implicating PGW in this Ponzi scheme.

The positions that have been staked out by the parties to these motions illustrate really why separate trustees should be appointed in this case. Each of the parties, Your Honor, is acting in a manner which promotes its own self-interest. Ritchie obviously has an interest in seeing that the corporate veil of PGW is preserved in this

Chapter 11 proceeding. As a major creditor or major creditors in the PGW case, Ritchie's interests are advanced if PGW's assets are separately administered and applied to pay only the claims of PGW's creditors. The assets of PGW may well be insufficient to satisfy those claims, and if PGW's assets are opened up to all of the PCI creditors or all of the victims of the Ponzi scheme, it will certainly diminish any recovery that might be available to the Ritchie Group.

So clearly, as separate creditors of PGW and all of the separate creditors of PGW, there is an interest to see that PGW's assets are maintained to the extent that that's feasible.

The creditor's committee which opposes the appointment of a separate trustee has adopted a position that really aligns with the interests of its members. All of the members of the creditor's committee are PCI creditors. The chairman of the committee, Mr. Peterson, is the Chapter 7 trustee for Lancelot. They have a huge claim against PCI for over a billion dollars.

The -- in obtaining assets -- excuse me. Obtaining access to the assets of PGW is quite obviously in the interests of Lancelot and the other PCI creditors who populate the committee. And indeed, Mr. Peterson, as the Chapter 7 trustee for Lancelot, may well owe a fiduciary obligation to Lancelot's estate to attempt to pierce PGW's corporate veil.

THE COURT: But he's not the one that's going to be allowing the piercing, is he? It's the Court.

MR. JORISSEN: Correct, Your Honor.

THE COURT: Based upon a showing which, of course, can have objection to it which I have no doubt whatsoever your client would object strenuously --

MR. JORISSEN: I concur.

THE COURT: -- if that came forward.

MR. JORISSEN: I agree with that premise, Your Honor.

THE COURT: I mean, what we're talking about is structural measures but there's still plenty of process after that.

MR. JORISSEN: There is. I think the point, though, Your Honor, is that the creditors of PCI have an interest that is different than the separate creditors of PGW. And the same conflict we believe exists with respect to Mr. Kelly. He's also acting in a manner which he believes promotes the interests of the receivership that he's administering. He's publicly acknowledged that far and away the most valuable asset in these bankruptcy cases is Polaroid. And an adjudication at some point along the way that PGW was not an instrumentality in this fraud and that its assets are not available to satisfy the claims of PCI creditors through forfeiture or through consolidation or whatever the mechanism would be to make that happen would obviously not be in the interest of what Mr. Kelly is attempting to do in his capacity as receiver. And so Mr. Kelly has an interest to seek to avoid the corporate veil of PGW so its assets are available for distribution to victims.

We think that Mr. Kelly's responsibilities as receiver conflict with his fiduciary obligations to PGW both in his present capacity as debtor in possession and prospectively were he appointed trustee of PGW. As the trustee for PGW, his first responsibility would be to protect the assets of PGW for the benefit of PGW's creditors. As receiver his duty is to protect all of the victims of the Ponzi scheme and his charge is to try to gather all of the assets of the Petters entities ultimately to fund restitution payments to victims.

Now, under Section 1104(B), a Chapter 11 trustee must be disinterested. And as the materials we've cited in our briefs indicates, disinterested means with any -- with respect to any class of creditors that the trustee must be free from any material adverse interest. And anyone acting as trustee for PCI has an inherent conflict of interest which would preclude simultaneous service as trustee for PGW. And I think if you look at the schedules, it really makes this point, Your Honor. PCI has few assets of value and a huge number of claims. I think over $3 billion in claims. PGW, in contrast, has about I think $850 million in claims but assets which are of substantial value even though their value has not been indicated at this point in the schedules. But I think everyone acknowledges that Polaroid is the most valuable asset in these bankruptcy cases.

PGW's creditors are largely distinct from the creditors of PCI. And again, if you look at the schedules, it shows that few of the creditors in PCI have contract claims scheduled in the PGW bankruptcy case. The PCI schedules reveal 19 creditors with claims for nearly $3 billion. The PGW schedules show well over a hundred creditors, excluding employees, primarily lenders and contract claimants and claims of a much smaller magnitude, less than a billion dollars. Because PCI's assets are small in comparison both to the assets of PGW and to the magnitude of the claims in the PCI bankruptcy case, a trustee for PCI would be bound to pursue the assets of PGW and to attempt to pierce the corporate veil.

A disinterested trustee for PGW on the other hand, would be bound to try to preserve and protect those assets of PGW for the benefit of its creditors. The separate creditors of PGW, and there are a number of them besides Ritchie, Your Honor, there are 99 separate creditors in the contract classification in the schedules, are entitled to a dispassionate and disinterested trustee uninhibited by competing duties owed to PCI or other bankrupt entities.

