UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION
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In re: Chapter 11

PALM BEACH FINANCE PARTNERS, L.P., a Delaware limited partnership, *et al.*,[1]

Case No. 09-36379-BKC-PGH

Jointly Administered

Debtors.
_____________________________________/

JOINDER OF GEOFF VARGA, AS JOINT OFFICIAL LIQUIDATOR FOR PALM BEACH OFFSHORE LIMITED AND PALM BEACH OFFSHORE II LIMITED TO UNITED STATES TRUSTEE'S MOTION TO CONVERT CASES TO CASES UNDER CHAPTER 7 OR, IN THE ALTERNATIVE, MOTION TO APPOINT CHAPTER 11 TRUSTEE
(Hearing on U.S. Trustee's Motion to Convert Set for 9:30 a.m. on December 17, 2009)

Geoff Varga, in his capacity as court-appointed Liquidator ("Liquidator") of Palm Beach Offshore Limited and Palm Beach Offshore II Limited, by and through his undersigned counsel, hereby files this Joinder (the "Joinder") to the United States Trustee's Motion to Convert Cases to Cases Under Chapter 7 or, in the Alternative, Motion to Appoint Chapter 11 Trustee and Request for Expedited Hearing (the "Motion to Convert") [D.E. 34][2], and in support thereof, states as follows:

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[1] The address and last four digits of the taxpayer identification number for each of the Debtors follows in parenthesis: (i) Palm Beach Finance Partners, L.P., 3601 PGA Blvd, Suite 301, Palm Beach Gardens, FL 33410 (TIN 9943); and (ii) Palm Beach Finance II, L.P., 3601 PGA Blvd, Suite 301, Palm Beach Gardens, FL 33410 (TIN 0680).

[2] The Liquidator generally adopts the factual allegations contained in the Motion to Convert but notes that the Liquidator seeks in excess of $723,229,260.50 in its action against the Debtors and others in the Superior Court for the State of Delaware. *See* Motion to Convert p. 3.

PRELIMINARY STATEMENT

1. The Liquidator represents the interests of Palm Beach Offshore Limited and Palm Beach Offshore II Limited (collectively, the "Offshore Funds"), which are the largest unsecured creditors of the Debtors.

2. The Debtors received loans and investments from various parties including the Offshore Funds, which sums were then subsequently directed to Petters Company, Inc., in exchange for notes. Petters Company, Inc. was an entity owned and controlled by Thomas J. Petters who was recently convicted by a federal jury in Minnesota of masterminding a $3.65 billion Ponzi scheme.[3]

3. The Debtors therefore have no business operations, no employees, no tangible assets and no prospects for a reorganization. To date, the only activity in these cases has involved the attempted retention of a group of professionals who are encumbered by a web of irreconcilable conflicts, most of which are rooted in their relationships with a group of the Debtors' limited partners – vaguely referred to in court filings as the "Steering Committees" – who are now in control of the Debtors (although their legal authority to file these cases is open to question).[4] The proposed retention of the professionals illustrates the one dimensional nature of these cases: prosecute claims against third parties to generate funds.

4. There is no need to "manage" debtors who have no business operations (and have had none) and no employees. In fact, the contemplated retention of restructuring professionals

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[3] For information concerning Petters' December 2, 2009, criminal conviction, *see, e.g.*, "*Tom Petters found guilty of Ponzi scheme fraud*" Reuters, Dec. 2, 2009, and Susan Carey, "*Petters Found Guilty of Fraud*" THE WALL STREET JOURNAL, Dec. 2, 2009.

[4] *See* 11 U.S.C. § 303(b)(3).

is the equivalent of a privately run Chapter 7, a perversion of the Bankruptcy Code, which provides for the United States Trustee (the "U.S. Trustee") and/or unsecured creditors to select the trustee.[5] The selection of a trustee to play the role that is contemplated in these cases should be made in the manner set out in the Bankruptcy Code.

5. In the Motion to Convert, the U.S. Trustee has demonstrated that cause exists to convert these cases to Chapter 7 and, significantly, the Debtors are unable to identify any unusual circumstance that would warrant remaining in Chapter 11.

THE MOTION TO CONVERT SHOULD BE GRANTED

6. On November 30, 2009 (the "Petition Date"), the Debtors each filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). By order dated December 1, 2009, the Court approved the joint administration of these cases [D.E. 19].

