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ATTORNEYS FOR THE WACHOVIA FINANCIAL SERVICES, INC.  
AND FIFTH THIRD BANK

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE NORTHERN DISTRICT OF TEXAS  
FORT WORTH DIVISION

IN RE: §  
§  
LEWIS EQUIPMENT COMPANY, INC., § CASE NO. 09-45785-rfn11  
et al.,<sup>1</sup> §  
§ Chapter 11  
Debtors. §  
§

**MOTION TO CONVERT CASE TO CHAPTER 7 OR, ALTERNATIVELY,  
FOR APPOINTMENT OF A CHAPTER 11 TRUSTEE AND BRIEF IN SUPPORT**

**IF YOU OBJECT TO THE RELIEF REQUESTED, YOU MUST RESPOND IN WRITING, SPECIFICALLY ANSWERING EACH PARAGRAPH OF THIS PLEADING. UNLESS OTHERWISE DIRECTED BY THE COURT, YOU MUST FILE YOUR RESPONSE WITH THE CLERK OF THE BANKRUPTCY COURT WITHIN TWENTY-THREE DAYS FROM THE DATE YOU WERE SERVED WITH THIS PLEADING. YOU MUST SERVE A COPY OF YOUR RESPONSE ON THE PERSON WHO SENT YOU THE NOTICE; OTHERWISE, THE COURT MAY TREAT THE PLEADING AS UNOPPOSED AND GRANT THE RELIEF REQUESTED.**

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<sup>1</sup> Other debtors include LWL Management, LLC, case no. 09-45786; Hardrock Machine Shop, LLC, case no. 09-45787; Great White Transportation, LLC, case no. 09-45788; Lewis Crane & Hoist, Inc., case no. 09-45790; Rock Island Rigging, Inc., case no. 09-45792; and Hardrock Road Properties, LLC, case no. 09-45814.

**EXPEDITED RELIEF HAS BEEN REQUESTED, AND A HEARING DATE AND TIME WILL BE SET ON THIS MOTION BY THE COURT.**

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

COMES NOW Wachovia Financial Services, Inc. (“WFS”) and Fifth Third Bank (“Fifth Third”) (collectively, “Movants”), creditors in the above-styled Chapter 11 case, and files this its Motion to Convert Case to Chapter 7 or, Alternatively, for Appointment of a Chapter 11 Trustee (the “Motion”), and would respectfully show this Court as follows:

**SUMMARY**

Dogged by mismanagement and a dismal construction market, the debtors are unable even to tread water after more than four (4) months in bankruptcy. Their balance sheet is steadily deteriorating, leaving the \$100 million in creditors’ claims with an ever diminishing prospect for recovery. For every \$3 in top-line gross revenue taken in by the debtors, they are now losing an astonishing \$5. As the examiner has now documented, the debtors’ sole owner, Kyle Lewis, drained approximately \$13 million in assets from the debtors during their plunge into bankruptcy. These voidable transfers are the principal source of potential recovery for unsecured creditors in this case. Yet three months after the Court openly called out Mr. Lewis for his looting of corporate assets, he has failed to return *any* of the debtors’ cash or proceeds to the estate or even to make any commitments for their return. Creditors would be better off with a chapter 7 trustee who could readily pursue and recover these obvious fraudulent transfers from Mr. Lewis and distribute them. Alternatively, if the Court is persuaded that efforts to rehabilitate the debtors should continue, the examiner’s report of sloppiness and misappropriation of

debtors' assets by its senior management confirms the need for appointment of a chapter 11 trustee without further delay.

**I.**  
**JURISDICTION**

1. This Court has jurisdiction over the subject matter of this Motion pursuant to 28 U.S.C. § 1334, and this is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(A).

**II.**  
**BACKGROUND**

2. Lewis Equipment Company, Inc. ("LEC"), LWL Management LLC ("LWL"), Lewis Crane & Hoist, Inc. ("LC&H") and several other affiliated companies (collectively, the "Debtors") filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code on September 18, 2009 (the "Petition Date").

3. At all relevant times, the Debtors have been owned and controlled by their president and sole shareholder, Kyle Lewis.

4. WFS and Fifth Third are large creditors of Lewis who purchased loans made by Key Equipment Finance and/or General Electric Credit Corp. in 2007.

5. As of the Petition Date, LEC owed loan obligations to WFS in at least the sum of \$8,185,786.44, which obligations were unconditionally guaranteed by the other Debtors and Mr. Lewis. The Debtors granted security interests in certain equipment to WFS and such security interests were duly and properly perfected. Pursuant to preliminary and final orders entered on October 23 and December 16, 2009, the Court granted relief from the automatic stay in favor of WFS as to all of its equipment collateral with the exception of seven (7) units that are either the subject of a preference adversary

or work-in-process. Based on a post-petition appraisal, WFS reckons that it will have a substantial unsecured claim in this case -- perhaps as much as \$5 million or more.

6. Likewise, as of the Petition Date, LEC and LWL owed loan obligations to Fifth Third in at least the sum of \$4,820,357.55, which obligations were unconditionally guaranteed by the other Debtors and Mr. Lewis. Pursuant to preliminary and final orders entered on November 2 and December 1, 2009, the Court granted relief from the automatic stay in favor of Fifth Third as to most of its equipment, retaining the stay on several items subject to adequate protection arrangements agreed to by Fifth Third and the Debtors. Based on a post-petition appraisal, Fifth Third reckons that it also will have a substantial unsecured claim in this case -- perhaps as much as \$2 million or so.