Now, we acknowledge that costs and efficiency are legitimate concerns in the administration of these cases. But as the Court in the BH&P case which has been cited in everyone's briefs held, if there's a tension between disinterestedness and economy or efficiency, then economy and efficiency have to yield to disinterestedness.

Finally, to address the United States Trustee's argument that the appointment of a separate trustee in the PGW case is premature, I think, as this Court knows, PGW was recently indicted in the federal court on a single count of money laundering. And to date it appears that no consideration has been given by the debtors or by Mr. Kelly to the retention of counsel to defend PGW's interest. From the perspective of PGW's creditors, it is imperative to have a disinterested trustee on the job to take a look at the indictment, to take a look at the charges and to determine whether there is a defense and, if appropriate, to defend against those charges because at the end of the day, the corporation, all it has is its assets. And if there's no defense on behalf of the corporation or not even one contemplated, then those assets will unquestionably be wound up in the forfeiture and that will be to the severe detriment of the separate creditors of PGW.

So in sum, Your Honor, we believe that the appointment of a separate trustee for PGW is mandated in this case. A trustee for PCI, by definition, is not disinterested since it's bound to pursue the assets of PGW in order to try to maximize the pot available for PCI's creditors. Because PGW and PCI have separate creditor constituencies with divergent interests, we would respectfully request that this Court enter an order authorizing the appointment of a trustee in the PGW case and mandating that PGW trustee be different from any trustee appointed for PCI or any of the other Petters affiliates.

THE COURT: All right. Thank you.

MR. JORISSEN: Thank you, Your Honor.

THE COURT: Mr. Lodoen.

MR. LODOEN: Thank you, Your Honor. There's two issues -- actually, one issue before the Court today that we think ought to be before the Court and that's whether a trustee should be appointed in these cases.

There's consensus subject to Your Honor's concurrence that a trustee ought to be appointed in these cases. If a trustee is appointed, I submit that that's all this Court needs to decide today. The rest of it is back in the hands of the U.S. Trustee's Office to proceed with their process as mandated by the Code and the bankruptcy rules in order to determine whom or whom the trustee should be, whether it's one or more, after consulting with parties in interest.

The only objection of this process as we've heard before is that the Ritchie Group says there ought to be two trustees. And assuming that the Court may or gives consideration of that point, I will proceed to address that even though I don't think that is an issue that's properly before the Court.

Just by way of a little background, we're here because Judge Montgomery's order provided that Mr. Kelly, as the receiver, have the authority to put these entities into Chapter 11 and to serve as a debtor in possession. There's also authority allowing that including the Bayou decision out of New York and other authority. The U.S. Trustee's Office at the inception of the case addressed concern with the receiver in the capacity as the receiver also being the debtor in possession, and I believe that the Bayou case is wrongly decided. In fact, they have appealed that to the Second Circuit and are awaiting a decision.

We contemplated having a fight with the U.S. Trustee's Office over that particular issue. But after considering the various alternatives and the effect that that would have on creating a sideshow for the estates at that point in time and, as Mr. Ridgway suggests, creating potentially ongoing skirmishes regarding standing, et cetera, with respect to claims that may be pursued in these cases, decided that it was not in the best interest of the estate in order to have that particular fight. And it's because of that conclusion that the debtors have consented to the appointment of a trustee.

By way of additional background, PCI and PGW are the two parent entities that are in bankruptcy. Their schedules have been filed. However, additional subsidiaries, both direct and indirect, are anticipated to be filing Chapter 11 cases over the next period of time.

Those particular entities also have claims among each other, between and among each other, upstream, downstream, across the streams, across the mountains. Every which way there are claims back and forth in these various cases. The Court, if you've had an opportunity to review the schedules, probably has a glimpse of what those various interrelated claims look like at the moment. It will only get more complex.

Now let's look at the Ritchie Group for a moment. In their initial motion the strong suggestion in that motion and memorandum is that Ritchie Group is a creditor of PGW. That's their whole story. Well, I don't know what makes a party a creditor per se, if it's a piece of paper in the midst of a fraudulent debtor scheme and empire that says PGW is the borrower or if it's where the funds go. There was no mention in Ritchie's pleadings that the 146 million at issue went to PCI. Ritchie, we submit, is probably and more likely a creditor, if you will, of PCI than it is of PGW.

It's been suggested that nobody contests their claims. Well, you only have to look at the list or the subsequently filed bankruptcy schedules that shows the Ritchie Group's claims are contested and disputed. Most of the notes have interest of a rate of 80 percent. Does that make them notes or claims? Does that make them equity? Does that make their debt debt that should be recharacterized as equity? These are all decisions, considerations, issues that are going to have to be explored by the trustee in the cases if claims are brought by this Court. But this will not be done until after there's a complete report of the forensic work that's being done at the various debtor entities and the other entities over which the receiver has authority which is being conducted by PriceWaterhouseCoopers.