7. No official committee of unsecured creditors has been appointed in these cases.

8. On December 10, 2009, the U.S. Trustee filed the Motion to Convert. A Preliminary Hearing on the Motion to Convert is scheduled for December 17, 2009.

9. Although the Debtors are ostensibly proceeding as debtors in possession under 11 U.S.C. §§ 1107 and 1108, by their own admission, the Debtors are not operating and have not operated for over a year. To the contrary, the Debtors have requested that the Court approve the retention of a corporation, Trustee Services, Inc. pursuant to 11 U.S.C. § 363(b) to manage the Debtors' affairs (e.g., oversee litigation). *See* Debtors' Response in Opposition to United States Trustee's Motion to Convert Cases to Cases under Chapter 7 or, in the Alternative, Motion to

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[5] 11 U.S.C. §§ 701 and 702.

Appoint Chapter 11 Trustee (the "Debtors' Response") [D.E. 44], p. 8, ¶ 19. Trustee Services, Inc. (a company believed to be wholly owned by Kenneth Welt) will in turn, employ the Debtors' pre-petition Chief Restructuring Officer, Kenneth Welt (the "CRO"). *Id.* at p.9, ¶ 20.[6]

A. Section 1112(b) Mandates Conversion of These Cases.

10. Section 1112(b) of Bankruptcy Code requires that a court must convert a Chapter 11 case to a case under Chapter 7 if a party in interest establishes "cause" absent unusual circumstances under which conversion is not in the best interest of creditors or the estate. 11 U.S.C. § 1112(b).[7]

11. Specifically, section 1112(b)(1) states:

> Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

11 U.S.C. § 1112(b)(1).

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[6] The Debtors argue that by making an application to the Court pursuant to 11 U.S.C. § 363(b) to approve the retention of Trustee Services, Inc. (and not Mr. Welt, individually) to manage the Debtors' affairs, avoids the issue of determining whether Mr. Welt is "disinterested," a finding required under section 327 of the Bankruptcy Code. *See* Debtors' Response, p. 9, ¶¶ 20 and 21. Such a blatant manipulation of the Bankruptcy Code provisions governing the retention of professionals runs afoul of the Bankruptcy Code and the legislature's basis for including a disinterestedness standard requirement in the Code when written.

[7] Courts no longer enjoy the discretion afforded to them prior to the amendments to section 1112(b) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"). *In re Fisher*, 2008 WL 1775123, at *5 (Bankr. D. Mont. Apr. 5, 2008); *see also Nester v. Gateway Access Solutions, Inc.* (*In re Gateway Access Solutions, Inc.*), 374 B.R. 556, 560 (Bankr. M.D. Pa. 2007); *In re Broad Creek Edgewater, LP*, 371 B.R. 752, 759 (Bankr. D.S.C. 2007). Section 1112(b) previously stated that "the court *may* convert a case under this chapter to a case under chapter 7 of this title or *may* dismiss a case under this chapter, whichever is in the best interest of creditors and the estate for cause… ." (emphasis added). 11 U.S.C. § 1112(b) (prior to 2005 BAPCPA amendments). If the party requesting conversion establishes cause, the Court must grant the requested relief unless it finds that appointment of a chapter 11 trustee under section 1104(a)(3) of the Bankruptcy Code would be more beneficial to creditors. *In re Prods. Int'l Co.*, 395 B.R. 101, 108 (Bankr. D. Ariz. 2008).

12. As creditor, the Liquidator has standing to request the conversion of these cases[8] and therefore submits this Joinder to the U.S. Trustee's Motion to Convert.[9]

13. The purpose of section 1112(b) of the Bankruptcy Code is to give creditors the ability to avoid the delay and costs associated with a reorganization process in cases where the prospects of an actual reorganization are slim (or, as here, nonexistent), and there is no need to wait for a debtor to propose a plan or for the period of exclusivity to lapse. *See In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th Cir. 1994) ("Creditors . . . need not incur the added time and expense of a confirmation hearing on a plan they believe cannot be effectuated. . . . The very purpose of § 1112(b) is to cut short [the] plan and confirmation process where it is pointless.") (internal citation omitted.)