7. According to Debtors' bankruptcy schedules, WFS and Fifth Third were not alone in making secured loans to the Debtors. Those schedules, to the extent they can be accurately deciphered, indicate that there were total secured claims of about \$100.4 million, each secured by a separate tranche of cranes, with the exception of Frost Bank, whose loan was generally secured by all of the Debtors' assets, subject to intercreditor agreements with the equipment lenders.

8. The conduct of Debtors' owner and management during the period leading up to bankruptcy was troubling, to say the least, and prior to the recent release of the Examiner's Report, creditors were aware of the following actions:

a. Creditors had discovered that Mr. Lewis had removed large sums of cash from the Debtors during their collapse into bankruptcy, although they were unable to confirm the full extent of those distributions.

b. After May, 2009, the Debtors generally ceased making their monthly loan payments to their secured creditors because they were allegedly unable to do so. In reality, a few months earlier, the Debtors had stashed approximately \$10,000,000 of cash into CDs for safekeeping and were pretending otherwise.

c. In a 2008 incident involving a \$33.8 million Wells Fargo equipment loan, Wells Fargo's auditors discovered that 22 units of equipment with a value of \$6,128,000 had been sold by the Debtors during the previous months without remittance of the sale proceeds to that lender. After initial denials by the Debtors' highest level of management/ownership, the Debtors were forced to acknowledge default and pay off the Wells Fargo loan in its entirety.

d. There were suspicions that the Debtors had moved some of their assets, potentially including some secured creditors' collateral, offshore to a New Zealand company owned by Mr. Lewis.

9. Following the Petition Date, WFS moved for the appointment of a Chapter 11 trustee or, alternatively, an examiner based on the prepetition conduct of Debtors' management. Several other secured creditors filed joinders in this motion. Pursuant to an Agreed Order Appointing Examiner entered on October 14, 2009 and agreed to by the Debtors and Frost Bank, the Court ordered the appointment of an examiner to investigate specified matters involving insider conduct. WFS' motion for appointment of a trustee was withdrawn without prejudice to refile after issuance of the examiner's report.

10. After obtaining an order extending time for the filing of their bankruptcy schedules, the Debtors filed them on or about October 22, 2009. The Debtors' schedules were materially and even grossly inaccurate, as was pointed out to, and acknowledged by,

the Debtors during their October, 2009 meeting of creditors. The Debtors have not amended their schedules to correct the errors since that time.

11. According to disclosures in the Debtors' schedules, exclusive of compensation to himself and other family members, Kyle Lewis caused the Debtors to make at least \$5,080,319.46<sup>2</sup> in extraordinary transfers to himself during the one-year period before the Petition Date while the Debtors' business prospects were in steep decline.

12. During the month of October, the Debtors -- although down to just 18% utilization of their fleet of cranes -- steadfastly opposed stay relief by *any* secured creditor as to *any* unit of equipment until the Court overruled their objections and lifted the stay at the preliminary hearing stage as to all units not actively employed on jobsites.

13. Because Kyle Lewis had provided unconditional guaranties of their loan obligations, Movants and several other secured lenders filed state court actions against Mr. Lewis during September and October, 2009.

14. On October 31, 2009, the Debtor filed their motion to extend the automatic stay to Kyle Lewis (the "Motion to Extend Stay"), which Movants and several other secured creditors opposed. A contested hearing was conducted before the Court on the Motion to Extend Stay on November 23, 2009. The Court denied the Motion to Extend based on findings of "unconscionable" conduct by Mr. Lewis in diverting millions of dollars of the Debtors' cash while the economy and the Debtors' business were in a distress and while he was also drawing a salary of \$56,000 per month. The

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<sup>2</sup> LWL Management's schedules indicate that Mr. Lewis repaid \$392,386.12 of this money shortly after the Petition Date.

Court simultaneously invited Mr. Lewis to return the Debtors' cash to them in order to move the case forward:

[T]here is the possibility of success on the merits if Mr. Lewis is willing to come in here and make a substantial contribution that's almost equal to, if it doesn't exceed, just the amount of money he took out of this company in the last year. But he hasn't agreed to do that yet.

Transcript of ruling, p. 6. The Court rejected the idea of reconsidering an extension of the stay based on the suggestion that Mr. Lewis would agree to return the funds under certain circumstances.

But I'm not willing to do it at this point just on the mere assertion that they're thinking about it and they might do it. That's not satisfactory to me, because they can always decide not to do it.

Transcript of ruling, p. 8.

15. During the hearing on the Motion to Extend Stay, the Mr. Lewis and other members of management insisted that their business activity had bottomed and had begun to increase, predicting that a much more significant upturn was imminent.

16. The Debtors' financial performance, as reflected in their monthly operating reports, has not borne out their prediction. First, the operating reports filed by the Debtors -- despite their being prepared by the Debtors' CFO and his outside CPA firm and signed off on by the Debtors' president Kevin Messenger -- contained material and even glaring errors.<sup>3</sup> A true and correct copy of the December and November operating reports are attached hereto as **Exhibits "A" and "B,"** respectively. The

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<sup>3</sup> In their operating reports through November, the Debtors treated the reorganization expenses of \$275,450.00 for Sep/October as "income," which when combined with other arithmetic errors, showed a net loss of \$1,122,281.73 instead of the correct figure of \$1,673,181.73 -- a difference of about \$450,000. Although patently erroneous and misleading, these reports were verified as accurate Mr. Wiley, a professional person employed by the estate. Movants reserve these matters to be addressed at the time of Mr. Wiley's final fee application.