What else do we know about the Ritchie Group? Well, they filed three financing statements in September of 2008. Prior to that time, I don't believe they had any filed even though their money came in in the early part of the year. They filed a financing statement on September 19 around which time they obtained a third-party pledge from Polaroid Corporation of trademarks in Brazil, China, and Turkey. They filed another financing statement three days later on September 22 which reflects a security interest obtained from PCI in notes owed PCI from Polaroid.

And finally, two days after the government search of the Petters facilities, they filed a financing statement. This one coming from Petters Capital, LLC, an entity to whom Polaroid had issued approximately 125 million of notes with a current balance of, at least on the records, approaching $200 million. We have not seen the underlying security documents but that financing statement was filed on September 26, 2008. It appears to be to an entity that would be an agent of Ritchie. It's not a name that ties to the Ritchie names but the address is the same as the Ritchie entities. As far as we know, either Polaroid or Petters Capital, LLC are indebted to the Ritchie Group. They have just granted the security interest.

So what are the reasons for a single trustee in this case? One is, Your Honor, the fact that this enterprise and these debtor entities in no way resemble a normal corporate enterprise. Funds, transactions, documentation went back and forth among the various entities in the Petters empire with, I submit, reckless abandon. Charts show transactions every which way and the transactions are only becoming more numerous and more complex as the ongoing investigations continue.

One of the best reasons, we submit one of the best examples as to why this case ought to have one trustee because one trustee can look at the entire enterprise and figure out what makes sense in order to have some type of a rational and reasonable pursuit of claims, some type of an allocation of these funds to the various creditors to whom they are entitled and to do that in a reasonable way. One of the best reasons why that ought to be done by a single trustee is the Ritchie transaction where the paper says the debt is at one entity but all the money went to another. And then if you look at Exhibit A to our response, virtually all of that money went out the -- went out of PCI to fund various other investors at the PCI side.

The Ritchie Group also keeps arguing that PCI is a dirty company and PGW is the clean company. Tom Petters was a sole board member and governor of each of those entities. He was the CEO of each entity. He obtained funds mostly through PCI and to have them disbursed at various places including PGW and its subsidiaries to fund acquisitions and to fund ongoing losses occurring at those entities. Both of those entities have been indicted.

If someone, Your Honor, allegedly robs from Peter to pay Paul and Paul knows the funds are stolen and uses the same entity to acquire the funds and distribute them, does that mean Paul is -- or does that mean Paul has the clean hands or does that mean Peter has the clean hands? I don't think so. And we don't think that after a full investigation of these transactions occur we will come to the conclusion that PCW is in a wholly different position from PCI.

Now, some of the entities on down the line, you know, the people operating those entities may well not have known what was going on, but from a corporate enterprise, from a corporate entity it's been alleged by the indictment that they were all involved in the conspiracy and they are all, Your Honor, we believe, in some form or another effected by the, quote, dirty company syndrome.

We talk about self-interest in this case. If there's one party who would not be a party with self-interest, that would be a trustee appointed in these cases. And it seems to me that you either have one trustee over all these cases or then you have a trustee for every parent, subsidiary, and subsidiary's subsidiary. It doesn't make sense to randomly argue that there ought to be two trustees when, in fact, you have various transactions among the subsidiary entities under PCI and PGW, all of whom have their own creditors or many of whom have their own individual creditors who have their own individual assets in some form or another.

And if you get to the point of having numerous trustees, numerous professionals for each trustee, then we will have a meltdown in these cases and everything will go to professional fees and there won't be a recovery for the creditors who have been damaged by the activities that have occurred to date.

A single trustee can make the determination as to what claims ought to be pursued, what assets ought to be sold, what security interest ought to be challenged but that's only an additional determination. As the Court suggested earlier in the hearing, the Court ultimately will make that decision and the Ritchie Group and any other creditors are very, very capable of taking care of themselves, as we have seen throughout the course of the receivership proceedings and the proceedings in bankruptcy. They have been well attended and well represented at all of these hearings and we suspect that they will continue to be as we go forward throughout the case.

And finally, Your Honor, it has been suggested that all of the assets are going to be at the PGW side and not the PCI side. That may or may not be true. There are operating entities at the PGW side. They are less but there's other entities at the PCI side, some of them have -- at least one of them has a significant loan obligation owed it from an entity that has paid $4 million to date and we expect to pay substantial amounts on a go forward basis. Their claims are being considered and will be reviewed and valued at the PCI side. So at the end of the day we don't know where the value is really going to lie. It may be at the PCI side. It may be at the PGW side. It may be someplace in between.

And then the next question is in terms of measuring value, that really gets upstream, if you will, to the various investors, the large -- those folks with large asserted claims. What makes it to that level is also another question that has not yet been answered today.

