UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

IN THE MATTER OF:

Civil No. 09-cv-680-ADM

Ritchie Special Credit Investments, Ltd., et al. v. U.S. Trustee, et al.

Bky No. 08-45257

APPELLANTS' OPENING BRIEF

APPEAL OF ORDER OVERRULING OBJECTION OF RITCHIE SPECIAL CREDIT INVESTMENTS, LTD., ET AL., TO APPOINTMENT OF TRUSTEE IN CHAPTER 11 CASES AND APPROVING APPOINTMENT

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Creditors Ritchie Capital Management, L.L.C., Ritchie Special Credit Investments, Ltd., Rhone Holdings II. Ltd., Yorkville Investments I, L.L.C., and Ritchie Capital Structure Arbitrage Trading, Ltd., (together, "Ritchie") respectfully submit this appeal of the Order overruling their objection to the appointment of a Trustee, and approving the appointment of a Trustee, which the Bankruptcy Court issued on February 26, 2009, in the jointly-administered cases of Petters Company, Inc., et al. (Court File No. 08-45257) (the "Trustee Order").

BASIS FOR APPELLATE JURISDICTION

This Court has jurisdiction over this appeal pursuant to 28 U.S.C. § 158(a), which provides in pertinent part that the District Court has jurisdiction "to hear appeals from the final judgments, orders and decrees" of bankruptcy judges. Appellants appeal the Bankruptcy Court's order overruling the Appellants' objection and authorizing the appointment of Douglas Kelley as Chapter 11 Trustee for all of the debtors in the jointly-administered bankruptcy cases below. An Order authorizing the appointment of a Chapter 11 trustee in a bankruptcy case is a final order subject to appeal under 28 U.S.C. § 158(a). *In re Marvel Entertainment Group*, 140 F.3d 143 (3rd Cir. 1998).

STATEMENT OF ISSUES AND STANDARD OF REVIEW

Issues presented. Did the Bankruptcy Court err in approving Douglas A. Kelley ("Kelley") as the Trustee for all Debtors despite: (a) the inherent conflicts of interest arising by Kelley serving as Trustee for both Debtor Petters Group Worldwide, LLC ("PGW"), and for Debtors Petters Company, Inc. ("PCI") and its subsidiaries,[1] given that PGW and PCI have competing claims to the same assets; (b) the inherent conflicts of interest in Kelley's concurrent status as Receiver for all Debtors, pursuant to the Orders of this Court in *United States v.*

[1] For ease of reference, PCI and its subsidiaries are referred to herein collectively as "PCI."

Thomas Joseph Petters, et al. (No. 08-5348), which obligates Kelley to cooperate with a forfeiture or a similar action by the United States government that, if successful, would dramatically reduce the recovery by creditors of PGW; and (c) denying Ritchie discovery into Kelley's actions, positions and strategies as Receiver and Trustee, which prevented Ritchie from identifying Kelley's specific actions that would demonstrate that he has not acted in the best interests of the creditors of PGW, which is his obligation as Trustee of PGW.

Standard of Review. No testimony was presented at the hearing on the appointment of Kelley. As the Trustee Order specifically states, the "findings of fact" made by the Bankruptcy Court primarily consisted of recounting events in various court proceedings, and thus generally are not subject to dispute, and the Bankruptcy Court specifically ruled that Ritchie's objection to the appointment of Kelley "was to be treated as a matter of law." (Trustee Order at 4, n.6.) Accordingly, the applicable standard of review is *de novo*. *See Matter of Newcomb*, 744 F.2d 621, 625 (8th Cir. 1984).

STATEMENT OF THE CASE

This case arises out of the jointly-administered Chapter 11 bankruptcy proceedings of PGW and PCI. The present dispute concerns whether Kelley can properly serve as a fiduciary in bankruptcy for both PGW and PCI in light of conflicts of interest grounded in (a) the competing claims of PGW and PCI regarding the same assets, and (b) Kelley's position as Receiver for PGW and PCI, as well as other entities that were owned by Thomas Petters, given that under the terms of the governing Receivership Order Kelley is obligated to cooperate with the United States government in any forfeiture action, which would remove assets from the PGW estate to benefit victims of Petters's fraud who are not also PGW creditors.

The relevant proceedings began on October 6, 2008 with Kelley's appointment by this Court to serve as Receiver for PGW and PCI. Kelley placed PGW and PCI into bankruptcy on October 11, 2008, and continued to operate the companies, ostensibly as debtor-in-possession. Ritchie questioned the propriety of permitting a pre-petition receiver to continue as debtor-in-possession in bankruptcy, and on December 2, 2008, the United States Trustee moved to have a Trustee or Trustees appointed for the Debtors. The Bankruptcy Court granted the motion, and directed the United States Trustee to appoint one or more Trustees for the Debtors. On December 24, 2008, the United States Trustee appointed Douglas Kelley as Trustee for all Debtors, and sought approval of the Bankruptcy Court for the appointment. On January 7, 2009, Ritchie timely opposed the appointment, citing the conflicts of interest Kelley would possess as Trustee for both PGW and PCI given their opposing claims, as well as the conflicts inherent in Kelley's role as Receiver for the Debtors. Additionally, on January 20, 2009, Ritchie served discovery requests on Kelley, seeking to obtain information regarding his activities and positions on key issues, such as potential claims of PCI against PGW and substantive consolidation of PCI and PGW, which could reveal specific examples of Kelley's prejudice against Ritchie and other PGW creditors. Kelley refused to engage in the requested discovery, and moved for a protective order. On January 27, 2009, the Bankruptcy Court heard argument on the motion for a protective order, the motion to appoint Kelley as Trustee and Ritchie's objection thereto. At the hearing, the court refused to allow Ritchie to engage in any discovery. In the Trustee Order issued on February 26, 2009, the Bankruptcy Court confirmed, over Ritchie's objection, Kelley's appointment as Trustee for all Debtors, including PGW and PCI, in the jointly-administered cases.

STATEMENT OF FACTS

Ritchie loaned PGW[2] over $158 million pursuant to promissory notes executed in February and May of 2008. (App. at A-235 – A-236 (showing $225,256,470.60 in secured claims held by Ritchie against PGW).) Ritchie appears to be the largest creditor of PGW that has no affiliation to PGW. (App. at A-221 – A-222; App. at A-226 – A-290.)

Petters is the sole owner of both PGW and PCI. (Trustee Order at 2.) PGW is a holding company for numerous legitimate operating businesses, some of which, such as Polaroid Corporation ("Polaroid") and Fingerhut Direct Marketing LLC ("Fingerhut"), have considerable value. (*Id.* at 14.) PCI, by contrast, is a holding company for shell entities that were created for the ostensible sole purpose of providing financing for certain merchandise transactions, but in reality were part of an elaborate Ponzi scheme. (*Id.*) Specifically, Petters and his associates misrepresented to potential lenders to these shell entities that Petters had an opportunity to acquire electronics equipment or other merchandise at a low price, and could re-sell the merchandise quickly to a major retailer at a hefty profit, but needed to borrow cash on a short-term basis for the initial purchase. (*See, e.g.*, App. at A-87.) In short, PGW has substantial assets, whereas PCI has virtually no assets. Indeed, PCI has listed a $216 million claim against PGW, and, if and to the extent such claim is valid, that appears to be its only asset of significance. (App. at A-226 – A-290.)

As the Court is now well-aware, on September 24, 2008, the Federal Bureau of Investigation ("FBI") and other state and local law enforcement agencies raided the offices of PCI and Petters in connection with their investigation into the massive Ponzi-scheme allegedly masterminded by Petters. In the Affidavit of FBI Special Agent Eileen Rice, dated October 2,

[2] Petters also personally signed all of the notes as co-obligor, and PCI was a co-obligor on the two promissory notes issued in May 2008.

2008 and submitted in support of the initial Complaint filed against Petters' entities in this Court, Agent Rice stated that the investigation "is focusing on the business and financing activities of PETTERS COMPANY, INC. ("PCI"), PCI affiliated entities and persons" and certain non-Petters-owned entities.[3] (App. at A-85.) Agent Rice described the fraud as "a scheme to fraudulently induce investors to provide funds for, and financing to, PCI." (App. at A-85.) Further, the merchandise transactions described to PCI lenders were fictitious and used "to induce investors to invest substantial sums in PCI," and documents that appeared to evidence PCI's purchases and sales of the merchandise were forged. (*E.g.*, App. at A-87.) Significantly, the Affidavit contains no mention whatsoever of PGW or its operating businesses.[4]

Immediately following the raid, Petters disengaged from all management roles at PCI and PGW, and appointed Kelley to run PGW as his representative. Petters later formally resigned those positions. (Trustee Order at 5.) Other PGW executives also quickly resigned. In these circumstances, the validity of Kelley's authority was uncertain, which effectively left PCI and PGW rudderless, and jeopardized the ability of the companies – particularly PGW's operating subsidiaries like Polaroid – to continue as going concerns. Concerned that the companies would collapse, and all value would be lost, Ritchie filed suit in the Circuit Court of

[3] Kelley has often represented that the government raid occurred at the headquarters of PCI *and* PGW. That is true only because PGW and PCI share the same headquarters. As the Rice Affidavit makes clear, the raid was directed at PCI, not PGW.

[4] PGW was subsequently named in a criminal indictment filed against PGW, PCI and Petters. However, only one of the twenty Counts (Count 20) of the indictment identifies a transaction involving PGW (a transfer of funds from PGW to Petters). (*See*, App. at A-302 (Indictment at ¶ 23 (D.Minn., Case No. CR 08-364 RHK/AJB, December 1, 2008)).) But Count 20 is a money laundering count, and is not even leveled at PGW (only Petters). (*Id.*) The indictment thus identifies no transaction involving PGW related to the fraudulent PCI merchandise-financing scheme.

Cook County Illinois against PGW, PCI and Petters based upon the promissory notes.[5] (*Id.* at 6.) Ritchie sought, and obtained, expedited injunctive relief and, on October 3, 2008, the Cook County court appointed a receiver for PGW and PCI.[6] (*Id.* at 7.)

Unbeknownst to Ritchie, on October 2, 2008, the United States Attorney had filed an action against Petters and PCI in this Court under 18 U.S.C. § 1345. (Complaint dated October 2, 2008, Case No. 08-5348.) On October 6, 2008, in reaction to the order Ritchie obtained appointing a receiver in Cook County for PGW, the United States Attorney moved this Court to amend the Complaint against Petters and PCI to add PGW as a defendant and to appoint a receiver for PGW and PCI pursuant to Section 1345. Kelley was put forth as a candidate for Receiver by the United States Attorney's office, which had contacted Kelley after Kelley had met with a Petters attorney about possibly representing PGW and PCI following Petters's resignations. The United States Attorney inquired whether Kelley was interested in serving as Receiver for the entities, and proposed that he do so. (Trustee Order at 5.) This Court granted the United States Attorney's request, and appointed Kelley as Receiver for PGW and PCI under Section 1345.[7] Under the terms of the Court's Receivership Order,[8] as amended, Kelley was generally given control of the companies, with the "full powers of an equity receiver." The

[5] Providing leadership and executive control for companies that currently had none was the sole motivation for seeking a receiver. Fraud had no part in Ritchie's desire to have a receiver appointed for PGW.

[6] The Trustee Order wrongly states that the Cook County court appointed its receiver on October 6, 2008.

[7] Petters and the U.S. Attorney signed a stipulation agreeing to the appointment of Kelley as the Receiver.

[8] Second Amended Order for Entry of Preliminary Injunction, Appointment of Receiver and Other Equitable Relief, p. 13 (D. Minn., Case No. 08-5348, December 8, 2008) ("Receivership Order").

overriding purpose of Kelley's Receivership is to obtain redress for victims of Petters's fraud. Kelley has indisputably adopted that view, as he plainly stated in his November 24, 2008 motion to amend the Receivership Order that "[v]ictim restitution is a primary focus of § 1345." (Aff. at A-216.) Pertinent to the present appeal, the Receivership Order contains the following provisions:

> IV. RECEIVERSHIP
>
> . . .
>
> B. Receivership Powers and Duties
>
> The Receiver is directed . . . to accomplish the following:
>
> . . .
>
> 2(c). Manage, administer and conduct the operations of the ongoing legitimate business operations of Defendants . . .; including but not limited to filing any bankruptcy petitions . . . . Any bankruptcy cases so commenced by the Receiver shall during their pendency be governed by and administered pursuant to the requirements of the Bankruptcy Code . . . . *Notwithstanding the foregoing*, any federal claims *relating to forfeiture and restitution* (1) *against* or to recover assets of the bankruptcy estates of such bankruptcy cases . . ., *are preserved and not affected in any way by this paragraph*.
>
> . . .
>
> 6. *Coordinate* with representatives of the United States Attorney's Office and Court personnel as needed *to ensure* that *any assets subject to the terms of this Order are available for criminal restitution, forfeiture* or other legal remedies in proceedings *commenced by or on behalf of the United States.*

(Receivership Order at 15-17 (emphasis added).)

In light of this Court's appointment of Kelley, the Cook County court allowed its order appointing a receiver to expire on October 10, 2008, eliminating the uncertainty regarding which receiver had control of PGW and PCI. (Trustee Order at 9.) The very next day, Kelley placed PGW and PCI in bankruptcy. (*Id.* at 12.) Initially, Kelley purported to continue to

operate and to control the companies under a prior iteration of the Receivership Order stating that Kelley could "act[] as management or debtor-in-possession of any of the Entities [placed into bankruptcy] by the Receiver."[9] (*Id.*) There is substantial authority, however, establishing that a pre-petition receiver for a company cannot act as a debtor-in-possession for that company once bankruptcy proceedings commence. (App. at A-123 – A-210.) Ritchie raised that issue, as well as its concerns regarding Kelley's conflicts of interest if he served as fiduciary in bankruptcy for PGW and PCI, in an October 31, 2008 letter to Kelley.[10] (App. at A-120 – A-121.) Ritchie subsequently provided Kelley with a draft brief fully explaining these issues. (App. at A-123 – A-140.) Kelley did not respond to Ritchie's requests to discuss the issues. Ultimately, these concerns were brought to the attention of the United States Trustee's office, which on December 2, 2008 moved the Bankruptcy Court for appointment of a Trustee for PGW and PCI. (Trustee Order at 13.)