December report was not filed until January 30, ten days late and in violation of the standing deadline for operating reports. After recent corrections by the Debtors in their December report, they acknowledge a serious and continuing deterioration of their financial condition:

	Sep/Oct 2009	November 2009	December 2009	Cumulative
Net Revenues	\$2,120,722	\$1,702,672	<b>\$1,472,542</b>	\$5,635,888
Gross Profit/Loss	\$1,107,126	\$637,626	\$741,099	\$2,485,851
Income/loss Before Non-operating expenses	(\$58,140)	(\$824,752)	\$33,481	(\$849,411)
Net Loss	(\$1,673,181)	(\$1,921,715) <sup>4</sup>	<b>(\$2,468,082)</b>	<b>(\$5,610,371)</b>

17. December's net loss of \$2,468,082 is probably an understatement. It is based on total reorganization expenses of only \$48,944, even though MOR-6 shows estimated incurred and unpaid professional fees of \$124,500 for December and a total "paid" during December of \$298,429. The fees and expenses of the examiner and his counsel are yet to be disclosed.

18. The operating report indicates that, during December, the Debtors managed to lose an astonishing \$5 for every \$3 in top-line, gross revenues brought in.

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<sup>4</sup> The amounts indicated exclude the effect of a \$1,499,000 book loss "realized" in November arising from repossession of equipment by secured creditors.

Prior months were only slightly better. The longer the Debtors operate, the faster they deplete the estates' assets.

19. On a balance sheet or "cash basis" -- wherein the Debtors can temporarily defer spending to replace obsolescent equipment and some reorganization expenses -- the Debtors have managed to reduce the \$8,270,000 in cash they held on the Petition Date to \$7,071,000 at the end of December, a period of just over 3 months. Similarly, the Debtors' total current assets have eroded from \$20 million to \$17 million during those 3 months.

20. Worse, there seems to be no improvement in sight in terms of the Debtors' losses. According to the projections for February and March contained in the Court's final cash collateral order (docket no. 327), the Debtors anticipate spending about \$2.4 million in cash collateral during those months -- a level quite consistent with December's rate of hemorrhaging.

21. The Debtors' operating report reflects another disturbing development. During one of the initial hearings in the case involving cash collateral in September, 2009, in response to creditor concerns about Mr. Lewis' \$14,000 per week salary, the Debtors represented to the creditors and the Court that Mr. Lewis' salary would be sharply curtailed post-petition. According to the Debtors' operating reports, however, Kyle Lewis has continued to receive "paychecks" of at least \$14,000 per week since the Petition Date that amount to an aggregate \$208,071 through December 31<sup>st</sup>. Not bad for 3 1/3 months -- while Mr. Wylie, as their CRO and Mr. Messenger, as their COO, have run the Debtors' business on a day-to-day basis.

22. Mr. Lewis' about-face on his salary reduction representation is consistent with his cavalier attitude toward the Court's authority in this case. In another example, two days after the October 21, 2009 preliminary hearing in which the Court lifted the stay on a 200 ton crane, Mr. Lewis arbitrarily decided to ignore the Court's order and send that crane out on rent for one month, frustrating Wachovia's repossession efforts. Similarly, the Debtors played cat-and-mouse with Wachovia and Fifth Third for weeks as to the time, place and manner of their repossessions following stay relief orders and initially stripped the returned cranes of many essential components like hook blocks, counterweights and bolts. Many of the units repossessed by Fifth Third have been stripped of their LMIs (or electronic controls), making them virtually unmarketable. And Fifth Third still hasn't been able to recover one unit (an 80-ton crawler crane - QUY 80 s/n 1123) on which the stay lifted in November, and has now learned that the crane is in the possession of a third party in Cleveland, TX who was holding it for \$6000 in ransom in unspecified charges until February 11, 2010, when he represented that the crane would finally be surrendered.

23. The December operating report indicates that an insider company called Sierra Equipment has reaped a further \$395,161 from "equipment rental" to the Debtors for unspecified services -- while the grand total of *all* lease and adequate protection payments was only \$591,586. Thus, Sierra Equipment has apparently received **68%** of all such payments although they provided only a tiny fraction of the Debtors' operational fleet, at best.

24. On February 8, 2010, the examiner, Milo Segner, filed his report (the "Examiner's Report"). Although Mr. Segner generally afforded the Debtors'

management the benefit of the doubt as to their prepetition handling of secured creditors' collateral, his findings regarding the magnitude of Mr. Lewis' misappropriation of Debtors' cash and other assets for his own benefit were shocking. According to the Examiner's Report, the asset diversions to Mr. Lewis during the two (2) years before the Petition Date included the following:

a. Beginning in December, 2007, a net \$8.7 million in cash and equipment were transferred to Mr. Lewis' New Zealand and Australian enterprises (the "South Pacific Affiliates"), including \$3.7 million in loans that Mr. Lewis later had the Debtors reclassify as "draws" during a period of likely insolvency. The Debtors did not receive any measurable value in exchange for these transfers. Examiner's Report, ¶¶ 52, 128; Appendix G thereto.