So, Your Honor, for those reasons we don't believe that it is in the best interests of anyone, unless perhaps just Ritchie, to have a different trustee appointed in these cases. And in the end we don't believe it's in their best interests either because we believe that any trustee will look at the claims, evaluate the claims, decide what they have to pursue or not pursue, and if there are two trustees appointed, it will just be additional administrative expenses that will inure to the detriment of the Ritchie Group along with everybody else.

THE COURT: All right. Thank you. Mr. Runck.

MR. RUNCK: Thank you, Your Honor. Your Honor, with respect to these motions, the Committee of Unsecured Creditors agrees with the United States Trustee. Your Honor, we believe that under Section 1104 of the Bankruptcy Code, we believe that cause exists to appoint a Chapter 11 trustee in this case based on the debtor's prepetition conduct and the prepetition conduct of the debtor's management.

Your Honor, we also agree with the United States Trustee that currently under the current situation substantial uncertainty exists with respect to Mr. Kelly's authority to continue acting as the debtors in these bankruptcy cases, and we believe that uncertainty exists with respect to his standing to bring certain avoidance actions for the recovery of creditors.

Your Honor, we feel strongly that

Mr. Kelly's authority needs to be clear in these cases, that he has the authority to act on behalf of the debtors and he has the authority to reach all available assets so as to maximize the recovery to the creditors. We agree with the United States Trustee that the best mechanism to achieve that type of certainty is by the appointment of a Chapter 11 trustee.

We also agree, Your Honor, that under 1104(D), the United States Trustee has the sole discretion to decide which trustee to appoint, how many to appoint, and who those entities should be. And as we set forth in our papers, Your Honor, the committee feels strongly that Mr. Kelly should be kept in place in these cases. We feel that the sake of efficiency of these cases, efficient administration of these Chapter 11 cases is of paramount importance in these cases. Your Honor, the interests at stake here are simply time and money with respect to this Chapter 11 trustee motion.

With respect to time, we think that removing Mr. Kelly from his current position would result in substantial delays in Mr. Kelly's investigation of what happened in these cases. We think that that type of a delay would cause substantial harm to the creditors of these estates and we think it would be very prejudicial to the creditors' recovery.

We also think, Your Honor, that that delay would result in a serious loss of value. The value of various assets in these estates are depreciating rapidly and we think that we need someone in place who can act quickly to realize that value for the benefit of creditors.

We also think, Your Honor, that the United States Trustee needs to be mindful of the administrative and professional costs that are occurring in these cases. This is a substantially complicated case. It's a massive fraud scheme that was orchestrated here. It requires huge amounts of professional resources in order to do this job effectively.

We think that Mr. Kelly has appropriately retained professionals to investigate these assets. He's retained Lindquist & Vennum. He's retained Hoolihan Lokey, FTI Consulting, and PriceWaterhouseCoopers to do forensic accounting. Your Honor, these various professionals aren't cheap. I mean, they're going to be very expensive, and the professional costs in this case are already substantial.

We think that removing Mr. Kelly from his current position will bring this whole framework and their investigation to a screeching halt, Your Honor, and will just be very disruptive to the estate. Putting a new trustee in place and having that trustee have to now pick up from the get go and hire their own professionals and their own forensic accountants and their own financial advisors, that's going to be extraordinarily expensive and inefficient. And then if you throw on us having a second trustee on top of that, now you've just, I think, tripled the administrative cost to this estate.

Your Honor, the professional costs in this case could be in the hundreds of thousands to even millions of dollars. And before the parties in this room decide to charge millions of dollars of administrative costs that will subtract dollar for dollar from the creditor's net recovery, we need to know that in fact that is the necessary thing to do and we don't believe that evidence exists in this case that requires that type of action.

As we pointed out in our papers, Your Honor, the Bankruptcy Code favors a common trustee in jointly administered cases. We cited the Ben Franklin case. We also cited the International Oil case which I believe is a Second Circuit Court of Appeals. And basically what we believe the Bankruptcy Code says is that the Court should avoid requiring duplicate trustees and duplicative expenses in favor of administering an estate on an efficient basis.

For those reasons, Your Honor, we do stand behind the United States Trustee's motion. We favor the appointment of a single common trustee in this case and we believe it should be Mr. Kelly.

Your Honor, there have been a number of allegations of various types of alleged conflicts of interest that could potentially disqualify a common trustee. Your Honor, our short answer to that question is that at this time there's simply no evidence before the Court of a disqualifying conflict of interest. We think that it is very premature to determine whether or not such a conflict exists. We think that in order to disqualify a common trustee, in order to justify incurring hundreds of thousands, if not millions of dollars of additional expenses, we believe that a conflict of interest must be based on fact and not based on speculation. In this case the allegations of a conflict of interest are speculative and they are premature.