In a response to the United States Trustee's motion, Ritchie explained that Kelley should not be appointed Trustee for the Debtors due to the conflicts of interest inherent in his role as Receiver for those entities, and that the Trustee appointed for PGW must be different from the Trustee appointed for PCI in light of the directly opposing interests of those two entities. (Trustee Order at 13, n.14.) The Bankruptcy Court denied Ritchie's motion as premature, noting that the United States Trustee had not yet put forth anyone as Trustee, or proposed that one Trustee or multiple Trustees should be appointed. (*Id.*) On December 24, 2008, the United

[9] Order for Entry of Preliminary Injunction, Appointment of Receiver and Other Equitable Relief, p. 13 (D. Minn., Case No. 08-5348, October 6, 2008) (Docket Entry 127).

[10] The Trustee Order wrongly implies that the United States Trustee's office initially raised the concerns regarding the ability of a pre-petition receiver to serve as debtor-in-possession. The United States Trustee became involved after Ritchie raised the issue with Kelley.

States Trustee appointed Kelley as Trustee for all of the Debtors, and moved the Bankruptcy Court to approve the appointment. Ritchie filed an opposition to the appointment on January 7, 2009, again citing the conflicts of interest arising from Kelley's role as Receiver and concurrent Trusteeship for PGW and PCI. On January 20, 2009, Ritchie served discovery requests on Kelley, seeking to ascertain the manner in which Kelley's conflicts were already impacting the performance of his duties as Trustee of PGW to the detriment of Ritchie and other creditors of PGW. Kelley refused to provide the discovery, and sought a protective order with Bankruptcy Court. On January 27, 2009, the Bankruptcy Court heard oral argument on Kelley's appointment. At the hearing, the court denied Ritchie's request for discovery, and took the Trustee appointment under advisement. On February 26, 2009, the Bankruptcy Court issued the Trustee Order, which overruled Ritchie's objection and approved Kelley's appointment as Trustee for all Debtors, including PGW and PCI.

Several events indicate the harm to Ritchie and other PGW creditors from Kelley's conflicts. For instance, PGW was included in an indictment filed by the United States Attorney that also named PCI and Petters as defendants. (App. at A-302.) In court pleadings, Kelley has characterized the indictment of Petters, PCI and PGW filed by the United States government as implicating PGW in Petters's fraud. (*See, e.g.*, App. at A-315 – A-316 (Debtors' Response to United States Trustee's Motion to Appoint a Chapter 11 Trustee and Motion of the Ritchie Group for Appointment of a Chapter 11 Trustee in the Bankruptcy Case of Petters Worldwide, Inc., ¶¶ 6-8 (D. Minn., Case No. 08-45257, December 11, 2008)).) A close reading of that indictment, however, reveals that PGW is identified as involved in only one purportedly improper transaction, and that transaction was cited in support of a money laundering count against Petters, but not PGW.

Kelley has also asserted that the affairs of PGW and PCI are closely intertwined. (*See*, *e.g.*, App. at A-307, Kelley Verified Statement, ¶ 6 (stating "there are likely various claims yet to be determined between and among the various Petters Entities, as the funds flowed freely between and among virtually all of the several dozen Petters Entities as financial needs arose").) Despite Kelley's statements, there is every reason to believe, however, that PGW, which had a separate general counsel from PCI, respected corporate formalities and maintained corporate independence.[11] And recently, in an affidavit dated April 13, 2009 and filed by Kelley in response to a motion filed by Ritchie in this Court regarding the validity of Kelley's Receivership, Kelley asserted that the United States government informed him, and that "his own independent forensic accountants" have concluded, that "virtually every dollar used to fund" PGW's purchase of Polaroid, PGW's most valuable asset, was derived from PCI "investors." (App. at A-224.) Kelley's investigation and the work of his "independent" forensic accountants was done entirely outside the view of the courts and PGW's creditors, including Ritchie. Documents filed with the SEC indicate that substantial portions of the funds used to purchase Polaroid came from J.P. Morgan. Aside from the conclusory statement in the Kelley Affidavit, Kelley offers no evidentiary support for the conclusion that any of the other funds were the proceeds of fraud. And as suggested, there is reason to believe that PGW did not use PCI-derived funds to purchase Polaroid.[12] A determination that PGW engaged in criminal wrongdoing, that PCI and PGW's affairs are "closely intertwined" or that Polaroid was purchased with PCI-derived funds, may impact upon a forfeiture action or substantive consolidation.

[11] Ritchie attempted to take discovery on this and other issues, but was refused, and therefore there are no specific facts to cite in this regard.

[12] Again, Ritchie's efforts to take discovery on these issues were refused.

SUMMARY OF ARGUMENT

Insuperable conflicts of interest preclude Kelley from faithfully serving as a fiduciary for both PGW and PCI. The conflicts arise from two sources: (i) Kelley's concurrent service as Trustee for both PGW and PCI, which are distinct entities with distinct creditor constituencies that have competing claims to the same assets; and (ii) Kelley's Receivership for the Debtors under this Court's supervision, which aligns Kelley with the government and its interests, primarily regarding criminal forfeiture, that are adverse to creditors of PGW. In both respects, Kelley's conflicts are disabling because his fiduciary obligation as PGW's Trustee, which requires him to act in the best interests of PGW creditors, is unavoidably compromised.

The Trustee for PCI has a fiduciary obligation to pursue all available avenues to invade the PGW estate, while the PGW Trustee has a fiduciary obligation to employ all available means to contest claims that may be invalid. PGW is the only bankrupt Petters entity with material assets, and PCI will attempt to access those assets, whether by a direct claim or through substantive consolidation or a similar mechanism. PGW and PCI thus have certain and inevitable conflicts, and the same person cannot faithfully serve as Trustee for PGW and as Trustee for PCI.

Kelley's role as Receiver similarly compromises Kelley's ability to serve PGW's creditors faithfully as their Trustee. Kelley is biased towards a forfeiture action brought by the United States government. Forfeiture is inimical to the interests of PGW's creditors. It would remove assets from the PGW estate to benefit victims of Petters's fraud, most of whom are not otherwise creditors of PGW. Kelley cannot fulfill his duty as Receiver "to ensure" that PGW's assets are available for forfeiture and simultaneously fulfill his fiduciary duty as Trustee for PGW to oppose forfeiture on behalf of PGW's creditors.

Lastly, the conflicts generated by Kelley's status as Trustee for both PGW and PCI as well as his status as Receiver for the Debtors and Trustee for PGW are, standing alone and together, disabling. However, the Bankruptcy Court overruled Ritchie's objection to Kelley's appointment in part because Ritchie did not demonstrate specific instances of prejudice or "actual," as opposed to "potential," conflicts. But the court also denied Ritchie discovery that would have revealed precisely such "actual" conflicts. Thus, to the extent that the Bankruptcy Court was correct that, without more, the conflicts described above are not disabling, the denial of discovery was in error because it ensured that Ritchie could not make the necessary showing.

ARGUMENT

A Trustee's first and highest duty is to act in the best interest of the creditors of the debtor corporation. *See* 11 U.S.C. §§ 323, 1106; *In re NWFX, Inc.*, 267 B.R. 118, 151 (Bankr. W.D. Ark. 2001); *see also, In re Suntastic USA, Inc.* 269 B.R. 846, 850 (Bankr. D. Ariz. 2001) ("The touchstone of a trustee's duty is to act in the best interests of all creditors").

A Trustee cannot fulfill that overriding duty unless it is free from material conflicts of interest. *See, e.g., In re BH&P, Inc.*, 949 F.2d 1300, 1311 (3d Cir. 1991). The inquiry into a Trustee's freedom from conflicts encompasses, but is not limited to, the requirement of Section 1104 of the Bankruptcy Code that a Trustee be "disinterested."[13] *Id.*; 11 U.S.C. § 1104(d). "Disinterested" is defined as free from "any material adverse interest." 11 U.S.C. § 101(14)(E). The Code does not define "adverse interest," but courts have held it to mean with respect "to

[13] In *BH&P*, the Third Circuit recognized that courts have held that the plain terms of the "disinterested" requirement in Section 1104 concern only conflicts in a Trustee's "personal" capacity, as opposed to a "representative" capacity. *See BH&P*, 949 F.2d at 1310. Generally, conflicts stemming from service as a Trustee for another debtor would arise in a "representative" capacity. However, as noted herein, the Third Circuit in *BH&P* held that Trustees can be disqualified for a "conflict of interest" apart from the technical terms of Section 1104, and ultimately upheld the bankruptcy court's decision to disqualify a Trustee because of conflicts arising from that person's concurrent service as Trustee for another debtor.

two or more entities (1) *to possess or assert mutually exclusive claims to the same economic interest*, thus creating an *actual or potential* dispute between the rival claimants . . .; or (2) to possess a *predisposition* or interest under circumstances that render such *a bias in favor of or against one of the entities*." *In re Roberts*, 46 B.R. 815, 826-27 (Bankr. D. Utah 1985) (emphasis added), *aff'd in part, rev'd and remanded on other grounds*, 75 B.R. 402 (D. Utah 1987). Section 1104(d) is broad enough to include anyone who in the slightest degree might have some "interest or relationship that would even faintly color the independence and impartial attitude required by the Code." *In re Crivello*, 134 F.3d 831, 836 (7th Cir. 1998).

The conflict of interest analysis focuses on the specific facts of each case. *BH&P*, 949 F.2d at 1313. A Trustee appointment "should not be upheld simply because, after the fact, no harm appears to have been done" *Id.* "The potential for conflict and the appearance of conflict may, without more, justify removing a Trustee from service." *Id.*; *see also In re AFI Holding Co., Inc.*, 530 F.3d 832, 850 (9th Cir. 2008). In considering whether a Trustee is fit to serve:

> the court should consider the full panoply of events and elements . . . The nature and extent of the conflict must be assayed, along with the likelihood that a potential conflict might turn into an actual one. An effort should be made to measure the influence the putative conflict may have in subsequent decision-making. Perceptions are important; how the matter likely appears to creditors and to other parties in legitimate interest should be taken into account . . . .
>
> What counts is that the matter not be left either to hindsight or the unfettered desires of the [parties involved], but that the bankruptcy judge be given an immediate opportunity to make an intelligent appraisal of the situation and to apply his experience, common sense, and knowledge of the particular proceeding to the request.

BH&P, 949 F.2d at 1312-13 (quoting *In re Martin*, 817 F.2d 175, 181-83 (1st Cir. 1987)). As the court in *AFI Holding* makes clear, courts must be vigilant in recognizing and eliminating potential conflicts, as well as actual conflicts.

I. KELLEY CANNOT CONCURRENTLY SERVE AS TRUSTEE FOR PGW AND TRUSTEE FOR PCI.

A. A Disabling Conflict of Interest Arises from Kelley's Dual Status As Trustee for PGW and Trustee for PCI.

Kelley cannot faithfully serve as Trustee for PGW and also serve as Trustee for PCI. PGW and PCI are distinct legal entities. The two companies also have distinct creditor constituencies, as indicated by their creditor schedules. (App. at A-226 – A-290.) The source of Kelley's conflict is rooted in PGW's ownership of substantial assets in legitimate operating companies, such as Polaroid and Fingerhut. In contrast, PCI and its subsidiaries have little or no assets of value, and appear primarily to have been vehicles for fraud. Indeed, PCI's only assets appear to be potential claims against other entities with assets, such as the $216 million claim against PGW. (*See id.*)

The different creditor constituencies and financial situations of PGW and PCI impose different, and directly conflicting, demands upon the Trustees for those two entities. The Trustee for PCI and its creditors must seek to maximize the value of the PCI estate by seeking access to all potential sources of funds, including making claims against PGW. On behalf of PGW's separate set of creditors, the PGW Trustee must resist any effort to gain access to PGW's assets for the benefit of the creditors of PCI if there is doubt as to the viability of their claims. The disparity between PCI and PGW's assets creates a real and inevitable conflict.

The need for separate Trustees among related entities when such conflicts of interest arise is widely acknowledged in the case law. *See, e.g., In re United Church of the Ministers of God*, 74 B.R. 271, 279 (E.D. Pa. 1987) (potential conflicts of interest among estates of debtor church and its founder led court to "appoint separate Trustees in each case"). The court's resolution of an analogous scenario in *In re BH &P, Inc.*, 103 B.R. 556 (Bankr. D.N.J. 1989), is instructive. In *BH&P*, the bankruptcy court concluded that a common Trustee should not have

been appointed for three related entities. The Trustee had the "right and duty to pursue the claims" of one debtor against a second debtor, and "unless all creditors are paid in full, such claims are materially adverse to" the claims of the unsecured creditors of the second debtor. *Id.* at 561. As further explained by the Third Circuit, which affirmed the result, the bankruptcy court concluded that Trustee for BH&P had an "obligation to pursue claims against Herman and Merkow," who were the founders of BH&P and who had also filed for bankruptcy. *In re BH&P*, 949 F.2d at 1313. The "claims were disputed," and thus required "advocacy of competing interests." *Id.* Consequently, separate Trustees were needed for BH&P and its founders.[14]

The conflict is even more compelling here. PGW is the only bankrupt Petters entity with substantial, tangible assets. Serving the best interests of PCI's creditors – the bulk of whom are *not* also PGW creditors – requires asserting claims against PGW's assets. Indeed, PCI has a scheduled claim of $216 million against PGW, and it is possible that Kelley, as Trustee of PCI might move for substantive consolidation of PGW and PCI estates. Thus, the present scenario does not merely require "advocacy of competing interests" – the question of whether PGW's assets should be available to creditors of PCI is the central issue of these bankruptcy cases.[15]

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[14] On appeal in *BH & P*, the Third Circuit disagreed with the bankruptcy court's conclusion that *any* inter-debtor claim would *automatically* require separate Trustees. *In Re BH & P*, 949 F.2d at 1311-12. The Third Circuit instead adopted the flexible, case-by-case approach to Trustee conflicts of interest described above, which takes into account all relevant facts, including inter-debtor claims, and permits Trustee disqualification, in the proper circumstances, for an actual or potential conflict, or even the mere appearance of a conflict. *Id.* at 1312-13. Using that standard, the Third Circuit let stand the bankruptcy court's decision to appoint separate Trustees. *Id.* at 1313. As discussed herein, the conflicts of interest here are more egregious than those at issue in *BH & P*.