b. Mr. Lewis additionally withdrew from the Debtors, respectively during 2007, 2008 and 2009, the following amounts: \$1,486,455, \$354,165, and \$283,498. *Id.*

c. Mr. Lewis diverted a total of \$793,584 in insurance checks representing proceeds of Debtors' equipment. Examiner's Report, ¶ 59.

d. Mr. Lewis cashed and diverted American Express checks totaling \$44,034 otherwise payable to the Debtors and masked an additional \$109,045 in payments by having checks issued to "Kennedale Gas Station" which were actually paid to him. *Id.* at ¶ 60.

e. Mr. Lewis also paid himself a steady draw of \$70,000 *per month* out of debtor Hardrock Road Properties, which aggregated to \$1,680,000 during the two year period before bankruptcy. *Id.* at ¶ 57.

f. Mr. Segner concluded that the Debtors were likely insolvent from at least September, 2008 onward. *Id.* at ¶ 127,

25. The Examiner's Report unearthed, or in some cases confirmed, other disturbing conduct by Mr. Lewis and his management immediately before the Petition Date. For example, at an unspecified time "just before" bankruptcy, Mr. Lewis withdrew \$5.2 million from the Debtors' bank accounts in the form of cashier's checks and secreted them in a family member's safe, before eventually returning the funds at the behest of other "senior management." Examiner's Report ¶ 64. Soon thereafter, the Debtors placed \$10 million into CD's at five different financial institutions. *Id.* It was at this time that the Debtors, although flush with cash, refused to make further payments to any of their secured creditors on the pretense that they were unable to do so.

26. The examiner concluded that Mr. Lewis' interested transactions with the Debtors "breached [his] duty of loyalty and care to the Debtors" once they entered the zone of insolvency. Examiner's Report ¶¶ 113, 116.

27. Apparently heedless of the Court's admonition in November that he should return the millions of dollars in siphoned funds to the Debtors, Mr. Lewis has neither replenished the estate nor made any firm commitment to do so. The Examiner's Report indicates that the magnitude of fraudulent transfers to Mr. Lewis is much greater than was known to the Court in November.

28. Another surprise contained in the Examiner's Report was the revelation that the Court-appointed CRO, Kevin Wylie, was summarily *terminated* by Mr. Lewis in January without any disclosure to creditors or Court approval. This removes a layer of

oversight of Mr. Lewis by a professional person and should be disconcerting to all parties in interest, given Mr. Lewis' history with the Debtors.

#### **IV. BASIS FOR RELIEF REQUESTED**

29. Pursuant to 11 U.S.C. § 1112(b), there is cause for conversion of this case to chapter 7 for, *inter alia*, the following reasons:

a. There is a substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

b. The Debtors have grossly mismanaged the estate, as reflected by continued excessive payments to insiders like Mr. Lewis and Sierra Equipment, submission of materially inaccurate bankruptcy schedules, their failure or unwillingness to amend those schedules during the months since they were filed, the filing of materially inaccurate and late operating reports, willful disregard for representations to the Court and/or court orders, and an unwillingness of the Debtors' owner to return millions of dollars of Debtors' cash that was looted during the Debtors' slide into bankruptcy;

c. The Debtors have failed to comply with one or more orders of the Court; and/or to timely satisfy their filing or reporting requirements applicable to this chapter 11 case; and

d. The Debtors continue to operate their business for the predominant benefit of Kyle Lewis and other insiders at the expense, and to the detriment, of their estates and their creditors.

30. Movants submit that conversion, rather than dismissal, is in the best interests of creditors because a chapter 7 trustee will be empowered to recover the

millions of dollars in fraudulent transfers from Mr. Lewis and his affiliated entities, while a case dismissal will place the Debtors' assets back under Mr. Lewis' control.

31. Alternatively, in the event that Court determines that the Debtors' cases should continue in chapter 11, the Court should order the appointment of a trustee in these cases under 11 U.S.C. § 1104(a) on the following grounds, each of which are present in this case:

a. for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the Debtors by current management, both before and after the commencement of the cases;

b. because such appointment is in the interests of creditors; and

c. because grounds exist to convert or dismiss these cases under section 1112 and the appointment of a trustee is in the best interests of creditors and the estate.

32.

### **ARGUMENT AND AUTHORITIES**

#### **1. There is ample cause for conversion of Debtors' cases to chapter 7**

The Debtors' assets in these cases are substantially encumbered by Frost Bank and the various equipment lenders. The only visible avenue of recovery for unsecured creditors is by reclaiming the fraudulent transfers that Mr. Lewis orchestrated for his personal benefit during the Debtors' spiral into bankruptcy. The Debtors' mounting losses -- fueled by outrageous payments to insiders -- are rapidly eroding their balance sheet and consuming their remaining assets. Unless the case is quickly converted, those losses and mounting administrative claims, such as Frost's adequate protection

(diminution) claims, will devour the unsecured creditors' potential recovery. Section 1112 of the Bankruptcy Code presents the Court with an emergency "off" switch where a case, as here, becomes a runaway train.

Section 1112(b)(1) provides:

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.