14. Courts have consistently held that conversion is the optimal relief for creditors when a debtor has no on-going business. *See In re Johnston*, 149 B.R. 158, 162 (B.A.P. 9th Cir. 1992); *In re Blixseth*, 2009 WL 1525994, at *5 (Bankr. D. Mont. May 29, 2009); *In re Fisher*, 2008 WL 1775123, at *12 (Bankr. D. Mont. 2008). Further, a Chapter 7 liquidation is generally recognized as more cost-effective and efficient than a Chapter 11 process regardless of whether a trustee has been appointed to run the case. *Blixseth*, 2009 WL 1525994, at *5; *Fisher*, 2008 WL 1775123, at *12; *In re Gateway Access Solutions, Inc.*, 374 B.R. at 568. As a result, where, as here, there is no on-going business to potentially increase the amount available for distribution,

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[8] As a "party in interest" under the Bankruptcy Code, a creditor has standing to request a conversion. 11 U.S.C. § 1109(b).

[9] The Motion to Convert seeks, in the alternative, appointment of a Chapter 11 Trustee pursuant to 11 U.S.C. § 1104(a)(3). Although the Liquidator joins the Motion to Convert generally, the Liquidator believes, and respectfully submits, that conversion of these cases to Chapter 7 cases is in the best interests of the estates' creditors.

the least costly and most efficient route (*i.e.*, Chapter 7 liquidation) will provide the highest return for creditors.

B. "Cause" for conversion exists because the Debtors have no operating business that can be rehabilitated and an unnecessary Chapter 11 plan process will be more costly and less efficient than a Chapter 7 liquidation.

15. The Bankruptcy Code enumerates sixteen non-exclusive examples of cause to convert a case. 11 U.S.C. § 1112(b)(4). Generally, each of these examples describes a situation in which it would be "unlikely that the benefits of reorganization will be achieved within a reasonable amount of time or at an acceptable cost." 7 Collier on Bankruptcy, ¶1112.04[3] at 1112-24 (15th ed. rev'd 2007). The list of examples is not exhaustive and courts may find cause exists for other equitable reasons. *See In re Strug-Division, LLC*, 375 B.R. 445, 448 (Bankr. N.D. Ill. 2007).

16. Here, this Court need look no further than the first example of cause listed in 11 U.S.C. § 1112(b) -- the "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." 11 U.S.C. § 1112(b)(4)(A). In the Debtors' cases, both criteria are satisfied because there is no reasonable likelihood of rehabilitation and there is a substantial or continuing loss to or diminution of the estates.

There is no possibility of rehabilitation.

17. Where, as here, a debtor has no business operations, cause for conversion exists under section 1112(b)(4)(A) because there is no likelihood of rehabilitation. *See, e.g., In re Johnston*, 149 B.R. at 162; *In re Gonic Realty Trust*, 909 F.2d 624, 626-27 (1st Cir. 1990); *In re Great American Pyramid Joint Venture*, 144 B.R. 780, 790 (Bankr. W.D. Tenn. 1992).

18. As the Eighth Circuit has noted, "courts have consistently understood 'rehabilitation' to refer to the debtors' ability to restore the viability of its business." *Loop Corp.*

v. U.S. Trustee, 379 F.3d 511, 516 (8th Cir. 2004) (lower court did not err in concluding that a liquidating debtor who had no intention of restoring its business had no reasonable likelihood of rehabilitation) (citing *In re Gonic Realty Trust*, 909 F.2d at 627 ("[W]ith no business left to reorganize, Chapter 11 proceedings were not serving the purpose of rehabilitating the debtor's business."); *In re Ledges Apartments*, 58 B.R. 84, 87 (Bankr. D. Vt. 1986) ("Reorganization encompasses rehabilitation and may contemplate liquidation. Rehabilitation, on the other hand, may not include liquidation.").

19. Here, there can be no dispute that the Debtors have neither the intention nor ability to rehabilitate – they admit as much in their filings. *See* ¶ 5 Chapter 11 Case Management Summary ("Case Summary") [D.E. 32].

20. The Debtors have no employees and no tangible assets to be maintained or disposed of. As such, the idea of the estates paying a CRO to liquidate the Debtors is incongruous with the facts. Permitting these estates to wind down with a paid manager at the helm is both wasteful and unnecessarily detrimental to the creditors' recovery.

The estates have suffered a catastrophic loss.

21. In addition to the impossibility of rehabilitation, cause can be shown where there is a substantial or continuing loss to the estates; here, the estates' loss is catastrophic and continuing. Keeping these cases in Chapter 11 will result in the accrual of substantial administrative expenses that will only diminish the value of these estates to the detriment of the creditors.