[15] Cost and efficiency are of course important considerations, but they must yield to the legal requirement that a Trustee be disinterested. Thus, "to the extent that there is any tension

Kelley has demonstrated that he has prejudged this paramount issue, and his position is detrimental to PGW's creditors. For instance, he has asserted without disclosing any actual admissible evidence that the affairs of PGW and PCI are closely intertwined. (*See, e.g.,* App. at A-307 (stating "there are likely various claims yet to be determined between and among the various Petters Entities, as the funds flowed freely between and among virtually all of the several dozen Petters Entities as financial needs arose").) This position could be cited in a dispute regarding the legal separateness of PGW under a "veil piercing" or "alter ego" theory. And, although Ritchie was denied discovery to obtain specific facts on the issue, there is reason to believe that PGW, which had a separate general counsel, respected corporate formalities and maintained its corporate separateness from PCI. PGW's fiduciary must fiercely fight any effort that would ignore the corporate separateness of PCI and PGW – yet Kelley is furthering the opposite approach, which if adopted would dramatically reduce the recovery of PGW creditors.

Similarly, in court pleadings, Kelley has characterized the indictment of Petters, PCI and PGW filed by the United States government as implicating PGW in Petters's fraud. (*See, e.g.*, App. at A-315 – A-316.) But a close reading of that indictment reveals that, aside from conclusory statements that Petters used PCI and PGW to perpetrate his fraud, the government failed to identify any allegedly fraudulent transaction that involved PGW.[16] A fiduciary for PGW's creditors should – indeed must – weigh all available evidence before making any public statements that might implicate creditor claims.

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between disinterestedness on the one hand and efficiency and economy on the other, disinterestedness must prevail" because "[i]ntegrity is no less necessary because it may be inconvenient or expensive." *In re BH & P*, 103 B.R. at 572.

[16] The only transaction involving PGW was in Count 20. The transaction consisted of a transfer of funds from PGW to Petters, and Count 20 was a money laundering charge against Petters, but not PGW. (App. at A-302.) PGW was not mentioned in any of the PCI merchandise financing transactions that lie at the heart of Petters' fraud.

Having prejudged this critical issue, Kelley's actions in investigating and analyzing claims and strategies – which occur outside the view of the Bankruptcy Court and the parties – are unavoidably tilted against PGW's interests. For example, prior to any decision regarding substantive consolidation, Kelley is the one who will assess and amass the facts that will be used in the decision. Kelley will thus focus on, and develop, the facts that support substantive consolidation, and disregard and omit facts that would support a conclusion against substantive consolidation. Ritchie and other parties opposing substantive consolidation will have limited ability to discover the facts that Kelley does not put forth, and, most importantly, presently lack a fiduciary free from conflicts to protect their interests, much to their considerable prejudice. As stated above, substantive consolidation or a claim by PCI against PGW is potentially devastating to PGW's creditors because PGW is the only bankrupt Petters entity with substantial assets, and each dollar pulled out to benefit the many victims of the Petters fraud who are not PGW creditors is a dollar taken away from a PGW creditor.[17] Kelley simply cannot serve as Trustee for both PGW and PCI.

B. The Bankruptcy Court's Reasoning is Flawed, And Does Not Support Kelley Serving as Trustee for PGW and PCI in the Face of his Conflicts of Interest.

The Bankruptcy Court characterized the conflicts of interest between PGW and PCI as only "potential conflicts" that would not arise until a creditor suffered actual harm, such as when a decision is made about asserting a claim or substantive consolidation. (Trustee Order at 32.) Until then, the Bankruptcy Court believed that the benefits of more efficient multiple-

[17] It is also important to note that the Unsecured Creditors Committee ("Committee") consists entirely of PCI creditors who have no contractual claims against PGW. The United States Trustee declined to create a separate Committee for PGW, or even to appoint creditors who have contract claims against PGW to the existing, supposedly joint committee. Appointing a separate Trustee for PGW is therefore all the more imperative because the Committee at present contains no representatives of these PGW constituencies.

estate administration outweighed any harm to PGW creditors. (*Id.*) The Bankruptcy Court also expressed the view that major decisions such as asserting claims and substantive consolidation require notice to the interested parties and court approval, and therefore Ritchie and other PGW creditors could participate in those processes to ensure that their rights were protected. (*Id.* at 33.)

The Bankruptcy Court's reasoning is critically flawed. *First*, it ignores that a court can, and should, disqualify a Trustee on the basis of actual or *potential* conflicts. *See In re AFI*, 530 F.3d at 850; *BH & P*, 949 F.2d at 1313. And, when considering a potential conflict, a key factor is the "likelihood that a potential conflict might turn into an actual one." *BH & P*, 949 F.2d at 1312-13. Here, the "potential" conflicts acknowledged by the Court and not disputed by the parties are *inevitable* – the question is not *if* PCI will seek access to PGW's assets, but *when*. *Second*, this inevitability of conflict equates to a present conflict. Kelley apparently has prejudged the ultimate issue of whether PCI should recover assets from PGW. As explained above, that view will necessarily color his actions prior to the issue being raised with the court, which rebuts the Bankruptcy Court's rationale that Ritchie will have the ability to oppose substantive consolidation or a PCI claim when the court takes up the issue. *Finally*, the Bankruptcy Court stated that Ritchie did not demonstrate actual harm or prejudice from any action by Kelley, and that disqualification is not appropriate until that time. Yet the court erroneously denied Ritchie's effort to obtain discovery from Kelley, which assured that Ritchie could not make such a showing.

II. KELLEY'S ROLE AS RECEIVER FOR THE DEBTORS PREDISPOSES HIM TOWARDS A FORFEITURE ACTION, WHICH WOULD BE DEVASTATING TO PGW CREDITORS, AND CONSTITUTES A DISABLING CONFLICT.

A. A Disabling Conflict of Interest Arises from Kelley's Roles as Receiver for PGW and other Petters Entities and as Trustee.

Kelley has a predisposition towards forfeiture, which stems from the terms of the Receivership Order, that is inimical to the interests of PGW creditors. The order expressly directs Kelley to "[c]oordinate with representatives of the United States Attorney's office and Court personnel as needed to *ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture or other legal remedies in proceedings commenced by or on behalf of the United States*."[18] (Receivership Order pp. 16-17 (emphasis added).) Consistent with the Receivership Order, Kelley has expressly acknowledged that "[v]ictim restitution is a primary focus of § 1345." (App. at A-215 – A-222; *see also* App. at 118.) At the very least, these dictates bias Kelley towards a forfeiture action, and prevent him from taking a serious stance against forfeiture; Kelley otherwise would not be "coordinating" with the United States Attorney's office to "ensure" that PGW's assets are available for forfeiture.

Furthermore, a corporation's assets generally cannot be forfeit to the government unless the corporation admits, or is found guilty of, a crime, or its assets represent traceable proceeds of a crime. *See*, 18 U.S.C.S. § 981(A) (allowing civil forfeiture of property only where that property was "involved in a transaction or attempted transaction in violation" of certain statutes, "or any property traceable to such property"). Accordingly, the PGW Trustee is obligated to present the evidence to date which suggests that PGW was not a vehicle for Petters's fraud or a direct recipient of the benefits of the fraud. Kelley, however, has done just the opposite, suggesting in court pleadings that PGW was in fact involved in the fraud. (*See, e.g.,* App. at A-315 ("The indictment states that PCI and PGW 'did knowingly devise and participate in a scheme and artifice to defraud and to obtain billions of dollars in money and property by means

[18] The fact that Kelley, as Receiver, would not actually file a forfeiture action on behalf of the United States government is irrelevant – the Receivership Order imposes duties upon Kelley that align his obligations with the interests of the government regarding forfeiture.

of materially false and fraudulent pretenses, representations, and promises'"; "[I]t becomes immediately obvious [upon reviewing the Debtor Entities' schedules] that the Debtor Entities…have accrued inter-company obligations, engaged in extensive transferring of funds between PCI, PGW and subsidiary entities of both…").) Kelley has based his position on information not available to Ritchie or the other creditors. Those actions may materially harm PGW's creditors by potentially inviting forfeiture claims, and at the very least indicate that Kelley is prejudicing PGW's efforts to fight forfeiture claims and any criminal charges before all the facts are known and weighed. Kelley's actions are particularly revealing of his predisposition towards forfeiture because there is nothing in the public record to date to indicate that PGW in fact engaged in any criminal activity. The affidavit submitted in support of the search warrants obtained for Petters home and PCI's offices clearly described Petters's fraud as "a scheme to fraudulently induce investors to provide funds for, and financing to, *PCI*." (App. at A-85.) PGW was never mentioned in that affidavit as having any role in such fraud.

Additionally, as mentioned above, the inclusion of PGW as a defendant in the indictment of Petters and PCI highlights the need for a PGW Trustee to advocate strongly against any accusation of wrongdoing by PGW. PGW is named a defendant and identified as a wrongdoer in conclusory statements, but is identified in only one of the twenty specific transactions in the indictment. And that transaction, a transfer of funds from PGW to Petters, is a money laundering count that names only Petters, not PGW, as a defendant. (App. at A-302.) Accordingly, a strong advocate would point out the deficiencies in the indictment with regard to PGW, and fight the charges. Instead, Kelley appears to have acquiesced in the United States Attorney's efforts to brand PGW a criminal wrongdoer. This is not surprising, given not only the Receivership Order's direction that Kelley "coordinate" with the United States Attorney

regarding forfeiture, but also the fact that the United States Attorney proposed, and helped to bring about, the lucrative Receivership position duties Kelley now exercises. (Trustee Order at 5; Order for Entry of Preliminary Injunction, Appointment of Receiver, and Other Equitable Relief, pp. 6, 15 (D. Minn., Case No. 08-SC-5348 (ADM/JSM), October 14, 2008); App. at A-291 – A-292; App. at A-315 – A-316.)

Moreover, just days before this filing, Kelley submitted the Kelley Affidavit in the Receivership action, in which he takes the position that "virtually every dollar" that PGW used to purchase Polaroid – PGW's principal asset – was obtained from defrauded PCI investors. (App. at A-224.) Kelley offers no proper, admissible evidence to support this statement, and indeed, at least a substantial portion of the purchase money was supplied by J.P. Morgan and was clearly not the proceeds of fraud. The position that Polaroid was obtained with tainted PCI funds comports with Kelley's duty to "coordinate with" the United States Attorney regarding forfeiture, but is inconsistent with his duty as PGW Trustee to resist forfeiture to the greatest possible extent. Further, the Kelley affidavit demonstrates that the conflict is actual, as these statements themselves could be used to harm PGW's creditors. Kelley cannot be on all sides of the issue, claiming to represent the best interests of PGW creditors while taking such positions in the Receivership.

The court in *In re Kalil Fresh Marketing, Inc.*, 2008 WL 2928562 (S.D. Tex. July 22, 2008), considered an analogous scenario and concluded that the same person could not properly serve in both fiduciary roles. That case involved a bankruptcy Trustee who executed an agreement with a subset of creditors called the "PACA Claimants." The Trustee's role with respect to the PACA Claimants was analogized to a federal court receiver. *Id.* at *2. The court frowned upon the arrangement, stating that it saw "substantial potential conflicts if the trustee

were to try to perform the function of federal court receiver for PACA Claimants and concurrently try to fulfill the duties and responsibilities set out in the Bankruptcy Code in favor of general unsecured creditors of an estate." *Id.* The court then offered the following example of a conflict, which illustrates the untenable scenario created where, as here, duties owed to separate constituencies pull a fiduciary in opposite directions:

> [U]nder the Bankruptcy Code the Chapter 7 Trustee owes a fiduciary duty to the general unsecured creditors. Under the agreement with some PACA Claimants, the trustee would owe like duties to the PACA Claimants. The Court finds it difficult to understand how the Chapter 7 Trustee could make a decision with respect to specific assets or claims. And even if the trustee were undecided and resolved to bring an issue to the Court for decision, the Court does not understand how the trustee could present the issue in an even-handed way since the Bankruptcy Code requires the trustee to protect the interests of general unsecured creditors, and presumably the trustee would have the same duty for the PACA Claimants.

Id. at *2, n.2. As in the scenario discussed by *Kalil Fresh Marketing*, Kelley owes fiduciary duties (i) to fraud victims in his capacity as Receiver, and (ii) to PGW's creditors in his capacity as Trustee. Those groups have competing claims to the Debtors' property. Kelley cannot adequately represent both groups simultaneously, and thus cannot serve as Trustee while also acting as Receiver.

B. The Bankruptcy Court's Reasoning Fails to Address the Critical Conflicts Posed By Kelley's Status as Receiver.

Like its reasoning regarding Kelley's dual Trustee status, the Bankruptcy Court's reasoning regarding Kelley's Receiver status is flawed. The court did not dispute that a forfeiture action against PGW would devastate PGW's creditors, but it found no reason to believe that Kelley's Receiver role biased him in favor of a forfeiture action.