Subsection (b)(2), a "linguistically difficult"<sup>5</sup> exception, permits a debtor to escape conversion or dismissal of its case if the debtor establishes that (1) there is a reasonable likelihood that a plan will be confirmed within a reasonable time, (2) the "cause" for dismissal is something other than a continuing loss or diminution of the estate coupled with a lack of reasonable likelihood of rehabilitation, and (3) there is a reasonable justification or excuse for a debtor's act or omission and that act or omission will be cured within a reasonable time. 7 COLLIER ON BANKRUPTCY ¶ 1112.05[2] at p. 1112-45 (16<sup>th</sup> ed. 2009); *In re Orbit Petroleum, Inc.*, 395 B.R. 145, 147 (Bankr. D. N.M. 2008).

Section 1112(b)(4) further provides, in relevant part, that:

For purposes of this subsection, the term "cause" includes --  
(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;  
(B) gross mismanagement of the estate;  
\* \* \*  
(D) unauthorized use of cash collateral substantially

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<sup>5</sup> As characterized in 7 COLLIER ON BANKRUPTCY ¶ 1112.05[2] at p. 1112-44 (16<sup>th</sup> ed. 2009). COLLIER'S concludes that "Congress included one too many negatives in describing the 'unusual circumstances' referred to in section 1112(b)(2)."

harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;

\* \* \*

(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

In general, “Section 1112(b)(1) of the Bankruptcy Code provides that the court ‘shall’ convert or dismiss a chapter 11 case, whichever is in the best interests of creditors, if a movant establishes ‘cause.’” *In re Ramreddy, Inc.*, -- B.R. -- (2009 WL 3763988) (Bankr. E.D. Pa. 2009). “Courts that have analyzed section 1112(b)(4) almost unanimously conclude that the list of items that constitute cause is not exclusive and the use of the word ‘and’ at the end of section 1112(b)(4)(O) is a scrivener’s error. The list should read in the disjunctive ...[o]therwise this section would lead to an absurd result.” COLLIER ¶ 1112.04[6] at p. 1112-27.

Section 1112(b) provides bankruptcy courts with wide discretion to convert a case to chapter 7 for cause. *In re Koerner*, 800 F.2d 1358, 1367 (5th Cir. 1986). Under subsection (b)(1), the initial burden lies with the movant to establish “cause” for conversion. *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 561 (Bankr. M.D. Pa. 2007). If the movant establishes “cause,” the burden shifts to the debtor to prove that it falls within the exception of subsection (b)(2) for “unusual circumstances.” *Id.*

The first example of “cause” for conversion listed in section 1112(b)(4) is a “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation” under subsection (A). COLLIER summarizes this provision as follows:

This standard asks two questions. First, does the debtor have a negative cash flow or declining asset values? This includes looking at the financial history of the debtor and determining if a pattern of decline exists. Second, will the debtor or another party be able to “stop the bleeding” and return the debtor to solid financial footing within a reasonable amount of time? The first question must be answered in the affirmative and the second in the negative for cause to exist.

COLLIER ¶ 1112.04[6][a] at 1112-28 - 29; *see also In re 1031 Tax Group, LLC*, 374 B.R. 78, 93 (Bankr. S.D.N.Y. 2007). The substantial or continuing loss prong is demonstrated by a loss that will “materially negatively impact the bankruptcy estate and the interest of creditors,” or “dwindling liquidity.” *Id.* at 1112-28; *see also In re Schriock Constr. Inc.*, 167 B.R. 569, 575 (Bankr. N.D. 1994) (“This element can be satisfied by demonstrating that the debtor incurred continuing losses or maintained a negative cash flow position after the entry of the order for relief.”).

The second element regarding the absence of a reasonable likelihood of rehabilitation is not synonymous with “reorganization.” “Rehabilitation means to reestablish a business. Whereas confirmation of a plan could include a liquidation plan, rehabilitation does not include liquidation.” COLLIER ¶ 1112.04[6][a] at 1112-29. “[I]f there is not a potentially viable business in place worthy of protection and rehabilitation, the Chapter 11 effort has lost its *raison d’etre*...” *In re Winshall Settlor’s Trust*, 758 F.2d 1136, 1137 (6<sup>th</sup> Cir. 1985). Again, COLLIER succinctly summarizes the case law:

In order to determine whether the debtor’s business prospects are sufficient to justify a finding of a reasonable likelihood of rehabilitation, the court should determine not only whether the causes of the debtor’s continuing losses can be corrected, but also whether the debtor or some other party in interest is capable of performing the necessary remediation. In almost every case, the debtor’s prospects will depend on whether the debtor has formulated, or can formulate within a reasonable amount of time, a reasonably detailed business plan.”

COLLIER ¶ 1112.04[6][a] at 1112-29. A debtor that has no ability to reorganize should

not be permitted to remain in chapter 11 “simply in order to enjoy the protections of the automatic stay.” *In re Mazzocone*, 183 B.R. 402, 412 (Bankr. E.D. Pa. 1995), *aff’d*, 200 B.R. 578 (E.D. Pa. 1996).