22. The continuing loss to the Debtors' estates in the form of wasteful and unnecessary administrative fees is exemplified by the fact that virtually all of the "substantive" motions filed by the Debtors concern retaining and paying professionals. *See* D.E. 6-9, 11.

Where a debtor has no business operations that can be rehabilitated, the mere presence of rising administrative costs from professional fees supports a finding of cause under section 1112(b)(4)(A). *See Loop Corp.*, 379 F.3d at 515-16; *Canpartners Realty Holding Co. IV, L.L.C. v. Vallambrosa Holdings, L.L.C. (In re Vallambrosa Holdings, L.L.C.)*, 2009 Bankr. WL 2868677, at *5 (Bankr. S.D. Ga. May 21, 2009); *In re Gateway Access Solutions, Inc.*, 374 B.R. at 564.

23. Indeed, in the Debtors' Response, the Debtors' proposal to address a conflict of interest faced by the Debtors' CRO, Kenneth A. Welt is to hire <u>still more</u> legal counsel. *See* Debtors' Response, ¶ 19. This is not and cannot be the answer -- the answer is to convert these cases and put them in the hands of a completely disinterested Chapter 7 Trustee who is beholden to no single constituent.

24. Rising administrative costs where there is no on-going business necessarily results in negative cash flow, creating a scenario ripe for conversion to Chapter 7. For example, in *Loop Corp.*, the Eighth Circuit noted that the debtors, "as liquidating entities that had ceased their business operations but continued to incur administrative expenses, had a negative cash flow." The court stated that "[u]nder the interpretation of § 1112(b)(1) consistently used in bankruptcy courts, this negative cash flow situation alone is sufficient to establish 'continuing loss to or diminution of the estate.'" 379 F.3d at 515-16.

25. The *Loop Corp.* court also stated that "[t]he purpose of § 1112(b)(1) is to 'preserve estate assets by preventing the debtor in possession from gambling on the enterprise at the creditors' expense when there is no hope of rehabilitation.' In the context of a debtor who has ceased business operations and liquidated virtually all of its assets, any negative cash flow – including that resulting only from administrative expenses – effectively comes straight from the

pockets of the creditors. This is enough to satisfy the first element of § 1112(b)(1)." *Id.* at 516 (citations omitted).

26. Combined with the lack of any operating business to justify continuing these Chapter 11 cases, this provides further evidence of cause for conversion under applicable case law.

C. Conversion is in the best interest of the Debtors' estates' creditors.

27. Upon a showing of cause, "the case should be converted or dismissed unless unusual facts and circumstances demonstrate that the purposes of chapter 11 would be better served by maintaining the case as a chapter 11 proceeding." *In re Prods. Int'l Co.*, 395 B.R. at 109 (quoting 7 Collier on Bankruptcy, ¶1112.04[3] at 1112-26, 1112-27 (15th ed. rev'd 2007)); see also 11 U.S.C. § 1112(b)(1).

28. The statute places the burden upon the Debtors to demonstrate what unusual facts or circumstances warrant the continued administration of these cases under Chapter 11. It is a burden that the Debtors have not carried. Indeed, the Debtors, in their Response, make no effort to demonstrate such circumstances and any attempt to do so would be futile. *See generally*, Debtors' Response.

29. The Debtors have no ability to propose or confirm a plan of reorganization. So, it is inevitable that these cases will eventually be converted or dismissed. There is no reason to delay the inevitable – continuing these cases in Chapter 11 will result in the accrual of unnecessary expenses to the Debtors' estates, which will be beneficial to no one. Accordingly, these cases must be converted to chapter 7. *See In re Johnston*, 149 B.R. at 162; *In re Blixseth*, 2009 WL 1525994, at *5; *In re Fisher*, 2008 WL 1775123, at *12.

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CONCLUSION

30. Because the sole purpose of these bankruptcy cases is to liquidate the Debtors, which have absolutely no business operations and no employees, they should be converted to Chapter 7, which is the process envisioned by the Bankruptcy Code. The Debtors have not demonstrated any unusual circumstances that warrant deviating from the statutory scheme.

31. For the foregoing reasons, the Liquidator respectfully joins in the U.S. Trustee's Motion to Convert.

I, Lynn Maynard Gollin, hereby certify that I am admitted to the Bar of the United States District Court for the Southern District of Florida and I am in compliance with the additional qualifications to practice in this Court set forth in Local Rule 2090-1(A).

Respectfully submitted,
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