Specifically, the court interpreted the Receivership Order's dictate that Kelley "coordinate" with the U.S. Attorney's office "to ensure that assets . . . are available for criminal restitution [and] forfeiture" as requiring only that Kelley "hold in place" the assets "pending

their ultimate disposition via separate court proceedings." (Trustee Order at 22.) Ritchie interprets this Court's Receivership Order differently. For instance, Ritchie believes that collecting and preserving assets and keeping them liquid does not require "coordination" with the U.S. Attorney's office. And, Ritchie interprets the Order to ensure that assets are available for criminal restitution and forfeiture to require more than that Kelley just hold such assets in place.

Furthermore, the Bankruptcy Court never addressed the U.S. Trustee's contention that Kelley's role as Receiver practically, if not legally, ended when PGW and PCI entered bankruptcy. (Trustee Order at 23-25.) As the court did acknowledge, there is nothing in the Bankruptcy Code that ends a person's status as receiver once bankruptcy is filed. (*Id.* at 24.) Moreover, the Receivership Order expressly states that, once a Receivership entity enters bankruptcy, the Bankruptcy Code and Rules govern the assets of the estate, *except* that "any federal claims *relating to forfeiture and restitution* (1) *against* or to recover assets of the bankruptcy estates of such bankruptcy cases . . ., *are preserved and not affected in any way by this paragraph*." (Receivership Order at 15 (emphasis added).) This provision makes clear not only that Kelley's role as Receiver survives, and continues beyond, the bankruptcy filings, but also that the bankruptcy process offers PGW creditors limited protections – procedural or otherwise – from a forfeiture action.

Additionally, the Kelley Affidavit, in which he asserts that Polaroid was purchased with fraud-tainted funds from PCI, reveals that harm to PGW creditors from Kelley's conflicts is occurring now. Given his predisposition towards forfeiture, Kelley has focused on the facts that support forfeiture and has avoided pointing to facts or leads that would cut against forfeiture. That is precisely the point Ritchie made to the Bankruptcy Court, and that is precisely what has

occurred. Kelley has announced, without Ritchie or other persons whose interests are potentially impacted to review the underlying facts, that Polaroid was purchased with purportedly illicit PCI funds – a potential boost to any forfeiture action. Kelley has full control about what to disclose regarding his actions, and chose not to allow the full facts to be developed, nor even to allow PGW creditors to review or comment upon any underlying facts before publicly announcing a conclusion that is potentially damaging to the very PGW creditors whose interests he has a fiduciary duty to protect. Kelley did not take up a fight on behalf of PGW creditors, but rather acquiesced to the view that favors forfeiture. It is not enough to have Kelley step down as PGW Trustee once the forfeiture action is brought. Kelley has been and is presently participating in public announcements and taking positions in court proceedings that are inimical to the interests of PGW's creditors. Kelley simply cannot faithfully serve as PGW's Trustee while undertaking such efforts.

Finally, as with the dual Trustee issue, Ritchie was denied the ability to take discovery into what actions Kelley has taken, and positions he has formed, in light of the conflicts created by his roles as Receiver and Trustee for PGW. Accordingly, to the extent that Ritchie's objection was overruled for failure to identify sufficiently specific instances of bias and prejudice, the Bankruptcy Court wrongly prevented Ritchie from making the very showing it subsequently held was required.

CONCLUSION

For the reasons stated herein, Ritchie respectfully requests that the Court reverse the Trustee Order and direct the Bankruptcy Court to order the United States Trustee to appoint a separate Trustee for PGW, and that the Trustee not be Kelley.

LEONARD, O'BRIEN, SPENCER, GALE & SAYRE, LTD.

Dated: April 17, 2009

By /e/ James M. Jorissen

James M. Jorissen, #262833
Brian F. Leonard
100 South Fifth Street, Suite 2500
Minneapolis, Minnesota 55402-1234
(612) 332-1030

Bryan Krakauer
Thomas K. Cauley, Jr.
Brian A. McAleenan
SIDLEY AUSTIN LLP
One South Dearborn
Chicago, Illinois 60603
(312) 853-7000

COUNSEL FOR RITCHIE CAPITAL MANAGEMENT, L.L.C., RITCHIE SPECIAL CREDIT INVESTMENTS, LTD., RHONE HOLDINGS II. LTD., YORKVILLE INVESTMENTS I, LLC, AND RITCHIE CAPITAL STRUCTURE ARBITRAGE TRADING, LTD.

ADDENDUM

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

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In re:	**JOINTLY ADMINISTERED UNDER CASE NO. 08-45257**
PETTERS COMPANY, INC., et al,	Court File No. 08-45257
Debtors.	
	Court File Nos:
(includes:	
Petters Group Worldwide, LLC;	08-45258 (GFK)
PC Funding, LLC;	08-45326 (GFK)
Thousand Lakes, LLC;	08-45327 (GFK)
SPF Funding, LLC;	08-45328 (GFK)
PL Ltd., Inc.	08-45329 (GFK)
Edge One LLC;	08-45330 (GFK)
MGC Finance, Inc.;	08-45331 (GFK)
PAC Funding, LLC;	08-45371 (GFK)
Palm Beach Finance Holdings, Inc.)	08-45392 (GFK)
	Chapter 11 Cases
	Judge Gregory F. Kishel

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ORDER OVERRULING OBJECTION OF RITCHIE SPECIAL CREDIT INVESTMENTS, LTD., ET AL, TO APPOINTMENT OF TRUSTEE IN CHAPTER 11 CASES, AND APPROVING APPOINTMENT

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At St. Paul, Minnesota, this 26th day of February, 2009.

These jointly-administered Chapter 11 cases came on before the Court on January 27, 2009, for hearing on an objection to the United States Trustee's appointment of Douglas A. Kelley, Esq., as Trustee for all of the Debtors in these cases. The objectors, Ritchie Special Credit Investments, Ltd. and other creditor-parties related to it (collectively, "the Ritchie Parties") appeared by their attorneys, James M. Jorissen, Leonard, O'Brien, Spencer, Gale & Sayre, Ltd., Minneapolis, and Bryan Krakauer, Sidley Austin LLP, Chicago. The United States Trustee appeared by his attorneys, Michael E. Ridgway and Robert B. Raschke. The Unsecured

Creditors' Committee for these cases ("the Petters Committee") appeared by its attorney, David E. Runck, Fafinski Mark & Johnson, P.A., Eden Prairie. Douglas A. Kelley, the Trustee-appointee, appeared personally and by James A. Lodoen and George H. Singer, Lindquist & Vennum, P.L.L.P., Minneapolis. Ronald R. Peterson, Esq., Chicago, trustee for the bankruptcy estates of Lancelot Investors Fund, L.P., et al, participated in the hearing in that capacity. Dennis M. Ryan, Faegre & Benson, Minneapolis, and Richard A. Chesley, Paul, Hastings, Janofsky & Walker LLP, Chicago, appeared as prospective counsel for the Unsecured Creditors' Committee in *In re Polaroid Corporation, et al*., BKY 08-46617 ("the Polaroid Committee"). The following order is based on the record made for the hearing.

INTRODUCTION

These Chapter 11 cases were commenced by voluntary petitions filed during October, 2008. Petters Company, Inc. ("PCI") and Petters Group Worldwide, LLC ("PGW") are the debtors in the two lead cases of the group. PCI and PGW were established by one Thomas J. Petters in 1987-1988, as "holding companies" for other entities through which he was to own and conduct various business enterprises and transactions. In his individual capacity, Petters is the sole shareholder of both PCI and PGW.[1] Except for Palm Beach Finance Holdings, Inc., all of the other debtors in this group of cases are subsidiaries of PCI, i.e., business entities as to which PCI is the shareholder or equity holder. Tom Petters is the sole shareholder in Palm Beach Finance Holdings, Inc.

Polaroid Corporation, a subsidiary of PGW, has been in Chapter 11 in this Court since mid-December, 2008. Its case is being jointly administered with those of nine other business

[1]For over a decade, Petters has been known in regional media by his nickname; hence, "Tom Petters" will be used for all further references to him as an individual.

entities related to it, in a case-grouping separate from the one at bar.[2] A number of other entity-subsidiaries of PCI or PGW are not in bankruptcy at this time.

When the PCI/PGW cases were commenced, Tom Petters was not the individual who authorized the filings. Nor did he sign the petitions to commence the cases. At that time, Tom Petters lacked the legal authority to do these acts; and, in a way, he was hampered physically from signing. Tom Petters was in the custody of the United States, incarcerated and charged with several felony offenses including mail and wire fraud. His personal assets and the bulk of his business enterprises were under the control of a receiver appointed by the United States District Court for this District. Under express authorization from the District Court, the Receiver, Douglas A. Kelley, Esq., signed the bankruptcy petitions and put the Debtors into bankruptcy. Tom Petters has had no involvement with these cases since their commencement. All decision-making and action on behalf of the bankruptcy estates has been considered, undertaken, and effected by Kelley, with the advice and representation of bankruptcy counsel.

On motion of the United States Trustee, this Court directed the U.S. Trustee to appoint a trustee or trustees for these cases, pursuant to 11 U.S.C. § 1104(a).[3] On December 24, 2008, the U.S. Trustee appointed Kelley as trustee for all of the cases, and applied for an order

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[2]MN Airlines, LLC, d/b/a Sun Country Airlines, is a business entity as to which Tom Petters was the controlling individual principal through two holding companies. Sun Country Airlines and its holding companies are also in Chapter 11 in this Court. That jointly-administered grouping is assigned to Judge Robert J. Kressel. The background and status of the Sun Country Airlines cases are not relevant to the matter at bar.

[3]The U.S. Trustee had made the motion after counsel in his office concluded that these corporate debtors had no individual officers legally chargeable as stewards of the bankruptcy estate and subject to the fiduciary obligations mandated by statute, after the cases were commenced. The unseating of Tom Petters from control and the resignation of other individuals who had made up the pre-petition management of these debtors had left them without anyone exercising day-to-day and strategic administration, with the continuity inherent in the statutory concept of a debtor-in-possession, 11 U.S.C. § 1101(1). The U.S. Trustee also concluded that bankruptcy law would not countenance a continuing status of managerial custodianship for Kelley in his role as a court-appointed receiver. The legal bases for his conclusion were the bar on appointment of a receiver within a bankruptcy case, 11 U.S.C. § 105(b), and the obligation of any custodian to turn over property of the estate to the trustee in bankruptcy, 11 U.S.C. § 543(b)(1)--the statutory definition of "custodian" including a receiver appointed pre-petition, 11 U.S.C. § 101(11).

approving the appointment pursuant to FED. R. BANKR. P. 2007.1(c).[4]

The Ritchie Parties timely filed an objection[5] to the U.S. Trustee's appointment.

The U.S. Trustee's appointment, and the Ritchie Parties' objection, are the matter at bar. The theory of the objection is summarized by the very first sentence of the Ritchie Parties' written submission: "Inherent, intractable and immediate conflicts of interest preclude Kelley from serving as Trustee for all the Debtors [in these jointly-administered cases]."

FURTHER BACKGROUND[6]

The Relevant Civil and Criminal Proceedings

These bankruptcy cases are the product of a swirl of events that began on Wednesday, September 24, 2008. On that date, agents of the Federal Bureau of Investigation, the Criminal Investigation Division of the Internal Revenue Service, and the United States Postal Inspection Service executed a search warrant at the Minnetonka, Minnesota headquarters of Tom

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[4]The text of this rule taken into account for this decision is the amended version that was effective December 1, 2008.

[5]In an order entered on December 17, 2008, the Court had set deadlines for various stages of the appointment process.

[6]As a technical matter, the recitations in the following section are findings of fact. Most of them merely identify the progression of various proceedings in courts, state and federal, in which Tom Petters, the debtors in these and other bankruptcy cases, certain creditors, and the United States of America were parties. As such, these recitations are not subject to dispute. The remaining recitations go to out-of-court events and the out-of-court acts of relevant persons or entities. They are based on verified statements in the record. The content of these recitations has been deliberately limited in topic and scope. At a hearing on January 22, 2009, the Court ordered that in-court testimony would not be taken for the objection at bar, and denied the Ritchie Parties' late-coming motion to conduct an expedited discovery process into a very broad array of subject matter. This disposition was based on a ruling that the Ritchie Parties' objection was to be treated as a matter of law, with the focus on three things: Kelley's specific charge under the District Court's orders governing his status as Receiver; the change of that status with the advent of bankruptcy for some of the entities previously under the receivership; and any resultant effect on Kelley's own definition of his prospective role as trustee. None of those considerations entail historical fact, per se. Thus, the recitation of events extraneous to the courts' records has been limited to those that the District Court clearly relied on when it appointed Kelley as Receiver, and vested him with broadly-described powers to take control over assets that had some arguable connection with the newly-commenced criminal cases against Tom Petters and others. This is also done with due regard for the Ritchie Parties. One can safely assume that they will maintain their position that this controversy is intensely fact-bound, in a very personalized way. Restraint in the scope of background fact-finding will avoid materially contradicting the Court's rejection of that position.

Petters's business entities. They seized and removed records of the Debtors, Tom Petters, and other individuals.

Within a day after the execution of the search warrant, a criminal defense attorney retained by Tom Petters asked Douglas A. Kelley, Esq., to represent the various entities of Tom Petters's business enterprise.[7] Two days after that, Kelley was contacted by an Assistant United States Attorney for the District of Minnesota. On behalf of the Department of Justice, the AUSA wanted to discuss Kelley's prospective role as counsel for the Petters entities and the intentions of the United States toward the assets and operations of Petters's business enterprises.