Here, the Debtors’ operating reports show large and accelerating losses on a post-petition basis. The Debtors’ losses, on an accrual basis, were about \$1.7 million during its first month of operation postpetition, \$1.9 million the next, and \$2.5 million the third month -- \$5.6 million in all. Although the Debtors contend that their cash diminution (\$1.3 million to date) has been less dramatic, they are in an equipment-intensive business in which their equipment wears out over time and must be replaced. *See In re Richmond Ready-Mix Corp.*, 37 B.R. 456, 458 (Bankr. E.D. Va. 1984) (debtor’s continuing loss should be examined on an accrual basis because it “gives a more realistic picture of the debtor’s profit and loss position”). This financial performance, coupled with a dismal construction environment and gross malfeasance by its management, negate any “likelihood” of a successful rehabilitation of the Debtors’ business. “[W]here there is no reasonable possibility of an effective reorganization, the bankruptcy court is not compelled to wait a certain period of time, to the detriment of creditors, before ordering conversion of the case.” *In re Johnson*, 149 B.R. 158, 162 (9th Cir. B.A.P. 1992) (affirming conversion of chapter 11 case to chapter 7 four months after petition date due to, *inter alia*, insufficient income to reorganize). Other courts have recognized that futility of continued efforts to reorganize is an appropriate ground for conversion. *See, e.g., Stage I Land Co. v. U.S. Dept. of H.U.D.*, 71 B.R. 225, 231 (D. Minn. 1986) (chapter 11 case should be dismissed at outset for cause where no reasonable possibility of a reorganization exists); *In re Macon Prestressed Concrete Co.*, 61 B.R. 432, 436 (Bankr.

M.D. Ga. 1986) (“debtor should be given a fair opportunity to reorganize, but the debtor should not be permitted to continue in a futile effort to reorganize”); *In re Economy Cab & Tool Co., Inc.*, 44 B.R. 721, 724 (Bankr. D. Minn. 1984)(conversion appropriate in early stages of chapter 11 case where movant show that there is “no more than a ‘hopeless and unreasonable prospect’ of rehabilitation”). Indeed, “creditors need not wait [to seek conversion] until a debtor proposes a plan or until the debtor’s exclusive right to file a plan has expired.” *In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th Cir. 1994).

Apart from subsection 1112(b)(4)(A), there is ample other cause for conversion of the Debtors’ cases to chapter 7. Debtors’ management has acted dishonestly both before the petition date as well as post-petition (frustrating repossessing secured creditors by removing crane components or knowingly placing cranes on rental after stay relief granted). After siphoning \$5 million of the Debtors’ cash into his own pocket, secreting another \$5.2 million in cashier’s checks into a relative’s safe, and stashing \$10 million into various deposit accounts, Mr. Lewis ceased paying his secured creditors based on an alleged inability to pay. Despite a stern admonition from the Court three months ago regarding the need for Mr. Lewis to return the \$5 million in diverted Debtor cash, he has obstinately refused to return the funds or at least make a firm commitment to do so. The Debtors’ management unilaterally shifted equipment between companies, and even to Mr. Lewis’ other companies in New Zealand and Australia, without the secured creditors’ consent. Post-petition, despite representations that his grandiose salary of \$14,000 per week would be sharply curtailed, he has continued to pay himself the same level of compensation from the estates’ dwindling cash. Taking into consideration the totality of circumstances here, creditors are unquestionably better off in a chapter 7 liquidation than

standing by while the Debtors' management continues to consume its remaining cash and generate an ever-increasing adequate protection claim in favor of Frost Bank for potential diminution of its collateral.

**2. Alternatively, the appointment of a trustee is appropriate and necessary in these cases**

Section 1104 governs the appointment of a trustee in chapter 11 cases. Significantly, section 1104(a)(3) directs the Court to appoint a trustee "if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or examiner is in the best interests of creditors and the estate."

In addition to subsection (a)(3), section 1104(a) provides that the court shall appoint a trustee for cause such as fraud, incompetence, dishonesty or gross mismanagement by current management, or if such appointment is simply in the interests of the creditors, equity security holders or other interested holders. *See* 11 U.S.C. § 1104(a).<sup>6</sup>

Subsection (1) of section 1104(a) addresses management's pre and post-petition

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<sup>6</sup> A bankruptcy court *shall* order the appointment of a trustee, according to Bankruptcy Code Section 1104(a):

at any time after the commencement of the case but prior to confirmation of a plan, on request of a party in interest or the United States Trustee, after notice and a hearing,

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor;

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor, or

(3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

misdeeds or mismanagement, while subsection (2) provides the court with “particularly wide discretion” to appoint a trustee even absent wrongdoing or mismanagement. *In re Bellevue Place Associates*, 171 B.R. 615, 623 (N.D. Ill. 1994).

**a. Cause exists for the appointment of a trustee based on the conduct of debtors’ management**

Fraud, dishonesty, incompetence, and gross mismanagement of a debtor’s business affairs are all cause for appointment of a chapter 11 trustee under 11 U.S.C. § 1104(a)(1). *See, e.g., In re Sharon Steel Corp.*, 871 F.2d 1217 (3d Cir. 1989); *In re Colby Construction Corp.*, 51 B.R. 113, 116-118 (Bankr. S.D.N.Y. 1985). The categories enumerated in 11 U.S.C. §1104(a)(1) “cover a wide range of conduct” and are best described as illustrative, rather than exclusive. *See In re Marvel Entertainment Corp.*, 140 F. 3d 463, 472 (3d Cir. 1998)(quoting *Committee of Dalkon Shield Claimants v. A.H. Robbins Co.*, 828 F. 2d at 242). The determination of whether cause exists must be taken on a case by case basis, taking into account all relevant factors. *Sharon Steel*, 871 F.2d at 1225. Where the court finds either that cause exists or that appointment is in the interest of the parties, an order for the appointment of a trustee is mandatory. *Official Comm. Of Asbestos Pers. Injury Claimants v. Sealed Air Corp. (In re W.R. Grace & Co.)*, 285 B.R. 148, 158 (Bankr. D. Del. 2002).

