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E-filed November 19, 2007

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7
8 **UNITED STATES BANKRUPTCY COURT**
9 **DISTRICT OF NEVADA**

10
11 In re:

12
13 **VESCOR DEVELOPMENT, LLC**
14 **07-15210 -- Lead Case**

15 **ADL 1, LLC**
07-15211

16 **IDL 9, LLC**
07-15212

17 **JDL 10, LLC,**
18 07-15213

19 Debtors.

Jointly Administered

Chapter 11 Cases
Judge **Mike K. Nakagawa** Presiding

Date: November 13, 2007

Time: 9:30 a.m.

Place: Courtroom # 2

Affecting:

All Cases

or Only:

Vescor Development, LLC

ADL 1, LLC

IDL 9, LLC

JDL 10, LLC

20
21 **THE UNITED STATES TRUSTEE'S FINAL REPLY REGARDING THE**
22 **APPOINTMENT OF A TRUSTEE PURSUANT TO 11 U.S.C. § 1104(a)**

23 To the Honorable **MIKE K. NAKAGAWA**, United States Bankruptcy Judge:

24 Following a hearing on November 13, 2007, the Court took the United States Trustee's
25 Motion for the Appointment of a Trustee Pursuant to 11 U.S.C. § 1104(a), and a variety of
26 related pleadings, under advisement. At the November 13, 2007 hearing, the Court afforded
27 debtors the opportunity for supplemental briefing. The Court also authorized the United States
28

1 Trustee to file a final reply brief by 12:00 p.m. Pacific time on Monday, November 19, 2007.
2 This final reply brief is supported by the pleadings and papers comprising the official Court files
3 in the cases identified in the caption, and the following Memorandum of Points and Authorities.

4 **MEMORANDUM OF POINTS AND AUTHORITIES**

5 **I.**

6 **INTRODUCTION**

7 At the November 13, 2007 hearing, the Court carefully considered, and correctly denied,
8 the debtors' claims that "new legal arguments" were advanced in the United States Trustee's
9 reply to the debtors' opposition to the trustee motion.¹ There is no reason to revisit that issue.

10 In their most recent filing, debtors suggest that there is no "independent evidence" of
11 facts which would support a finding of cause for the appointment of a trustee under 11 U.S.C.
12 § 1104(a). In reality, the only evidence admitted into the record at the November 13, 2007
13 hearing was evidence offered by the United States Trustee in the form of exhibits and requests
14 for judicial notice. The record evidence before the Court is sufficient to meet the burden of
15 proving that cause does in fact exist for appointment of a trustee pursuant to 11 U.S.C. §
16 1104(a). Debtors did not offer a scintilla of proof - - not witness testimony, an affidavit, or an
17 exhibit - - to counter the evidence presented by the United States Trustee in support of its
18 motion.²

19 Instead, at the November 13, 2007 hearing, debtors' counsel generally engaged in a
20 colloquy with the Court regarding a purported "global settlement." However, there is no
21 evidence in the record before the Court - - not witness testimony, an affidavit, or an exhibit - -
22 that establishes the existence, scope, terms, or parties to such a "global settlement." In addition

23 _____
24 ¹See generally DE # 99 and 101.

25 ²The debtors' position is akin to the position taken by opponents of a motion for appointment of a trustee in
26 In re Sharon Steel, 871 F.2d 1217 (3d Cir. 1989). In Sharon Steel, the parties opposing the appointment of a trustee
27 "hoped to sail past the trustee appointment by arguing that the court's remaining determinations of postpetition gross
28 mismanagement do not satisfy the heavy burden of proof imposed on the movants." Id. at 1228. The conclusion
reached by the Third Circuit Court of Appeals in Sharon Steel is compelling here: "We conclude that the bankruptcy
court did not abuse its discretion by appointing a trustee. Therefore, we will affirm the judgment of the district
court." Id. at 1229.

1 to falling far short of being admissible evidence, the substance of the commentary made by
2 debtors' counsel is irrelevant. The undisputed record evidence compels a finding that cause for
3 appointment of a trustee exists. "Once the court finds that cause exists under § 1104(a)(1), *there*
4 *is no discretion; an independent trustee must be appointed.*" In re SunCruz Casinos, 298 B.R.
5 821, 828 (Bankr. S.D. Fla. 2003)(emphasis added), *citing* In re Oklahoma Refining Co., 838 F.2d
6 1133, 1136 (10th Cir. 1988)(emphasis added) *and cf.* Committee of Dalkon Shield Claimants v.
7 A.H. Robins Co., 828 F.2d 239, 242 (4th Cir. 1987).