In the wake of that conversation, the U. S. Attorney did not take action on behalf of the United States to seize the assets of Petters or the Petters businesses under color of civil or criminal forfeiture. This meant that Sun Country Airlines and Polaroid Corporation were able to continue their business operations in the marketplace.

On Kelley's advisory in relation to the government's forbearance, Tom Petters resigned his offices and positions with PCI, PGW, and all related entities on Monday, September 29, 2008. He physically vacated his office at the corporate headquarters on that date.

During the following several days, Kelley conducted a factual investigation of the surroundings into which he had placed himself. He started the task of determining the scope of the assets and operations of the Petters business entities; he interviewed various of their employees; he interviewed potential counsel to assist him; and he fielded inquiries from creditors and other persons. He also had numerous and frequent contacts with employees of the office of the United States Attorney, discussing options to preserve the values of the Petters enterprises for the benefit of those who would be entitled to that value.

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[7]Previously, PGW had had in-house counsel and the various Petters business entities had been represented by an outside law firm. All of those attorneys resigned and withdrew after the execution of the search warrant.

During this week, the office of the United States Attorney took no action toward a government seizure of any part of the Petters enterprise.

In the meantime, the Ritchie Parties had commenced a civil action in the Circuit Court of Cook County, Illinois, by a filing made on September 29, 2008. The Ritchie Parties are a Chicago-based group of hedge funds and other investment vehicles. In their lawsuit, they asserted rights to payment under a series of promissory notes executed by Tom Petters and PGW or PCI. They also claimed to have been defrauded by the makers of the notes. The Ritchie Parties obtained an *ex parte* temporary restraining order from that court against Tom Petters, PCI, and PGW. That order restricted the disposition of those parties' assets other than transfers made in the ordinary course of business.

Kelley learned of the Ritchie Parties' lawsuit during the week of September 29. On Thursday, October 2, 2008, he advised the United States Attorney's office of it. The United States Attorney then filed a complaint in the United States District Court for this District, under the caption *United States of America v. Thomas Joseph Petters, et al*. In it, the government sought various forms of legal relief toward the containment and assemblage of the assets of Tom Petters and the entities in his business enterprise, and protection against the further use of those assets in connection with an "elaborate scheme to defraud individual and group investors." The government also sought to prevent the dissipation of assets or their value by Tom Petters or anyone in consort with him. The government "estimated that the Defendants [had] to date profited in excess of $3 billion from their illegal activities."

The named defendants in this proceeding were Tom Petters, PCI, PGW, and other individual persons alleged to have participated in a pattern of fraudulent activity ultimately attributed to Tom Petters. The remedies invoked in the complaint were equitable in nature: interim injunctive relief to prevent the defendants or those in consort with them from taking any further action affecting the assets, and an accounting for the whereabouts of liquid assets. The government also prayed

for "such other additional relief as the Court determines to be just and proper." In an early-filed first amended version of the complaint, this catch-all request specifically included "the appointment of Receivers."

This civil action was given file no. 08-cv-05348. It was assigned to Judge Ann D. Montgomery of the United States District Court. On Friday, October 3, 2008, Judge Montgomery granted an *ex parte* temporary restraining order, essentially freezing all of the assets of PCI, PGW, and all related entities owned or controlled by them.

On that same day, October 3, 2008, Tom Petters was arrested on federal charges of mail and wire fraud, money laundering, and conspiracy. He remains in federal custody to date. He is now under indictment for those offenses, a federal grand jury having returned such in 20 counts on December 1, 2008.

Meanwhile, in their civil action in Cook County, Illinois, the Ritchie Parties filed an *ex parte* request for the appointment of a receiver over PCI and PGW on Friday, October 3. Asserting that their collateral would be in jeopardy otherwise, they cited the pendency of the criminal proceedings, the resignation of the companies' management, and an indeterminacy of Kelley's legal authority. Kelley and the United States Attorney learned of this request during the weekend of October 4-5.

On October 6, 2008, the Illinois court entered an order appointing one William "Billy" Procida as Receiver for both PCI and PGW. The order gave Procida "the authority to take possession of the Collateral." As a term, "the Collateral" was not otherwise defined in the text of the order. Apparently, it referred to all assets of PCI and PGW in which the Ritchie Parties asserted security interests or liens. Beyond that, however, the order granted Procida "all of the usual powers of a receiver, including without limitation, management and operation of [PCI and PGW], collections of receivables, rents, and other Collateral." It gave him other broad powers, including the ability to "hire and fire employees and make all other necessary employment decisions" and to make

"payment of . . . necessary expenses, including reasonable compensation for himself," without the obligation "to apply to the Court for approval of such fees."

The United States Attorney's office then took action in the civil proceeding in the United States District Court here, to request the appointment of a receiver under federal law, 18 U.S.C. § 1345(a)(2)(B)(i) - (ii).[8] Kelley's name was among those submitted to Judge Montgomery for her consideration in the appointment.

On October 6, 2008, Judge Montgomery entered an order appointing Kelley as Receiver of PCI, PGW, "and any affiliates, subsidiaries, divisions, successors, or assigns owned 100%" by PCI or PGW. The United States and Tom Petters had stipulated in writing to the entry of this order. In a later order, entered on October 14, 2008, she appointed Kelley as Receiver for all but one of the remaining individual defendants being prosecuted in conjunction with the criminal case against Tom Petters.[9]

Pursuant to authority granted in the District Court's orders, Kelley then hired counsel to represent him for all legal matters entailed by his status as receiver. Later he hired other

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[8]In pertinent part, these subsections authorize legal actions as follows:

> . . .
>
> (2) If a person is alienating or disposing of property, or intends to alienate or dispose of property, obtained as a result of a banking law violation (as defined in [18 U.S.C. § 3322(d)] . . ., the Attorney General may commence a civil action in any Federal court--
>
> . . .
>
> (B) for a restraining order to--
>
> (i) prohibit any person from withdrawing, transferring, removing, dissipating, or disposing of any such property or property of equivalent value; and
>
> (ii) appoint a temporary receiver to administer such restraining order.

[9]Another person was appointed as receiver for that defendant, Frank E. Vennes, Jr.

professionals, including a team of forensic accountants whom he tasked with reconstructing and tracing the flow of funds and assets through the various entities in Tom Petters's business enterprise.

On October 10, 2008, the Illinois state judge presiding over the Ritchie Parties' lawsuit determined that his court's orders for a freeze of PCI's and PGW's assets and appointing Procida as receiver had "expired and [were] of no present effect." Essentially, the Illinois judge deferred to the United States District Court's appointment of Kelley. Expressly relegating the Ritchie Parties to "their rights on appeal or otherwise with respect to the Minnesota District Court's order," he deferred further consideration of the proceeding before him to mid-April, 2009.

KELLEY'S RECEIVERSHIP: THE SPECIFICS

Four different forms of order providing for the appointment of Kelley as Receiver have been entered in file no. 08-cv–05348.

The first, entered on October 6, 2008 as previously noted, named Kelley as Receiver for PCI, PGW, "and any affiliates, subsidiaries, divisions, successors, or assigns owned 100% or controlled by" those two entities.[10] This order authorized him to take certain specific actions in relation to PCI, PGW, and the other entities under his receivership; it amounted to a grant of near-plenary power to amass their assets and to control them while he continued to hold them. In specific, he was empowered to:

> [c]onserve, hold, and manage all receivership assets, and perform all acts necessary or advisable to preserve the value of those assets in order *to prevent any irreparable loss, damage, or injury to consumers or creditors of the Entities* [under the receivership], including but not limited to obtaining an accounting of the assets [and] preventing transfer, withdrawal, or misapplication of assets and including . . . filing any bankruptcy petitions for any of the Entities [under the receivership] to protect and preserve the assets of any of [them] and acting as management or Debtor in Possession of any of

[10]The scope of the receivership expressly excluded "Thomas Petters, Inc., and its subsidiaries including but not limited to: MN Airlines, LLC, dba Sun Country Airlines."

the Entities so filed by the Receiver . . ."

(emphasis added).

The second, entered on October 14, 2008, made Kelley the Receiver of the assets and business operations of Tom Petters individually, and of other individuals who were named defendants.[11]

The third, entered on October 22, 2008, amended the terms of the two earlier orders via a partial reorganization and reformatting of the provisions for Kelley's authority. Its one major addition was the creation of a "Stay of Actions against Receivership Defendants," in the form of an injunction against any judicial or extra-judicial "action that would interfere with the exclusive jurisdiction of [the District] Court over the assets or documents of the Receivership Defendants."

The fourth version, the one currently effective, was docketed on December 8, 2008. It was entered on Kelley's motion and over the objection of certain creditors of PCI, PGW, or their affiliates. In pertinent part, it provides first that Kelley is:

> . . . appointed Receiver for [Tom Petters, PCI, PGW, and the other individual defendants] with the full power of an equity Receiver. The Receiver shall be solely the agent of this Court in acting as Receiver under this Order and shall have judicial immunity. The Receiver shall be accountable directly to this Court and shall comply with any local rules of this Court governing receivers, as well as the Federal Rules of Civil Procedure. He is appointed Receiver for [Tom Petters, PCI, PGW, and the other individual defendants] until such time as real or perceived conflicts arise, at which time he will consult the Court to determine how to proceed.

It then gives him "all necessary powers to accomplish the following":

> 1. Take exclusive immediate custody, control, and possession of all the property, assets, and estates belonging to or in the possession, custody, or under the control of [Tom Petters, PCI, PGW, and other individual and corporate defendants], wherever situated, except those assets seized by the United States pursuant to valid orders of a court. The Receiver shall

[11]Both of these orders were entered after the entry of stipulations between the United States and various named defendants.

have full power to divert mail and to sue for, collect, receive, take in possession, hold, liquidate or sell and manage all assets of [Tom Petters, PCI, PGW, and the other defendants] and other persons or entities whose interests are now held by or under the direction, possession, custody, or control of [Tom Petters, PCI, PGW, and the other defendants];

2. The Receiver shall also assume control over all ongoing business operations in which [PCI, PGW, and the other defendants] have a controlling interest. With regard to these business operations, the Receiver shall:

. . .

c. Manage, administer, and conduct the operations of the ongoing legitimate business operations of [Tom Petters, PCI, PGW, and the other defendants], until further Order of this Court, by performing all incidental acts that the Receiver deems to be advisable or necessary; including but not limited to filing any bankruptcy petitions for any of the [Petters business] entities to protect and preserve the assets of any of the entities. Any bankruptcy cases so commenced by the Receiver shall during their pendency be governed by and administered pursuant to the requirements of the United States Bankruptcy Code, 11 U.S.C. section 101 *et seq*., and the applicable Federal Rules of Bankruptcy Procedure. Notwithstanding the foregoing, any claims arising under federal laws relating to forfeiture and restitution (1) against or to recover assets of the bankruptcy estates of such bankruptcy cases, or (2) for distribution from such bankruptcy cases, are preserved and not affected in any way by this paragraph.[12]

. . .

6. *Coordinate with representatives of the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are*

[12]This paragraph basically supplanted Terms IV.B.4. and IV.B.5. of the October 6, 2008 order. As quoted earlier, the October 6 order did contain an authorization for Kelley to file bankruptcy petitions, plus an authorization to "act[ ] as management or Debtor in Possession of any of the Entities so filed . . .," at Term IV.B.4.

> *available for criminal restitution, forfeiture, or other legal remedies in proceedings commenced by or on behalf of the United States*;[13] . . .

THE BANKRUPTCY CASES: COMMENCEMENT AND CONDUCT

Under the authorization of Term IV.B.4. of the October 6, 2008 order, Kelley had his attorneys prepare petitions for bankruptcy relief under Chapter 11 for PCI, PGW, and several of PCI's subsidiaries. He signed the petitions in his status as Receiver. They were filed, variously, on October 11 (Petters Company, Inc. and Petters Group Worldwide, LLC); October 15 (PC Funding, LLC; Thousand Lakes, LLC; SPF Funding, LLC; PL Ltd., Inc.; Edge One LLC; and MGC Finance, Inc.); and October 17, 2008 (PAC Funding, LLC). The petition for Palm Beach Finance Holdings, Inc., a corporation owned directly by Tom Petters as sole shareholder, was filed on October 19, 2008.

After these cases were commenced, Kelley exercised authority over the ongoing business operations of PCI, PGW, and the other Debtors. He worked with the bankruptcy counsel whose employment for the Debtors had been court-approved, to meet the various filing and compliance duties of a debtor-in-possession under statute, rule, and United States Trustee prescription. With bankruptcy counsel, he brought and prosecuted various motion proceedings in these cases. For all this, he asserted the authority to "act[ ] as management or Debtor-in-Possession of any of the Entities so filed [into bankruptcy] by the Receiver," under the District Court's orders of October 6 and 22, 2008.

Early in these cases, however, attorneys for the United States Trustee raised the substantive concerns identified in n.3, *supra*--i.e., whether bankruptcy law countenanced Kelley acting in the capacity of a debtor-in-possession in Chapter 11 cases under color of the District

[13]The emphasis here is added for the purposes of the present decision. It is imposed only to highlight the major item of contention that the Ritchie Parties gleaned from the attributes of Kelley's receivership. This paragraph did not have an analogue in the October 6, 2008 order.

Court's order alone, given that the Debtors had no continuing management personnel independent of the bankruptcy process. The issue was made more pointed by the District Court's express contemplation that the substantive law of the Bankruptcy Code would govern the cases of any of the Petters business entities. The issue, abstruse as it was, was novel; it was not significantly explored in published case law, and apparently there was no published decision that was on all fours factually and procedurally. The issue implicated the authority of two different federal forum courts, and it seemed to require the harmonization of alternate schemes of legal governance.