In this case, it appears that, at a minimum, management was incompetent and, at worst, fraudulent, in diverting the Debtors’ assets to Mr. Lewis’ other companies while the Debtors were plunging into bankruptcy. Clearly, this management team does not understand how to conform its behavior to comply with its contractual commitments, much less to raise to meet the standard of a fiduciary. Whether by incompetence or by gross mismanagement or otherwise, the debtors’ management team acted in a manner

prepetition in liquidating assets and dissipating proceeds of collateral that should give no creditor confidence in their ability to act as a debtor in possession. Moreover, these leopards apparently did not change their spots in the months immediately preceding bankruptcy. Rather than paying their obligations to secured creditors during the months leading to bankruptcy, the Debtors instead ceased making any payments whatsoever while deceptively secreting millions of dollars in cash.

“Cause” exists for the appointment of a Chapter 11 Trustee because management, through its history of deceptive acts and gross mismanagement of the debtor, has (i) threatened the viability of the debtors, (ii) failed, and continues to fail, to preserve assets for the benefit of its creditors and (iii) demonstrated that it should not be entrusted with management of the Debtors’ assets. Determinations under § 1104(a) are fact intensive. Whether cause exists is a matter within the discretion of the court. *Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc.*, 828 F.2d 239, 240 (4th Cir. 1987).

Factors to consider in determining whether to appoint a Chapter 11 Trustee include: (1) materiality of misconduct; (2) evenhandedness or lack thereof in dealings with insiders or affiliated entities vis-à-vis other creditors or customers; (3) the existence of pre-petition voidable preferences or fraudulent transfers; (4) unwillingness or inability of management to pursue estate causes of action; (5) conflicts of interest on the part of management interfering with its ability to fulfill fiduciary duties to the debtor; and (6) self-dealing by management or waste or squandering of corporate assets. *In re Intercat, Inc.*, 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000)(citing *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239 (4<sup>th</sup> Cir. 1987). *See also In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1990) (additional factors to consider in

determining whether a trustee should be appointed include “the overall management of the debtor, both past and present; the trustworthiness of the debtor’s management; the nature of and availability of financial records; the movement of funds between the debtor and related entities; the ability of management to act as a fiduciary for the estate; and pragmatic considerations such as cost”) and *In re Rivermeadows Associates, Ltd.*, 185 B.R. 615, 617 (Bankr. D. Wyo. 1995). Every one of these factors points in favor of a trustee in this case!

A debtor in possession has the fiduciary duty to preserve estate assets for the benefit of creditors. *In re Nautilus of New Mexico, Inc.*, 83 B.R. 784, 789 (Bankr. D.N.M. 1988)(citing *In re Four Score Broadcasting, Inc.*, 77 B.R. 404, 407 (Bankr. W.D.N.Y. 1987)). When a debtor in possession is incapable of performing these duties, a trustee is properly appointed. *Id.* (citations omitted). *See also* Glenda Raborn, *Setting Standards for Appointment of a Chapter 11 Trustee Under § 1104(a)(1) of the Bankruptcy Code: Can a Debtor Cooperative Remain in Possession?* 18 MSCLR 509, 526 (Spring 1998) (courts tend to find “cause” under § 1104(a)(1) to remove debtors who detrimentally affect the reorganization effort or are dissipating the estate’s assets).

If the Court determines that “cause” exists for the appointment of a trustee, the appointment becomes mandatory. *In re McCordi Corp.*, 6 B.R. 172 (Bankr. S.D.N.Y. 1980); *see also In re V. Savino Oil & Heating Co.*, 99 B.R. 518 (Bankr. E.D.N.Y. 1989) (“Once the court has found that cause exists under § 1104(a)(1), there is no discretion; an independent trustee must be appointed.”).

**b. Appointment of a trustee is in the best interests of creditors**

Section 1104(a)(2) of the Bankruptcy Code provides a second basis for the

appointment of a chapter 11 trustee: “if such appointment is in the interests of creditors.” Courts have construed Section 1104(a)(2) to provide for a “flexible standard.” *See, e.g., In re Sharon Steel Corp.*, 871 F. 2d at 1226; *see also In re Ionosphere Clubs, Inc.*, 113 B.R. 164 (Bankr. S.D.N.Y. 1990). The Court has particularly wide discretion under § 1104(a)(2), which sets forth a flexible standard for the appointment of a trustee, even when no “cause” exists. *See In re Bellevue Place Associates*, 171 B.R. 615 (Bankr. N.D. Ill. 1994). The “factors constituting a basis for appointment of a trustee under § 1104(a)(2) are amorphous, diverse and necessarily involve a great deal of judicial discretion.” *Committee of Dalkon Shield Claimants*, 828 F.2d at 240. Section 1104(a)(2) emphasizes the court’s discretion, allowing it to appoint a trustee when to do so would serve the parties’ and the estates’ interests.” *Id.*

Courts have considered the following factors in determining whether the appointment of a trustee is in the best interest of the parties under Section 1104(a)(2): (1) the trustworthiness of the debtor; (2) the debtor’s past and present performance and prospects for the debtor’s rehabilitation; (3) the confidence or lack thereof of the business community and of creditors in present management; and (4) the benefits derived by the appointment of a trustee, balanced against the cost of the appointment. *See In re Cajun Electric Power Co-Op, Inc.*, 1991 B.R. 659 661-62 (M.D. La. 1995) *aff’d* 74 F.3d 599 (5th Cir. ), *cert. denied*, 117 S. Ct. 51 (1996); *Accord Inre Ionosphere Clubs, Inc.*, 113 B.R. at 168. *See also In re Evans*, 48 B.R. 46 (Bankr. W.D. Tex. 1985) (considering the trustworthiness of the debtor; the reasons the debtor acted as it did; reliance and harm to another party; evidence of detriment to the estate; the possibilities of future rehabilitation; and whether the costs of a trustee outweigh the protection

provided to the estate by the appointment).