And by way of example, Your Honor, from reading the papers, some of the alleged conflicts that have been raised, the first one that I notice is that PCI and PGW have no common creditors. Well, Your Honor, I think that's completely unknown at this point. Yes, there have been schedules filed that show who has a contract claim against which entity based on the debtor's investigation and the debtor's records but no proofs of claim have been filed in this case, Your Honor. We think it's quite possible that parties may file proofs of claim against more than one debtor in this case. It's quite possible that parties may file tort claims or assert tort claims against various debtors in addition to any contract claims that may exist.

The bottom line, Your Honor, is we just don't know and we think it's highly possible, if not likely, that many of these debtors have common creditors in this case. So we think that raising that allegation as a basis for incurring all these additional costs is just speculative at this point. We do not know at this point in time.

The allegation that PGW is a completely innocent business and PCI was the fraudulent debtor and they had no interaction and no connection, we don't know that either at this point. We just don't know. As it was pointed out, both PCI and PGW were indicted. We don't know the extent to which PGW was involved in that at this time. But to make that type of a conclusion at this stage to justify incurring such huge costs is just premature.

The same with respect to the relative values of the different estates, Your Honor. The allegation has been made that PGW has value and PCI has no value. We don't know at this point, Your Honor. Again, the investigation by the debtors is still being performed into the debtor's various assets. We don't know the value of various causes of action that PCI might have. We don't know the value of the various subsidiary companies that PGW has. To me, Your Honor, this relative value question basically boils down to a question of whether or not these estates should be consolidated. That question, Your Honor, is not yet before the Court. I don't know if it will become before the Court but it's definitely not before the Court today, Your Honor, and we think it's premature to try to disqualify a common trustee based on an argument that's not yet before the Court, an issue that may come down down the road. But at this point, the parties just simply aren't in a position to weigh in on these issues and decide where the relative value is in these cases.

I would also point out, Your Honor, that the Ben Franklin case appointed -- cited in our papers specifically says that creditors are not prejudiced by the appointment of a common trustee with respect to their later positions on the issue of substantive consolidation. That decision specifically addresses that question and says that the appointment of a common trustee does not prejudice the issue of substantive consolidation one way or the other. So the parties -- the estates still remain separate even though there is a common trustee appointed for jointly administered cases.

So, Your Honor, as a bottom line with respect to the committee, the committee's position is that in order to disqualify a common trustee in this case, in order to justify incurring and substantially increasing the administrative costs that will reduce the net recovery to creditors, we believe that type of information, that type of an argument needs to be based on fact. And we think it needs to be based on fact that we can know today, not based on mere speculation of events that may come down the road.

So the committee, Your Honor, we support the appointment of a trustee. We support the United States Trustee's motion and we request that Mr. Kelly remain in possession of the estates so that he can continue with his investigation in securing recovery for the creditors.

THE COURT: All right. Very good. Thank you.

MR. RUNCK: Thank you, Your Honor.

THE COURT: Well, all right. Insofar as the issue that I'm going to decide today, I think I've heard enough here and I don't know that we need another round of argument.

The matter at bar is somewhat abstract in the aspects of it that at least Ritchie is urging have to be decided today are considerably more abstract than the basic motion here which is for appointment of a trustee. These are very unusual bankruptcy cases in that we have the looming backdrop, the predecessor of the proceedings in the United States District Court, this remedy of a receivership appointed under a statute that apparently has not been applied very often at all during the couple of decades of its existence. The receivership apparently being directed toward the curtailment and prevention of further fraudulent activity by business enterprises that are under the pall of possible or actual criminal proceedings.

As I read the several iterations of Judge Montgomery's order for the appointment of a receiver, Mr. Kelly's role is basically to seize control over assets, stabilize the situation insofar as their control and value are concerned, to investigate the extent of transactions in those assets by extension liabilities entailed with them and so forth. Ultimately, that's an ongoing process that end up being responsive to the purpose for the receivership which, as I say, was to ensure that fraudulent conduct was not carried on and to preserve assets against the backdrop of the criminal proceedings and the consequences of those criminal proceedings, including the possibility of forfeiture or restitution obligations imposed in connection with them. However, the receivership order did give the receiver the authority to place any of these business entities that were named in the order into bankruptcy in part for the furtherance of the general goals of the receivership process.

We also have the question of how much beyond that the purpose of the bankruptcy cases go and that's probably an issue for another date. But these entities were placed into bankruptcy. When a company goes into Chapter 11 under our American system, of course, the prebankruptcy management stays in place. This is different from the systems that have prevailed across virtually the whole world until fairly recently. In Europe, of course, if a company goes into bankruptcy, the Court appoints a trustee. The trustee essentially assumes responsibility for the ongoing operations of the company and takes over control from prepetition management.

It's only been in the last decade that

European legal systems have begun to adopt something in the nature of American Chapter 11 which leaves the prepetition management in place subject to significant oversight by the Court and, as is underlined here, by a different branch of the government, the United States Trustee being in the executive branch within the Department of Justice and being something in the nature of a watchdog for the integrity of the administration of the bankruptcy estate.