Ultimately, the United States Trustee forced the issue by filing his motion for appointment of trustee on December 2, 2008. After evaluating the very unsettled nature of the legal issues, and in light of the need to conserve resources to address the massive substantive complications of all of the Petters-related cases in all courts, Kelley did not oppose the U.S. Trustee's motion.[14] The U.S. Trustee appointed Kelley when he was directed to exercise his appointment authority; and in turn, the Ritchie Parties objected to the appointment, reprising the demands they made in response to the U.S. Trustee's initial motion. By the time the objection got to a hearing, the Petters Committee and the Polaroid Committee had aligned with the U.S. Trustee, in opposition to the Ritchie Parties. For the hearing, Kelley presented a recap of case history that, he submitted, showed the objection to lack foundation.

In the meantime, and in an unbroken line since the commencement of these cases, Kelley has acted, de facto, as if he were a managing officer of these Debtors for the purposes of all their post-petition activity, related to the Chapter 11 process or not. There was no one else to do these things. There is no indication in the record for this motion that Kelley has ever taken any action that was self-interested, contrary to the interests of the bankruptcy estates, or in any way

[14]The Ritchie Parties injected themselves into this initial motion proceeding, by insisting that the Court act at that time to order the U.S. Trustee to appoint a person as trustee for PGW who would be different from anyone appointed as trustee for any of the other Debtors. The Court ruled that such a request would not be ripe until the U.S. Trustee had exercised his authority to appoint a trustee *or trustees* for the several cases, and denied it without prejudice.

inconsistent with the obligations of a fiduciary steward of the estates.

DISCUSSION[15]

I. Introduction

A. The Ritchie Parties' Perceived Stakes, and Their Motives as Objectors

Before launching into the analysis, it is important to note one thing: the Ritchie Parties do not come forward as neutral, distanced friends of the abstract value of integrity in the administration of bankruptcy estates, as their rhetorical rectitude would suggest. Rather, they project a powerful self-interest onto the strategic plane. Identifying the elements of their self-interest does much to illuminate the predicates of their objection.

For the great majority of their claim, the Ritchie Parties assert the status of contractual creditors to which PGW alone was indebted. As such, they maintain, they are entitled to a pro rata share of the estate of that Debtor alone. More specifically, they insist that they must not be forced to share with claimants that had been in contractual privity with PCI or its subsidiaries--whether that sharing were to be forced via substantive consolidation of the bankruptcy estates or by other means.

This could be a matter of some magnitude. PGW apparently was Tom Petters's holding company for subsidiaries that maintained ongoing operating businesses. At least some of those operating businesses had substantial assets of real value when PGW was put into bankruptcy. On the other hand, PCI has been portrayed as his holding company for "single purpose entities," corporations formed to handle one-time acquisitions of large lots of high-ticket consumer merchandise or other goods, each one procuring the attendant financing in its own right. At least from Kelley's early investigation, it appears that many of these one-shot companies had neither goods nor money when these bankruptcy cases were commenced, their business deals

[15]In the main, the recitations in this section are conclusions of law. Here and there they will include an additional finding of fact, going to very specific aspects of the procedural backdrop.

unconsummated. The suspicion is that the enabling funds were spirited away into other sectors of Tom Petters's business structure.[16]

One really cannot gainsay the Ritchie Parties for their objection; their exposure is large, rendering high the stakes on their participation in the bankruptcy process.[17]

Thus, the wellspring of the Ritchie Parties' position for their objection stems from their wish to have their claims, or at least the bulk of them, allowed in the case of PGW alone. If this were done, they would share pro rata in a distribution from the one estate that promises to liquidate its debtor's valuable subsidiary companies down to a very substantial corpus to apportion to creditors.[18] The Ritchie Parties fear the alternate scenario, having their claims allowed against the PCI estates; there, the recovery of any significant value for distribution to creditors is uncertain and litigation-dependent. They also oppose the substantive consolidation of the estate of PGW with that of PCI or any of the other Debtors, which they project to greatly dilute their pro rata share of any distribution.

Thus, the Ritchie Parties make their bid for the appointment of a separate trustee for PGW. They envision such an appointee as virtually mandated to resist substantive consolidation, piercing of the corporate veil, cross-allowance of claims, or any other measure that could lead to the reduction of their in-hand distribution. And they clearly believe that a separate trustee would have to do all things possible to box off the Chapter 7 process for PGW from the rest

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[16]So go the allegations, anyway. The alleged parlaying of these single-purpose entities and their related transactions, to the detriment of creditors and the investors that were financing the deals, is the core of the prosecution's theory for the federal criminal charges against Tom Petters and his associates.

[17]The Ritchie Parties are said to have a potential loss of $250,000,000 from their dealings with Tom Petters. This, however, is not the largest potential claim in these cases. Tom Petters's downfall carried another group of Chicago-area hedge funds headed by Lancelot Investors Fund, L.P. into Chapter 7. The trustee in the Lancelot cases, who is now active as a prospective claimant in these cases, estimates the total of his estates' claims here to exceed $1.3 billion.

[18]At this time, it appears that PGW's equity interest in the Polaroid Corporation and its related entities is the principal plum. The debtors in that case-grouping have commenced proceedings to bring about a sale of their assets and business operations under 11 U.S.C. § 363.

of these cases.

On the broader plane of Kelley's own disinterestedness, they project a palpable fear of a different outcome, which they insist could result from Kelley's court-appointed status outside of bankruptcy: the chimera is that as receiver Kelley has the duty to aid the government in any seizure of *all* of the value to be garnered from Tom Petters's business enterprise, via forfeiture or ancillary to a restitution process in the criminal case(s), with all that potentially going to those holding the status of "victims" within the meaning of the criminal law, and none going to any party in the status of "creditor" under the bankruptcy laws. They see this ostensible obligation as subordinating the fiduciary duty imposed by a trustee status in Kelley's administration; and this, they say, would leave creditors of the various Debtors unsatisfied on their claims, or undersatisfied as compared to their expectancy through a bankruptcy process.

B. The Ritchie Parties' Goals, as to Trustee Appointment

The Ritchie Parties' two distinct fears stream into the two separate thrusts of their legal theory. On the one hand, they propound an "external conflict" on Kelley's part, a circumstance arising outside the structure of these bankruptcy cases. They argue that this conflict would bar him from serving as trustee for *any* of the Debtors. On the other, they allege an "internal conflict," one arising from factors internal to the bankruptcy processes for these Debtors.[19] This one, they say, bars Kelley or any other one person from serving as trustee simultaneously for all of the Debtors. They insist that the bankruptcy estate of PGW must have its own trustee, a person other than the trustee to be appointed for the estates of PCI and the other Debtors.

In their broader attack, the Ritchie Parties would have the Court nullify the appointment of Kelley across the board, leaving it for the U.S. Trustee to appoint at least two other persons as trustees within this grouping of cases. As a fallback, though, they state that "one for

[19]The terms "external conflict" and "internal conflict" are the Court's own, coined as shorthand. They are not legal terms of art.

PGW"--i.e., a separate trustee for that Debtor in the person of someone other than Kelley--"would be fine for us," with the U.S. Trustee's appointment of Kelley for the remaining cases to be left intact.[20]

II. Analysis

A. The Allegation of an External Conflict: 11 U.S.C. §§ 1104(d) and 101(14)(C)

In the Ritchie Parties' view, Kelley's pre-petition status as a court-appointed receiver for Tom Petters and the whole range of business entities owned or controlled by him, a circumstance pre-dating the bankruptcy filings and persisting in some way since then, prevents him from qualifying as trustee for any of the Debtors.

The Ritchie Parties build out this theory on the requirement of 11 U.S.C. § 1104(d), that any trustee appointed post-petition for these cases be a "disinterested person."[21] The Bankruptcy Code defines the term "disinterested person," in pertinent part, as ". . . a person that--

> . . .
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason . . .

11 U.S.C. § 101(14)(C).[22]

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[20]It was not clear from the Ritchie Parties' briefing whether they would acquiesce to such a result. At the end of the first round of oral argument, their counsel acknowledged that they would, using the quoted wording.

[21]11 U.S.C. § 1104(d) governs the process of trustee appointment in a Chapter 11 case, after the court has ordered the U.S. Trustee to appoint one. In pertinent part, it reads:

> If the court orders the appointment of a trustee, . . . then the United States trustee, after consultation with parties in interest, shall appoint, subject to the court's approval, one disinterested person other than the United States trustee to serve as trustee . . . in the case.

[22]Another portion of this definition bars the status of "disinterested person" to a creditor, an equity security holder, or an insider of the debtor in the bankruptcy case. 11 U.S.C. § 101(14)(A). In addition, a person who "is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor" may be a "disinterested person," 11 U.S.C. § 101(14)(B), which means that a person who did have that status is not a "disinterested person." Neither of these exclusions is

The Ritchie Parties insist that Kelley's charge and role under the District Court's receivership orders give him an "interest materially adverse" to a substantial class of parties in interest to these cases. They define those parties as the claimants whose claims would stem from a status of "contractual creditors" of one or more of the Debtors, in particular of PGW--trade creditors that supplied goods or services to enable the maintenance of the Debtors' business operations, and at least some lenders of money to specific Debtors. They distinguish this class of parties from those whom they call "victims." They define the latter as those "investors" who "provid[ed] funds for, and financing to," the Debtors and other entities in the Petters structure, and were induced to do so by fraud on the part of Tom Petters or others.[23]

Per the Ritchie Parties, the material adversity to the former class would arise from the directive to Kelley under Term IV.B.6. of the December 8, 2008 order, to "[c]oordinate with representatives of the United States Attorney's office and Court personnel as needed *to ensure that any assets* [garnered and administered by Kelley as Receiver] *are available for* criminal restitution, forfeiture, or other legal remedies in proceedings commenced by or on behalf of the United States . . ." (emphasis added).

The Ritchie Parties rely entirely on the operative verbs here, "coordinate" and "ensure," coupled with the static notion of receivership assets being "available for criminal restitution, forfeiture, or other legal remedies" that the government may seek from the District Court. From those words, they extrapolate that Kelley is:

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material to the controversy at bar.

[23]The objection's nomenclature is somewhat confusing, if one thinks about it. Under the criterion that the Ritchie Parties propose for defining "victim" status, the lending of money, a "victim's" claim would have its genesis in contract no less than a trade creditor's would. And since lenders of money would be members of both of the classes that the Ritchie Parties posit, the genesis of the claim in a loan does not, in itself, make a distinction. The thought behind the assumed dichotomy is never made all that clear; perhaps it would have been better-served had the Ritchie Parties identified the class of opposed interests as "victims of PCI." Ultimately, this point is not important; but it does reinforce the impression of a somewhat overwrought tendentiousness to the objection.

1. ". . . obligated to assist the government with forfeiture . . .";

2. ". . . charged with seeking redress for the victims of [Tom] Petters's fraud . . ."; and

3. ". . . expressly commanded to make [the] Debtors' assets available for, and thus not to oppose, any forfeiture or other action by the United States on behalf of victims . . ."[24]

In further shadings and extensions of the same accusation, they insist that:

4. Kelley's charge is to "maximize the assets of the receivership" and "in essence to help the United States build its case" for forfeiture;

5. Kelley's "job" is "to put a context around those assets [i.e., those he would recover on account of the past business dealings of PCI and PGW] to bring them into the receivership estates";

6. there is "active assistance in what is going on," as between Kelley's performance as receiver and the government as prosecutor, and "a cooperative element that is going on . . .";

7. the United States, in its role as prosecutor, "is the major party to the receivership," which "at the end of the day" will "make some claim to the assets of the receivership"; and

8. "a tenor of the [receivership] order . . . clearly requires" Kelley "to assist the United States."[25]

Under this characterization of Kelley's duties as receiver, the Ritchie Parties argue that "real and immediate conflicts [would] arise with respect to Kelley's dual roles as Receiver and Trustee," giving him "an interest materially adverse" that prevents him from being disinterested as the statute requires.

There are several reasons why this argument is wrong.

First, it does not recognize the applicable statutory language. Section 101(14)(C)

[24]These are all quotations from the Ritchie Parties' briefing.

[25]These are all direct quotations or very close paraphrasings from the oral argument made by counsel.

uses the verb "have," a word that denotes possession, in a personal capacity. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE UNABRIDGED 1039 (2002 ed.) (defining "have" as, *inter alia*, "to hold, keep, or retain especially in one's use, service, regard, or affection or at one's disposal . . ."). In construing § 101(14)(C), the Third Circuit Court of Appeals found that Congress's choice of this language was intentional; in the Third Circuit's view, the choice of verb narrowed the source of disqualification to adverse interests held by a prospective trustee *personally*, and did not extend to interests to which the trustee had the relationship of *representative*. *In re BH & P, Inc.*, 949 F.2d 1300, 1310 n.12 and 1311 (3d Cir. 1991).[26] The Third Circuit's parsing of statutory language and conceptual structure is lengthy and careful. It supports the rejection of the Ritchie Parties' argument here, at a very basic level: in his status as Receiver, Kelley does not "have" an interest of *any* sort that is even cognizable under § 101(14)(C), and hence he is not deprived of the disinterestedness that is required of a trustee for any of the Debtors.

This conclusion is based on somewhat abstract considerations, as to an issue that is not very developed in the case law. One can envision arguments against it.[27] But even if one were to recognize Kelley as "having" an interest of some sort via his receivership, the structure of his past relationship in that capacity with the Debtors now in bankruptcy is simply not the one that

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[26]The Third Circuit recognized the distinction between the text of § 101(14)(C) and that of 11 U.S.C. § 327(a). The latter bars anyone who "hold[s] *or represent[s]* an interest adverse to the estate" from serving as a professional person for the estate. 949 F.2d at 1310 n.12 (emphasis added to quotation of statutory text). In an unspoken fashion, the Ritchie Parties' theory conflates the sense of these two statutes, which depart from one another based on the verbs used in their text. *BH & P* involved the question of whether one person appointed as trustee for all of the related Chapter 7 cases of a corporation and its two individual principals could be a "disinterested person" within the definition of § 101(14), when there were claims cross-running between the estates. The *BH & P* ruling was expressly directed toward the situation of "multiple debtors served by a single trustee," 949 F.2d at 1310, where the potentially-conflicting "interests" were all subject exclusively to a bankruptcy process. This configuration was different from the one at bar. However, the statutory text is the statutory text; it does not draw a distinction between the two configurations, or give any support to a refinement of the *BH & P* construction; and thus the Third Circuit's analysis should apply to the situation at bar.