The facts in this case when applied to these considerations of the court demand appointment of a trustee in this case.

It is axiomatic that a debtor in possession is a fiduciary. As a fiduciary, the debtor in possession does not act in its own interest but, like a trustee, must act in the best interest of the creditors of the estate. *Commodity Futures Trading Comm. v. Weintraub*, 47 U.S. 343, 354-55 (1985). In making that determination, courts should be cognizant of the fact that “section 1104 represents a protection that the court should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession.” *In re V. Savino Oil & Heating Co., Inc.*, 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989). And, “in an appropriate case, the appointment of a trustee is a power that is critical for the Court to exercise in order to preserve the integrity of the bankruptcy process and to insure that the interests of creditors are served.” *In re Intercat, Inc.*, 247 B.R. 911, 920 (Bankr. S.D. Ga. 2000).

The *Marvel* Court applied flexible best-interests standard and affirmed the district court’s appointment of a trustee in a case where the “level of acrimony found to exist certainly [made] the appointment of a trustee in the best interest of the parties and the estate.” *Marvel Entertainment Corp.*, 140 F. 3d at 474. The court concluded that the parties’ sharp divisions on many issues supported the district court’s exercise of discretion in appointing a trustee. *Id.* at 474-476.

Here, an analysis of the relevant facts clearly demonstrates that the appointment of a chapter 11 trustee is in the best interest of the parties and the Debtors’ estates as the Debtors’ creditors have no trust in management and, if these cases continue on their

present trajectory, there is no prospect for the Debtors' rehabilitation.

As the Examiner's Report has underscored, the Debtors' owner and sole director - clearly a fiduciary -- breached both his fiduciary duty of care and of *loyalty* to the Debtors. ¶¶ 111, 114, 116. Movants maintain that the Debtors have consistently placed the interests of Debtors' management and equity ahead of the interests of creditors in violation of their fiduciary duties. Accordingly, the appointment of a trustee is also warranted under §1104(a)(2) of the Bankruptcy Code.<sup>7</sup>

Once a party in interest has established the benefits that would flow from the appointment of a trustee, the court can then complete the cost-benefit analysis of making such an appointment. *Sharon Steel*, 871 F.2d at 1220. In *Sharon Steel*, the court upheld the bankruptcy court's finding that the cost of having a trustee installed was trivial when compared with the costs of administration and the enormous benefit to be achieved by the re-establishment of trust and confidence in management. *Id.*

Here, as in *Sharon Steel*, the cost of appointing a trustee would be trivial when compared to the enormous benefit to be achieved from jump starting the reorganization process herein and the re-establishment of trust and confidence in management.<sup>8</sup>

Management's fraud and gross mismanagement of the debtors has caused and continues to cause assets to dissipate. Thus, cause exists for the appointment of a Chapter 11 trustee pursuant to § 1104(a)(1). Once cause is found, the Court must appoint

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<sup>7</sup> There is also a third basis in the code for the appointment of a trustee, that is, if there are grounds to convert or dismiss, as discussed hereinabove.

<sup>8</sup> Further, it is not necessarily true that the appointment of a trustee would eliminate the continuity of operational management. The court in *W.R. Grace* noted that an appointed trustee may make the rational decision to retain current management for the purpose of continuing operations, but the trustee would oversee the activities of the management. *W.R. Grace & Co.*, 285 B.R. at 160.

a trustee. Additionally, the appointment of a trustee is in the best interests of creditors under § 1104(a)(2) or as an alternative to dismissal under (a)(3).

For the foregoing reasons, Movants alternatively request that the Court order the appointment of a chapter 11 trustee in this case for the Debtors.

WHEREFORE, PREMISES CONSIDERED, WFS hereby respectfully requests that (1) the Debtors' bankruptcy cases be converted to chapter 7 as soon as practicable, or (2) alternatively, that the Court order the appointment of a chapter 11 trustee to oversee the Debtors' estates, and (3) that the Court grant WFS any further relief to which it may be legally or equitably entitled.

Respectfully submitted,

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AND FIFTH THIRD BANK

**CERTIFICATE OF CONFERENCE**

On February 10, 2010, I conferred telephonically with Debtor's counsel, Davor Rukavina, about the foregoing relief. The Debtor opposes the relief requested herein.

*/s/ Larry Chek* \_\_\_\_\_

Larry Chek

**CERTIFICATE OF SERVICE**

The undersigned certifies that he served all parties requesting notice in this case with a copy of the foregoing Motion via this Court's ECF electronic filing system on the date of filing of the Motion. To the extent that a party-in-interest requesting notice did not receive notice via this Court's ECF system, service of the Motion will be accomplished through United States Mail, First Class, e-mail, and/or facsimile no later than the next business day following the date of service hereof.

*/s/ Larry Chek* \_\_\_\_\_

Larry Chek