To carry out that watchdog function, the U.S. Trustee acts in various capacities in a Chapter 11 case receiving ongoing financial reports from the debtor's management as to the operation of the business, having input on the future of the case to the court as a party in interest, participating intensely in the process of preconfirmation disclosure of financial information and, in turn, having the standing to move to convert or dismiss the case, to object to confirmation on the ground that the plan doesn't comply with the various structural requirements of Chapter 11 or the debtor is not complying with the procedural requirements to ensure a fair process of airing the debtor's reorganization to creditors. And, as here, where there is a perceived difficulty with the debtor's management, its role and its ability to carry on either with legal authority or as is the case not in this case but as is the case in some cases, with complete responsibility to administer the assets of the estate and protect them for creditors, the U.S. Trustee has the standing to move for the appointment of an operating trustee, an operating trustee who functions, then, in turn much like that operating trustee works in those continental European systems of bankruptcy in their classical set up.

Now here, the U.S. Trustee and Ritchie as well for just one of the debtors, PGW, Petters General Worldwide, both of these parties have come forward and said appoint an operating trustee. They've done so because of the rather anomalous posturing of things that goes right back to the very inception of these cases. These business enterprises were not put into Chapter 11 by the debtor's management acting voluntarily. They were put in by this officer of the U.S. District Court, the receiver appointed by the U.S. District Court to carry out a function of amassing and protecting assets, preventing further fraud, stabilizing operations, and ultimately directing those assets toward the satisfaction of claims. They were put in by that third-party entity who was not part of the debtor's prepetition management. The debtor's prepetition management here was necessarily removed before these cases were even commenced by the order of the U.S. District Court de jure as a matter of law and a number of them were removed de facto by the fact of having been criminally charged and being arrested. So Mr. Kelly stepped into the position of being, in a broad sense, the management of these business entities, but he's chargeable in that capacity outside the realm of bankruptcy to the U.S. District Court for those very specific purposes.

Now, the case law that the parties have brought up identifies the tension there because under Chapter 11, in a more conventional sort of setting, the debtor's management generally has the motivation of keeping the business afloat or engaging in an orderly liquidation to see that things are wrapped up or that things go forward operating the company's way out of Chapter 11. Management's only personal motivation is often to keep their job as well as to see that the job is done properly and that as much is preserved as possible, creditors that have contracted in good faith get paid and the like. Now, these companies are not in a position, especially the overall holding companies, are not in a position really to operate their way out and there's no particular reason. The question is just how -- what's going to happen going forward.

The cases that both parties have cited have underlined the tension that is present where the debtor's management has been supplanted by a court-ordered receiver but not a receiver in the state law sense. In the state law sense a receiver is usually appointed to manage a piece of real property, a hotel or an apartment complex, a shopping center, the like, and to carry it forward pending a foreclosure.

This is a different kind of a receivership and a much more broadly defined one under the enabling federal law. So de facto this receiver is not acting as management. He has a different charge and to a different court and there is a real tension there with the notion of operating -- ongoing management that was seated prepetition that is sort of the fundament of the debtor-in-possession concept.

And additionally, of course, you have the tension under bankruptcy law the fact that a bankruptcy court is specifically prohibited from appointing a receiver whether under state or federal law. The functionary, the officer of the estate that carries out a function operable to a receiver under state law is a trustee. We are not to incorporate the law of receivership over into bankruptcy because we have our own analog in the law of trustees and very specific explicit duties and obligations as set up under the Bankruptcy Code, trustees having the obligation to maximize the value of assets so that prepetition creditors can be paid as much as possible in accordance with their contractual and legal expectations as they stood when the debtor went into bankruptcy.

A receiver I would hazard a guess -- or I'd hazard to say specifically and especially a receiver appointed under authority like the one that the district court used here has a rather different charge. So there is this tension between the two roles and that's why, just to resolve the legal tension and to make sure that the person in control of these debtors has all of the accountability that bankruptcy law requires of any person who is in control of the assets of the bankruptcy estate, those assets that are under the protection of the court and are there for the purpose of ensuring that creditors don't lose out further to ensure that that person has the right standing, the right power, the right authority under bankruptcy law. It's unquestioned here, and I'm certainly going to agree, there are ample cause for the appointment of a trustee or trustees in these jointly administered cases.

So I'm going to grant the U.S. Trustee's motion. And to the extent that the Ritchie Group's motion entailed one of these debtors, I guess I'm granting that motion as well. To that extent of ordering I'm authorizing the U.S. Trustee to appoint a trustee or trustees for these cases.

After that, then, we get into that whole question that Ritchie has raised here, the Ritchie Group has raised here of whether I should place -- and the way I phrase it now is whether I should place any limits or conditions on that grant of authority to the U.S. Trustee at this time.