[27]For instance, the closing words of § 101(14)(C) broaden the *source* of a materially-adverse interest to "any direct or indirect relationship to, [or] connection with . . . the debtor." That could support a reading of the verb "have" beyond the denotation of ownership or possession in a personal capacity.

the Ritchie Parties impute in such florid fashion.

Under the objection, the implication is that Kelley, under his charge as Receiver from the District Court, is inescapably bound to any future election by the government to seize all of the assets of the whole Petters enterprise through the processes of the criminal cases. As the Ritchie Parties would have it, Kelley is not only beholden, virtually as a cat's paw, to assemble and ready these assets for that end, and that end only; he must also actively assist the government in preparing a case at law for the forfeiture or diversion of the assets through the restitution process.

This simply is not supported by the boundaries drawn by the statute under which Kelley's receivership was created, or by the scope and nature of the authority that Kelley has, as a receiver who is an officer of the District Court.[28] The statute, quoted *supra* at n.8, contemplates the appointment of a receiver only for the administration of injunctive relief against the further disposition of assets that are implicated in banking law violations. *Cf. Aviation Supply Corp. v. R.S.B.I. Aerospace, Inc.*, 999 F.2d 314, 316-317 (8th Cir. 1993) (listing comparable considerations for appointment of receiver in federal case under diversity jurisdiction). Its language does not contemplate any advocacy role for the receiver in determining and effectuating a legally-proper, final disposition of such assets.

As to the specific incidents of a receiver's powers and mission, the district court's order is the sole source from which the scope of the authority is to be determined. *Liberte Capital Group, LLC v. Capwill*, 462 F.3d 543, 551 (6th Cir. 2006) ("As an officer of the court, the receiver's powers are coextensive with his order of appointment . . ."); *Resolution Trust Corp. v. Bayside Developers*, 43 F.3d 1230, 1241 n.8 (9th Cir. 1994). *See also* 13 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 66.03[2] (3d ed. 2007) ("The district court that appoints the receiver establishes the extent of the receiver's authority . . ."). The terms of Judge Montgomery's receivership orders,

[28] *See* 13 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 66.03[2] (3d ed. 2007) (receiver is officer of the court presiding over litigation that concerns property entrusted to receiver).

even in the most involved version entered on December 8, 2008, do *not* vest Kelley with any "interest" at all, let alone one that is coeval with those of the United States or aligned with them. The terms do not charge him with protecting or advancing the interests of the United States. They do not obligate him to work in consort with the federal prosecutors in any degree, to advance any strategy on the government's part.

Rather, the directives to Kelley are unadorned. They mandate him to take control of those assets that were immediately accessible to him after the appointment; to recover further liquid value via collection on rights to payment, sale of assets, or management of income streams; to manage all such acquests to preserve their value; and if warranted, to use the bankruptcy process for eligible Petters-related entities to further those basic missions. After that, the only duty imposed on Kelley from the face of the receivership orders, is to "hold in place," to keep the assets secure pending their ultimate disposition via separate court proceedings.[29]

There is nothing more than that to be read into the duty to "coordinate" with the United States Attorney. The verb here is not loaded with any meaning suggestive of a current, joint action toward government seizure. The notion of having the assets in Kelley's hands "available for criminal restitution, forfeiture," and the like signifies a duty to fully disclose their form and whereabouts and to maintain current liquidity, but only that. This reflects the transparency that our legal system makes incumbent on any entrusted officer of a court, in the performance of obligations *to the appointing court*. It reflects no more than that.

This conclusion is reinforced by the fact that the District Court, as an institution, has

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[29]Per local media reports, Kelley has been making disbursements of various sorts from receivership assets, to pay maintenance-related expenses personal to Tom Petters and his dependents, and toward the cost of his criminal defense. The record at bar has no content that goes to this, but it appears that these expenditures have been made out of assets traceable to Tom Petters in his individual capacity. Per the statements of bankruptcy counsel, Kelley has, with the District Court's authorization, used funds from the receivership over Tom Petters individually, i.e., moneys derived from assets titled in him, to meet the initial administrative expenses for PGW's bankruptcy case. These details are not relevant to the dispute at bar; they are mentioned only to qualify the reference to the Receiver's duty to "hold in place," and to specify that it applies to asset-value net of the operation of the receivership.

no inherent stake in the disposition of the assets in the way that a party would. It acted in furtherance of the general public interest in mitigating further losses to innocent parties, and in maintaining a status quo during the pendency of litigation, in light of accusations of wrongdoing as large and systemic as those made against Tom Petters.[30] It acted on motion of the United States Department of Justice, an agency of the Executive Branch. But the creation of the receivership made the receiver's control over its subject matter chargeable to the court, an institution of the Judicial Branch, with the receiver responsible to the court alone.

On its face, the order fixing Kelley's duties as Receiver did not vest him with any interest aligned with the United States, nor mandate any action on his part that would make him its servant, agent, or ally.

That analysis goes to Kelley's past status as Receiver, and to any continuing, active duty he would have in the status of Receiver, in relation to the Debtors and their assets. The question now is whether he would even have such a duty going forward were he to assume the status of trustee. The answer to this is not as perfunctory as the U.S. Trustee and the Petters Committee urge, that Kelley's legally-seated role and status as Receiver "terminated by operation of law" as soon as the Debtors filed their bankruptcy petitions. The U.S. Trustee has cited no on-point authority for that proposition.[31] Judge Montgomery's order does not expressly terminate the

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[30]In a footnote-aside in the Ritchie Parties' brief, counsel referred to the District Court's nomination of Kelley as its agent, "accountable directly to the Court," and then made its prediction of the consequence of approving Kelley's appointment as trustee:

> Thus, with respect to any given action, Kelly must answer not only to [the bankruptcy] court and the creditors, but also to the District Court--a circumstance rife with likely conflicts.

As baleful and portentous as this verbiage sounds, it is so vague that it has no place in an argument that is to be structured under legal principles.

[31]The one case cited, *In re 400 Madison Ave. Ltd. P'ship*, 213 B.R. 888 (Bankr. S.D.N.Y. 1997), does not stand for the proposition noted. Its holding, essentially, is that there is no place for the role, status, or function of a receiver within the bankruptcy case, that "the receiver has absolutely no responsibility . . . to perform any other duties which are the prerogative and burden of a debtor-in-possession and a trustee." 213 B.R. at 894-895.

receivership over any of the Debtors upon the filing of a bankruptcy petition.

And, the urged result simply does not fit into the structure of the Bankruptcy Code. The Code contains no provision for the termination of the *status* of a pre-petition receiver upon the filing of a bankruptcy petition that entails the assets subject to the receivership, either automatically or on court order. More to the point, if a receiver's *appointment* were terminated automatically upon bankruptcy, there would be no warrant for the statutory prohibition of a receiver making post-petition disbursement from the property of the debtor, 11 U.S.C. § 543(a), nor a need for the statutory obligations to turn over to the trustee in bankruptcy all property of the debtor, 11 U.S.C. § 543(b)(1), and to file an accounting of such property that, "*at any time*, came into the possession, custody, or control" of the receiver, 11 U.S.C. § 543(b)(2) (emphasis added). Finally, by empowering the bankruptcy court to excuse a receiver from the duty of turnover under § 543(b)(1), but not mandating it to do so, the Code expressly countenances the possibility of a receiver both retaining its legal commission post-bankruptcy, and continuing to exercise it. 11 U.S.C. § 543(d)(1).

However, the individualized legal governance for this Receiver and prospective trustee, as established by the District Court's orders, will achieve something equivalent, once Kelley performs under that governance as he has promised.

With the input of bankruptcy counsel for the Debtors, the District Court clarified in the order of December 8, 2008, that these Chapter 11 cases will go ahead fully governed by the substantive law of bankruptcy. Under the configuration of assets and business operations, that governance necessarily entails the turnover of all property of the Debtors to the control of the steward contemplated by bankruptcy law--in this instance, a trustee in the person of Kelley. Such a turnover has not yet been formally evidenced of record in this case, not the least because the

legal posture for such a steward has been anomalous.[32] But to fully harmonize the status, a turnover can now be effected, and hence will be ordered as a condition of approving the appointment.

Through the representations of bankruptcy counsel, Kelley has committed to proceeding with the administration of the estates in these cases in accordance with the values and priorities of bankruptcy law. Kelley acknowledges that this will entail maximizing the value of all assets collected, and then distributing them to the holders of all allowed claims against the Debtors, pursuant to statutory priorities and *pro rata* if necessary, all as the Bankruptcy Code envisions.[33] Addressing the concern most loudly and persistently raised by the Ritchie Parties, Kelley now has committed on the record to resisting any effort by the United States to seize the assets of these Debtors' estates through remedies ancillary to the criminal process, at least until there is a residuum-surplus remaining after satisfaction of all claims through the vehicle of these cases, in accordance with bankruptcy law. And, as the U.S. Trustee points out, the law governing any forfeiture proceeding that might be commenced upon the conviction of PCI or PGW will give Kelley,

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[32]Judges in at least one district court--for the Southern District of New York--have found no anomaly in equating a person who had been the pre-bankruptcy receiver of a company, appointed as such by a federal court, with a managing officer who would be empowered to carry out the duties of a debtor-in-possession, where the receiver had been court-authorized to file a petition under Chapter 11 for the company and the order of appointment had provided for the subject individual to "be deemed a debtor-in-possession for [the company] in proceedings under Chapter 11 . . ." *In re Bayou Group, L.L.C.*, 363 B.R. 674, 680 (S.D.N.Y. 2007). *See also S.E.C. v. Byers*, ___ F.Supp.2d ___, 2008 WL 5236644 (S.D.N.Y. Dec. 17, 2008). But, per n.3 *supra*, there are colorable arguments to the contrary, based on the Code's text and the legislative history for its 1978 enactment. At oral argument, counsel for the U.S. Trustee advised that the *Bayou Group* ruling had been appealed to the Second Circuit.

[33]The provision in the District Court's December 8, 2008 order for these cases being governed by the Bankruptcy Code would require him to follow through as trustee in that way, regardless; but the layering of his personal recognition makes it a matter of his volition as well as court mandate and automatic operation of statute. Since Kelley's performance will be governed by the Code's regulatory structure for trustees, this takes care of the Ritchie Parties' concern over the District Court's grant of judicial immunity to him. That was there, this is here.

as trustee, a forum to advocate for the bankruptcy estates' interests in the subject property.[34]

Kelley can do no more than state this commitment at this point, and of course he can not guarantee that court-ordered forfeiture or a seizure through restitution will not pluck the assets out of the bankruptcy estates. That will be a matter for Judge Montgomery or another district judge to determine, when and if the government pursues those remedies. But through the statements made by his counsel here, he has committed to advocate for the bankruptcy process in such proceedings, essentially "bankruptcy first, forfeiture or restitution for the balance," i.e., the residual equity value of the components of Tom Petters's enterprise.

So, once Kelley's appointment is approved and he formally effects a turnover, the two predicates for the Ritchie Parties' assertion of an "external conflict" will be vitiated or extinguished. In the abstract, there may still be a gossamer remnant of Kelley's status as Receiver, unless Judge Montgomery formally terminates it over these Debtors.[35] But the assets of these Debtors will no longer be subject to administration through the receivership; they will be committed to the bankruptcy process, and absent the override of court-ordered forfeiture or a restitution process, their value first will be funneled through bankruptcy to the holders of allowed claims.

In sum, then, Kelley's past status as trustee does not make him not disinterested so as to bar his appointment as trustee for these cases. Any such status he may technically retain after a full effectuation of his appointment as trustee will not do so either. The "external conflict"

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[34]The conviction of the owner of the assets is a prerequisite for the commencement of criminal-forfeiture proceedings; criminal-forfeiture proceedings result in an *in personam* order against the defendant. *United States v. Vampire Nation*, 451 F.3d 189, 202 (3d Cir. 2006); *United States v. Lazarenko*, 476 F.3d 642, 647 (9th Cir. 2007). Once an order of forfeiture is entered, third parties that assert an interest in the defendant's assets may assert them in an ancillary proceeding under 21 U.S.C. §§ 853(k) and 853(n). *United States v. Puig*, 419 F.3d 700, 703 (8th Cir. 2005). The ancillary proceeding is the forum through which third parties may obtain an adjudication of their interests in the property, so that those interests may be protected from the forfeiture of the defendant's interests. *United States v. Totaro*, 345 F.3d 989, 993-994 (8th Cir. 2003). This clearly would give Kelley a forum to assert that only the residual equity interest of Tom Petters or any convicted corporate defendant should be subject to forfeiture, after all allowed creditors' claims had been satisfied through the bankruptcy process.

[35]Such a measure would, of course, be a matter for the District Court alone.

urged by the Ritchie Parties is not a ground for disapproving the United States Trustee's appointment.

B. The Allegation of an Internal Conflict: FED. R. BANKR. P. 2009

In the alternative, the Ritchie Parties point to circumstances internal to the bankruptcy process for these Debtors: the positioning in a grouping of jointly-administered bankruptcy cases, of a number of closely-tied business entities that apparently engaged in numerous inter-company transfers and transactions pre-petition, and the U.S. Trustee's action in appointing the same person as the trustee for the estates in all of the cases. The Ritchie Parties focus on the appointment of the same person as trustee for the estates of PCI and PGW; they insist that "serving in both roles . . . results in a conflict of interest," and that "[t]he substantial differences between PGW and PCI and the other Debtors lie at the heart of the conflict."