8 LEGAL ARGUMENT

9 A. Additional Record Establishes Southwick's Unwillingness and Inability to 10 Pursue Estate Causes of Action

11 Debtors suggest that there is only "innuendo" to support the position that the debtors are
12 unwilling to pursue actions relating to over \$19 million in intercompany receivables, and over
13 \$5.5 million in potentially recoverable preference payments to insider entities. To the contrary,
14 the existence of those receivables and potentially recoverable preferences are confirmed by
15 pleadings the debtors caused to be filed with the Court under oath. *See* Exhibit 4, p. 13 of 18;
16 Exhibit 5, p. 12 of 26; Exhibit 6, p. 12 of 28; Exhibit 8, pp. 3-4 of 13; Exhibit 10, p. 3 of 9. In
17 addition to that record evidence, at the November 13, 2007 hearing, the Court took judicial
18 notice of the fact that no adversary proceedings have been commenced by the debtors seeking to
19 recover those sums.

20 The record before the Court is replete with proof, not innuendo, establishing that
21 Southwick is unable to cause the debtors to take action directed toward recovery of their
22 intercompany receivables and preference claims. In addition to asserting his Fifth Amendment
23 right against self-incrimination, Southwick's attorneys have already instructed him not to sign
24 "amended petitions, amended schedules, amended statements of affairs, monthly operating
25 reports, declarations or applications seeking to employ professionals with respect to the cases the
26 Debtors [sic]." *See* Pachulski Declaration, DE # 62 at p. 9 para. 29 - p. 10 para. 31. *See* In re
27 Fiesta Homes of Georgia, Inc., 125 B.R. 321, 325-26 (Bankr. S.D. Ga. 1990), *citing* In re L.S.
28 Good & Co., 8 B.R. 312 (Bankr. N.D. W. Va. 1980)(removal of present management and

1 appointment of trustee is appropriate where there is a strong probability of conflict of interest
2 such as to hinder management's ability to make impartial investigations and decisions in
3 pursuing claims on behalf of the estate).

4 The record evidence developed at the November 13, 2007 hearing establishes that
5 Southwick has not caused, and is in no position to cause, the debtors to pursue intercompany
6 receivables and preference claims. Those claims comprise the bulk of the debtors' assets other
7 than real estate holdings, and an independent trustee is necessary to ensure that those claims are
8 properly evaluated and pursued. *See In re Intercat, Inc.*, 247 B.R. 911, 922-23 (Bankr. S.D. Ga.
9 2000)(where debtor's manager, his family and closely held corporations were targets of claims
10 held by debtor's estate, court found it "impossible to believe" that the manager would pursue
11 those claims "in the manner that a disinterested person would.").

12 **B. The Record Confirms That Southwick Suffers From a Conflict of Interest**
13 **That is Interfering With His Ability to Fulfill Fiduciary Duties as Manager of**
14 **the Debtors**

15 Debtors rely on the existence and terms of a "global settlement" that has no evidentiary
16 foundation in the record before the Court in advancing the argument that Southwick does not
17 have a conflict of interest and has acted in keeping with his fiduciary duties as the debtors'
18 manager (notwithstanding his refusal to testify or otherwise participate in these proceedings
19 based upon his Fifth Amendment right to avoid self-incrimination). There is no substance to
20 debtors' position.

21 The record evidence is that while enjoying management control over the debtors, and
22 during negotiations with third parties that took place after the debtors' bankruptcy petitions were
23 filed, Southwick agreed to the transfer of the debtors' real estate interests to third parties, subject
24 to the condition that "All lawsuits against Val Southwick and Vescor and other parties will have
25 to be settled. The settlement will require that all parties agree to release any claims against any
26 and all other parties included in the agreements." *See* Exhibit 12 at DE #85-2, p. 9 of 11. The
27 debtors' \$19 million in intercompany receivables, and over \$5.5 million in preference claims
28 against insider entities, would be destroyed through such a settlement and release agreement.
Significantly, while Southwick was engaged in those negotiations, he refused to answer related

1 questions at the 341 meeting of creditors. When asked under oath at October 3, 2007 meeting of
2 creditors whether he was engaged in attempts to sell the debtors' real estate assets, and to use the
3 proceeds to settle outstanding litigation with creditors or claimants of other entities, Southwick
4 refused to answer and asserted his right to avoid self-incrimination pursuant to the Fifth
5 Amendment to the United States Constitution. *See* Exhibit 1, p. 55 l. 3 - p. 56 l. 19.