So that's essentially what Ritchie Group is asking me to do, to direct the U.S. Trustee to exercise that authority in a specific way. In other words, to appoint two trustees if a trustee is to be appointed for more than just Petters General Worldwide.

Early on in my brief colloquy with Mr. Jorissen I made reference to both structural and procedural dimensions of this issue. Ritchie's asking me to impose a structural dimension on the grant of relief in relation to the appointment of a trustee. In other words, he's saying don't just order the appointment of a trustee. Direct that it be done in a certain way structurally. That request for relief is not ripe. I agree with the U.S. Trustee's analysis which the creditors committee concurs in. There's plenty of procedure going forward here through which the issue that Ritchie poses will ripen.

I am doing this both because I think the U.S. Trustee's reading of the governing rules and statutes is correct and I'm also doing this out of some deference to the whole separation of powers dimension of this, something that I have to be sensitive to. The U.S. Trustee's Office is a part of the executive branch of government. They are empowered under the Bankruptcy Code with a specific role in bankruptcy cases. They are just a party in interest in the case. I don't appoint the U.S. Trustee or anybody in their office. No bankruptcy judge does. The Attorney General of the United States appoints the United States Trustee for each trustee district and in turn, that U.S. Trustee then appoints the attorneys in his office and the panel trustees under Chapter 7 and the like. The U.S. Trustee's Office never hesitates to remind me of the fact that the U.S. Trustee is part of a distinct branch of government and that the court's control over their performance of their ongoing day to day functions is very limited and this is one of those aspects.

The Code prescribes a process and the rules flesh it out under which the U.S. Trustee will undertake in the exercise of the U.S. Trustee's oversight and administrative authority to vet potential operating trustees to vet persons for the office of operating trustee for one or more of these debtors, one, two or all of them, and the U.S. Trustee, then, will determine and see that the person that the U.S. Trustee chooses is qualified. There are those prerequisites, proof of disinterestedness and the bonding that's required to ensure fidelity and all the rest of it and then in turn the U.S. Trustee will appoint a trustee or trustees.

That whole process is one for the Office of the United States Trustee. It's not really incumbent on the Court and it's not even really open to the Court at this juncture to direct that that process be channeled in any particular direction. The issue simply isn't ripe until the U.S. Trustee has decided whether to appoint one or two or more than two trustees. The issue simply isn't ripe. And I think the parsing of the language that the U.S. Trustee's Office did here is correct in that regard.

Now, Ritchie filed a reply to the U.S. Trustee's response to Ritchie's motion but the reply just glosses over the fact that Rule 2009(D) which addresses the whole question of raising the issue of potential conflict of interest on the part of a common trustee has the qualifying phrase attached to the words "a common trustee" in the past tense who has been appointed. This is one where grammar controls and plain language directs. Plain language identifies or I should say the flow of the process here. The flow of the process is that the U.S. Trustee will ultimately appoint a trustee or trustees.

Before the end of this hearing we'll arrive at some sort of time line through which this will likely be done and I want to structure up, then, a process by which objection would be raised. And then at that point, depending upon what the U.S. Trustee does, and I'm not going to forecast it, but depending on what the U.S. Trustee does, any party that objects to the U.S. Trustee's action at that point can interpose an objection and then it will come before me.

Now, will this amount to a duplication of the effort that's been put in thus far by Ritchie raising nine and a half yards of argument and everybody else and doing four and a half yards back in response? Yeah. But, folks, I'm not the one that put that stuff in here in the first place. All of you did.

Admittedly the process of everybody dumping this on me has sort of sharpened up my attention to exactly what the process was going to be, but the duplication of evidence such as it might be was not something that I could have avoided. I'm making the determination that the issue isn't ripe and it really isn't because I don't know what the U.S. Trustee is going to do and I am keeping hands off of the U.S. Trustee's process. That's for them to follow through on.

So what I will do by way of an order here is I will direct the appointment of a trustee or trustees and then provide for a deadline for objection to the U.S. Trustee's action after the filing and service of the appointment and whoever makes an objection will have the obligation to set the matter on for hearing in accordance with the local rules but not really very far out at all from the ordinary notice period which would be two weeks more or less and then at that point the parties can raise these contentions.

I will say right now for everybody here I would have no problem with anybody simply stating that they're going to rely on the briefing they've done for today's hearing. I don't expect everybody to churn out a lot more words on this unless you can come up with a more finely focused argument.

There's a lot of food for thought in

what Ritchie has brought forward here and what the U.S. Trustee, the debtors, and the committee have brought forward in response. And I certainly am in no position to make a ruling on it today even if the issue were ripe, although I think it could be done in reasonably short order and the circumstances would certainly compel that.

The upshot of all of this is that I would foresee this issue coming on for hearing sometime in January. In the meantime, quite frankly, I do not see the prospect of any prejudice ripening to any party. The question of this alleged conflict of interest that the Ritchie Group frames up is not such as to ripen until some time further down the road anyway and quite some time further on down the road.