FED. R. BANKR. P. 2009(c) contemplated the United States Trustee making an appointment in the way he did:

> (c) **Appointment of trustees for estates being jointly administered**
>
> . . .
>
> (2) **Chapter 11 reorganization cases**
>
> If the appointment of a trustee is ordered, the United States trustee may appoint one or more trustees for estates being jointly administered in chapter 11 cases.

In turn, FED. R. BANKR. P. 2009(d) addresses and provides guidance for the dispute at bar:

> (d) **Potential conflicts of interest**
>
> On a showing that creditors or equity security holders of the different estates will be prejudiced by conflicts of interest of a common trustee who has been elected or appointed, the court shall order the selection of separate trustees for estates being jointly administered.

The Ritchie Parties divine a conflict of interest from the following reasoning:

> PGW is a distinct legal entity with a creditor constituency that is separate and distinct from the creditor constituency of PCI and each of the other Debtors. It appears that, while many of Petters's victims had a contractual relationship with PCI and its subsidiaries, very few of them also had a contractual relationship with PGW. These circumstances produced the different creditor constituencies for PGW and PCI, and those constituencies have diametrically opposed interests given the dramatically different financial circumstances of PGW and PCI.

They prognosticate that PGW's estate, having "substantial operating assets, such as Polaroid and Fingerhut, . . . with potentially considerable value," will likely be in the money, generating a significant distribution to creditors. Their forecast for the PCI-related cases is greatly different: their debtor-entities having "little or no assets of value" pre-petition, their administration in bankruptcy will generate much less in liquidation for distribution to the parties that advanced money to finance the revolving transactions in consumer merchandise that Tom Petters purveyed through PCI's single-purpose corporate subsidiaries. Apparently, those that did such financing toward the end of PCI's operations, without seeing the merchandise-sale transactions close so as to enable repayment of their loans, are to be considered the "victims" of the Ritchie Parties' nomenclature. The Ritchie Parties would distinguish these claimants from the "creditors" of PGW--among which the Ritchie Parties place themselves.

Beyond that, the Ritchie Parties allege that the PGW estate and those of PCI and its Debtor-subsidiaries could find themselves in actual opposition, if the forensic-accounting reconstruction of the Petters enterprise's affairs reveals avoidable transfers between related debtor-entities via the broad-scaled commingling that Tom Petters is alleged to have transacted. Citing the result in *In re BH & P, Inc.*, 949 F.2d at 1313-1314, they argue that the possibility of such faceoffs prevents the appointment of a single trustee here.

In arguing this, the Ritchie Parties assert the status and standing of creditors of PGW alone. The proponents of Kelley's appointment maintain that the situation is not as clear-cut as

that. They point out that PCI, through a wire transfer to its own bank account, received at least one of the substantial advances that the Ritchie Parties made to Tom Petters's enterprise at his request, and that this and other evidence could bind the Ritchie Parties into the administration of the estates of PCI and its debtor-subsidiaries, as creditors there.[36] And, in briefing and at oral argument, the proponents of Kelley's appointment started quite a fracas over the Ritchie Parties' about-face from their position in the Illinois state court; there, they had sought the appointment of one person as receiver for both PCI and PGW, and they got him empowered to do just about anything he chose with both companies, with little court oversight imposed by the terms of the order of appointment.

None of the parties who raised these potential blocks specified where they were relevant to the legal analysis. Perhaps they were intended as a challenge to the Ritchie Parties' standing to argue this sort of conflict. Perhaps they were just an effort to discredit and delegitimize the Ritchie Parties' arguments generally, in a connotative sense. One can lay these points to the side where they belong, however. This prong of the Ritchie Parties' objection should be overruled, on its merits, under the present posture of these cases.

First, it should be noted that the issue of disqualification of a trustee from serving as to all of the estates of related debtors is to "be evaluated prospectively on a case-by-case basis"; and the determination is committed to the bankruptcy court's discretion. *In re BH & P, Inc.*, 949 F.2d at 1313.

Second, in ascertaining the existence of *disqualifying* conflicts, "horrible imaginings alone cannot be allowed to carry the day." *Id*. (quoting *In re Martin*, 817 F.2d 175, 183 (1st Cir. 1987); interior quotes omitted). Rather, given the governance of Rule 2009(d), the question is

[36]They also note that two of the counts of the criminal indictment are based on allegedly-fraudulent transactions by PGW subsidiaries, resulting in PGW being criminally charged under the umbrella of conspiracy. And this, they say, further erodes the Ritchie Parties' demand that the bankruptcy process for PGW must be quarantined from the administration of the PCI-related estates, on the alleged ground that the two major parts of Tom Petters's enterprise were free-standing and fraudulent activity was purveyed through the PCI structure alone.

whether creditors will actually be prejudiced by any conflicts of interest that are inherent in the posturing of jointly-administered estates.[37]

This inquiry is more concrete, and that is entirely appropriate. Rule 2009(c)(2) clearly recognizes the considerations that can support the appointment of a single trustee for related cases: economy; the focusing of expertise; the advantage of building familiarity with complex facts and relationships; efficiency in considering and acting in administration; and greater ease in presenting common disputes to the court. There is also the valid goal of avoiding inconsistent approaches to common problems and the lessening of contradictory outcomes in administrative action. Given the greater probability of pre-petition commingling and the like, as among related debtors, Rule 2009(d) makes no bones about it: joint administration will probably entail some conflicts of interest among the estates, at least in the abstract. The real issue is whether the conflicts bode actual and particularized prejudice--real detriment--to the creditors of one of the debtors, or to a particular creditor-constituency of one of the debtors, as the estates go through administration under the control of a single person, and that administration passes through the procedural and substantive permutations that that one person elects.

To their credit, the proponents of Kelley's appointment do not try to bluster their way around the prospect that such prejudice could emerge. Where two or more jointly-administered estates have cross-running claims, where they have competing claims against particular assets, where related debtors had engaged in inter-company transfers, or where related debtors have cross-pledged assets on debt to third parties, conflicting interests may ripen. It could happen at different stages--for instance, through a proposal for substantive consolidation of estates, where a creditor's expectancy of a particular pro rata distribution from the estate of one could be diluted by a forced sharing with creditors of a related entity. It might not emerge until a proposed

[37]The *BH & P* opinion does not mention Rule 2009(d), which was on the books in 1991, with a text nearly identical to today's. But, clearly, the rule speaks directly to the problem at bar.

distribution of the liquidated value of one debtor in tandem with that of others, whether there had been a substantive consolidation or not. It could come from a trustee's decision to invoke or forgo available bankruptcy remedies for one estate against another, or against third parties. At this early stage of the cases at bar, one cannot deny any of these possibilities out of hand.

But on the other hand, the characteristics of these cases and their backdrop cannot be ignored: multiple pending, major criminal prosecutions against key management personnel of the Debtors; the sheer magnitude of the sums of money in question; the present indeterminacy of what happened to build and then fell the edifice of Tom Petters's enterprise; and the large complexities that must be coordinated to responsibly propel bankruptcy procedures forward. These circumstances powerfully support the concentration of attention and effort into one fiduciary steward, at this time and for a while to come. Kelley has gone up an immensely steep learning curve in the last five months; he has had to amass knowledge, and analyze it with his professional persons; he is making use of that to recover assets, via legal proceedings and otherwise.

Given the intensity of his own investment of attention to these cases, there is no argument on the considerations of economy and efficiency to be made against appointing Kelley, and him alone, as trustee.[38] Appointing anyone else at this time would entail a two-staged duplication of effort, with a second trustee getting up to speed and the two then going forward on parallel tracks. The significant extra transactional expense to bring a second trustee into the process would be massive, particularly if that trustee were to hire a second group of attorneys and financial analysts. The evaluation of respective options, the determination of whether to coordinate or to go off in opposition, and so forth would cause delay in pursuing recovery of assets or prosecuting causes of action. The Ritchie Parties have not even made a squawk about economy

[38]It has long been recognized that economy is a proper consideration in the matter of appointing one trustee in jointly-administered cases. *In re Int'l Oil Co.*, 427 F.2d 186, 187 (2d Cir. 1970) (per curiam) (decided under Bankruptcy Act of 1898); *In re Ben Franklin Retail Stores, Inc.*, 214 B.R. 852, 859 (Bankr. N.D. Ill. 1997).

or efficiency supporting or ultimately vindicating the appointment of a second trustee, and there is no credible way they can.

At this point, the issue of prejudice under the meaning of Rule 2009(d) is readily answered, and largely by the nature of the large tasks that have only been started. As described at the hearing, Kelley and his professional persons see their work cut out for an extended period, most likely a year or more. As described, their plan does not entail any action or process that would pit the distribution rights of PGW's creditors directly against those of the creditors of any of the other Debtors, until most or all recoverable assets have been garnered in. The first mission of a trustee for these cases is to recover as much value as possible in liquid form, from where it reposed in the Debtors' ownership or from third parties now obligated to account to the bankruptcy estates. After that, the trustee will have to get the legal status of encumbrances against that value ascertained, by stipulation or adjudication. The Ritchie Parties have not identified any aspect of these tasks, administrative in nature or legally-oriented, that would present a trustee with cross-running allegiances.

After the recovery and assemblage of the estates' due, the next phase of administration would begin. At that point, a trustee's pursuit of claims cross-running between the estates, or the potential dilution of a realization via substantive consolidation, could raise the prospect of disqualifying prejudice. However, the issue could arise only then, and only then would it get focused.

At that time, there would be several different means to resolve the issue of prejudice-causing conflicts among the estates. Kelley himself and the Debtors' counsel have pledged to take action, i.e., to seek appointment of a second trustee or to bring the issue to the court, if they see conflicts-in-the-abstract ripening to untenable. The Ritchie Parties have not said that they trust the Trustee to be responsible in this regard, and they have not said that they don't. But in any event they can renew their motion, after a cash-bearing estate has been assembled and at a time when

investigation has made the alignments clearer and more concrete. They could renew their motion if Kelley forgoes pursuing a particular claim or cause of action, that bodes actual prejudice to their participation in these cases, and he does not respond to their expressed concerns. At such time, they will receive the judicial attention that the situation deserves, when real focus will be possible.

And in any event, any party that fears prejudice to its interests will have due process before the prejudice ripens to actual detriment, for many of the foreseeable administrative acts.[39] Substantive consolidation is a court-granted remedy that requires a substantial record going to multiple factors, *In re Giller*, 962 F.2d 796, 799 (8th Cir. 1992), and as to which the abiding consideration is "fairness to all creditors," *F.D.I.C. v. Colonial Realty Co.*, 966 F.2d 57, 61 (2d Cir. 1992).[40] Proposals to abandon estate assets, such as pre-petition causes of action, must come before the court by motion in a Chapter 11 case. LOC. R. BANKR. P. (D. Minn.) 6007-1 and 6004-1(e). In a Chapter 11 case, settlements of avoidance actions or rights of action require court approval, obtained only on motion. LOC. R. BANKR. P. (D. Minn.) 9019-1(a) and 6004-1(e). All of these vehicles give an opportunity for objection to any creditor that sees prejudice to its interests from a particular administrative action by a single trustee for multiple estates.

The structure of Rule 2009(d) imposes a burden of proof on the party that asserts disqualifying prejudice--both a burden of production of evidence if the existence of the prejudice is fact-dependent, and a burden of persuasion if the arguments pro and con are in equipoise. The Ritchie Parties have not carried that burden; they have not made a prima facie showing that, at present, their interests, or the interests of the creditors of any particular debtor, are actually prejudiced at present by the existence of conflicts of interest that arise out of the configuration of

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[39]"The election or appointment of a [single] trustee [in jointly-administered cases] does not alter substantive rights of creditors or change the character of the estate." *In re Ben Franklin Retail Stores, Inc.*, 214 B.R. at 857.

[40]One court has gone so far as to opine that "[s]ubstantive consolidation should be invoked 'sparingly' where any creditor or debtor objects to its use." *In re Reider*, 31 F.3d 1102, 1109 (11th Cir. 1994).

the Debtors' rights against each other, pre- or post-petition. At this time, there is no "internal conflict" that prevents Kelley from serving as trustee for all of the Debtors, pursuant to the U.S. Trustee's appointment. And, because Rules 2009(c)(2) and 2009(d) do not require the determination on prejudice to be made once and for always, any party in interest may seek judicial relief if Kelley and his attorneys do not acknowledge when future developments in his administration create and focus such prejudice. If appropriate, that relief could include a directive for the appointment of a second trustee.

OUTCOME

The Ritchie Parties' objection must be overruled, and the U.S. Trustee's appointment will be approved, subject to the one condition previously-identified.

ORDER

On the decision just memorialized,

IT IS HEREBY ORDERED:

1. The objection of Ritchie Special Credit Investments, Ltd., to the U.S. Trustee's appointment of a trustee for these cases is overruled.

2. The U.S. Trustee's appointment of Douglas A. Kelley, Esq., as trustee for all of the Debtors in these jointly-administered cases, is approved.

3. Douglas A. Kelley, Esq., shall, forthwith:

   a. meet all requirements set by the U.S. Trustee for his appointment of the status of trustee, including the posting of a bond; and

   b. in his status as Receiver appointed by the United States District Court for the District of Minnesota, execute and file an appropriate document memorializing his turnover of all of the assets of the Debtors' bankruptcy estates to the appointed trustee.

BY THE COURT:

/e/ Gregory F. Kishel

GREGORY F. KISHEL
UNITED STATES BANKRUPTCY JUDGE