6 Southwick's conflict of interest alone, established by evidence admitted into the record at
7 the November 13 2007 hearing, is sufficient cause to warrant the appointment of a trustee. *See*
8 SunCruz Casinos, 298 B.R. at 831 (collecting cases holding that conflicts of interest alone are a
9 sufficient basis to appoint a trustee), *citing* In re Cajun Elec. Power Cooperative, Inc., 74 F.3d
10 599 (5th Cir. 1996), In re Fiesta Homes of Georgia, Inc., 125 B.R. 321, 325 (Bankr. S.D. Ga.
11 1990), *and* In re Bellevue Place Associates, 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994); *see also*
12 Intercat, 247 B.R. at 922-23 (where debtor's manager, his family and closely held corporations
13 were targets of claims held by debtor's estate, court found it "impossible to believe" that the
14 manager would pursue those claims "in the manner that a disinterested person would.").

15 **C. There is No Admissible Evidence of a "Global Settlement" in the Record**
16 **Before the Court, and a Trustee Must Be Appointed Now.**

17 The entirety of Section C of debtors' Response is dedicated to discussions regarding a
18 "global settlement." As noted previously, there is no evidence in the record before the Court - -
19 not witness testimony, an affidavit, or an exhibit - - that establishes the existence, scope, terms,
20 or parties to such a "global settlement."³ In addition to falling far short of constituting
21 admissible evidence, the substance of the commentary made by debtors' counsel is irrelevant.
22 The undisputed record evidence compels a finding that cause for appointment of a trustee exists.⁴

23
24 ³It is worthy of note that in their Response, debtors asserted that "on Monday, November 19, the Debtors
25 intend to file a proposed chapter 11 plan implementing the global settlement[.]" Response, DE # 106, at p. 2 of 7.
As of the filing of this Final Reply, no such filing has occurred.

26 ⁴Notably, in addition to the complaints and other papers admitted into evidence as Exhibits 13 -20, debtors'
27 response discloses the interest of the Securities and Exchange Commission and the Utah Securities Division in
28 Southwick's affairs. *See* Response, DE # 106, p. 4 ll. 13 - 23. Such information is "also relevant to a determination
regarding trustee appointment. [. . .] Here, the bankruptcy judge was aware of such allegations not only through the
trustee appointment process, but also by virtue of overseeing a related bankruptcy proceeding. It would be
inconsistent with the discretion and equitable powers afforded a bankruptcy court judge not to permit him to add

1 “Once the court finds that cause exists under § 1104(a)(1), *there is no discretion; an*
2 *independent trustee must be appointed.*” In re SunCruz Casinos, 298 B.R. 821, 828 (Bankr.
3 S.D. Fla. 2003)(emphasis added), *citing* In re Oklahoma Refining Co., 838 F.2d 1133, 1136 (10th
4 Cir. 1988)(emphasis added) *and cf.* Committee of Dalkon Shield Claimants v. A.H. Robins Co.,
5 828 F.2d 239, 242 (4th Cir. 1987).

6 Because cause has been established through admissible evidence, appointment of a
7 trustee is required by the express language of 11 U.S.C. § 1104(a)(1). Such an appointment
8 would be far from fatal to negotiations for a “global resolution” involving the assets held in the
9 debtors’ estates. To the contrary, a trustee would be in a position to evaluate the propriety of
10 such a resolution unburdened by the conflicts of interest, exposure to personal liability, and other
11 concerns that have kept Southwick from participating in these proceedings in any substantive
12 manner.

13
14 **CONCLUSION**

15 For the reasons and pursuant to the authorities discussed above, the United States Trustee
16 requests that the Court enter an order directing the United States Trustee to appoint a single
17 trustee to serve in these four jointly administered Chapter 11 cases pursuant to 11 U.S.C.
18 § 1104(a)(1) and (3), and FED. R. BANKR. P. 2009(c)(2). The United States Trustee further
19 requests that the Court grant such other and additional relief as is just and equitable.

20 Respectfully submitted,

21 **SARA L. KISTLER**
22 **ACTING UNITED STATES TRUSTEE**
23 **REGION 17**

24 By: /s/ August B. Landis
25 August B. Landis, Assistant United States Trustee
26 United States Department of Justice

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28 such knowledge and experience to the balance.” Tradex Corp. v. Morse (*In re Tradex Corp.*), 339 B.R. 823, 835 (D.
Mass. 2006).