The estate's professionals will be evaluating the nature and extent of assets, the amount and liability for claims, prepetition transactions, the avoidability of any prepetition transfers, the recovery of value and the like for some number of months yet and it really will only ultimately be after that and probably some time after that that we get to the position of parsing out, parceling out I guess I should say, as among creditors the fruits of those recoveries.

So it is not really incumbent upon me to decide the issue today even if it were ripe and there will be no prejudice if the issue is aired in January in present form or with refined arguments.

So the question would be here -- I guess I'll put this to the people from the U.S. Trustee's Office. Can you give me any indication of when you think you would be in a position to file an appointment of a trustee or trustees? You can be as vague or as specific as you care to be. And I know we're entering into a time of the year when everybody has personal conflicts with work and may have travel plans but I just -- I'd just like to have some idea here because I'd like to structure something up in this order so as to get this issue going sometime in January ideally or later if the U.S. Trustee's process would take longer than that.

MR. RIDGWAY: Your Honor,

Mr. Raschke and I have conferred and we anticipate having this process resolved sooner rather than later and toward that end we both had mentioned having the appointment in place by close of business Christmas eve, December 24.

THE COURT: Okay.

MR. RIDGWAY: And we had thought that we would announce either today, I can do it on the record, that which would invite any and all interested attorneys on behalf of their respective clients to submit to our office either electronically or by letter or by phone call or a combination thereof, interested candidates for such position together with contact information and, if possible, a short curriculum vitae, resume or what have you and we would be in a position to act on that expeditiously.

THE COURT: Okay. So what you're looking toward, then, is to file a statement of appointment, then, by close of business December 24?

MR. RIDGWAY: That's our expectation, Your Honor.

THE COURT: Okay. All right. After that is when it gets a little bit dicey here simply because from order of the District Court, the federal courthouses are closed on the 26th and the 2nd. So that puts us down to three business days that the courts are open in between. And I don't have any idea of knowing just how law firms are transacting their business except I do know that everybody in the bankruptcy trade these days is pretty swamped and working long hours. I guess what I'd be of a mind to do is to order the filing of any objections to that appointment just to give people -- I'm speaking specifically to attorneys and their clients for that matter who may file objections, until January 7 to file objections.

Does that sound like something that people can live with? Mr. Jorissen, I'm looking at you with a smile.

MR. JORISSEN: Certainly, Your Honor. I think that's very reasonable.

THE COURT: Okay. All right. Good. All right. I'll require the filing of any objections by January 7. And I'll have to take a look at my calendar for January but I will -- I think what we'd be looking toward is having the hearing on any such objection held during the week of January 26, then, just because I want to see that the two weeks more or less of notice requisite by the local rules goes out, everybody has their input, and I'll require the filing of all documents in connection with that hearing by January 23, then. All right. So the issue, then, will be up and fully running before me.

I say my take on this is that it would be ripe at that point when the U.S. Trustee actually makes an appointment. I suppose if some fancy law professorial sort of argument would be that it's not really ripe until a conflict actually emerges, but I'm not going to put anybody in the position of putting a vast amount of work in on this and then having somebody come forward and saying gee, you're conflicted. You just worked -- you should be disqualified and you should have worked for nothing and I'm asking the court to order you to receive nothing. So I think the issue would be up and running and would be ripe for determination then.

All right. I will see that an order along those lines goes out probably tomorrow morning, then.

Is there anything else we should be talking about at this point? Does anybody have anything else they want to take note of?

All right. Good enough. Well, it's obviously up to the U.S. Trustee to publicize their invitation for statements of interest in any other fashion. What I would ask the U.S. Trustee to do, then, is to serve their statement of appointment on all attorneys who have noted an appearance in this case.

I'm trying to think here. Perhaps CM/ECF's automatic notice function would be sufficient. I'll ask the clerk about that and make absolutely sure. If that will be sufficient, I won't require separate notice to be made by the U.S. Trustee's Office but I'll double-check with the clerk. But you just want to make sure that the issue goes up the flag pole so nobody can claim that they didn't receive notice of the identity of the appointee or appointees and we can just address this issue and get a final determination on it at a reasonably early date.

All right. Good enough. I think that should about take care of it, then. Anybody have anything else? All right. Good enough. Stand adjourned.

MR. RIDGWAY: Thank you, Your Honor.

* * *

STATE OF MINNESOTA)
) ss.
COUNTY OF WASHINGTON)

BE IT KNOWN, that I transcribed the electronic recording relative to the matter contained herein;

That the proceedings were recorded electronically and stenographically transcribed into typewriting, that the transcript is a true record of the proceedings, to the best of my ability;

That I am not related to any of the parties hereto nor interested in the outcome of the action;

IN EVIDENCE HEREOF, WITNESS MY HAND.

s:/ Lisa M.Thorsgaard