U.S. BANKRUPTCY COURT
District of South Carolina

Case Number: **19-01198-hb**

ORDER GRANTING MOTION TO APPOINT CHAPTER 11 TRUSTEE

The relief set forth on the following pages, for a total of 21 pages including this page, is hereby ORDERED.

FILED BY THE COURT
05/13/2019

Entered: 05/13/2019

US Bankruptcy Judge
District of South Carolina

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

IN RE:	C/A No. 19-01198-HB
Mairec Precious Metals U.S., Inc.,	Chapter 11
Debtor(s).	**ORDER GRANTING MOTION TO APPOINT CHAPTER 11 TRUSTEE**

THIS MATTER came before the Court for consideration of the *Motion for an Order Directing the Appointment of a Chapter 11 Trustee, or Alternatively, Conversion of the Case to Chapter 7* filed John P. Fitzgerald, III, the Acting United States Trustee for Region 4 ("UST").[1] The Official Committee of Unsecured Creditors ("Committee") supported the Motion[2] and Debtor Mairec Precious Metals U.S., Inc. ("Mairec") objected.[3] Unsecured creditors Ford Component Sales, LLC and Volkswagen Group of America, Inc. ("VW") also responded.[4] Also pending before the Court and heard at the same hearing are Mairec's *Motion for Appointment of a Limited, Special Purpose Examiner to Investigate and Pursue and Debtor Claims Against Debtor's Shareholders and Former Officers, Directors, and Employees for Alleged Fraud or Actional Misconduct* ("Examiner Motion")[5] and the Committee's *Motion Pursuant to 11 U.S.C. § 1121(d) to Terminate the Debtor's Exclusive Right to Propose a Chapter 11 Plan and Solicit Acceptances*[6]

[1] ECF Nos. 84 & 85, filed Mar. 22, 2019.
[2] ECF No. 162, filed Apr. 12, 2019. The Committee members are Commerzbank AG, Davis Recycling, Inc., 366 Processing Service, Inc., PGM of Texas, and Unicredit Bank, AG.
[3] ECF No. 157, filed Apr. 12, 2019. *See also* ECF No. 188, filed Apr. 19, 2019.
[4] ECF Nos. 158 & 161.
[5] ECF No. 128, filed Apr. 4, 2019.
[6] ECF No. 130, filed Apr. 5, 2019.

(collectively, the "Remaining Motions"). Contested hearings were held on April 23, 24, and 30, 2019.[7]

FACTUAL AND PROCEDURAL BACKGROUND

Mairec, a South Carolina corporation operating in Spartanburg, was formed in 2015. It employs approximately 40 people and specializes in the recovery of precious metals (platinum, palladium, rhodium, and gold) from discarded materials. Mairec's business consists of collecting and recycling scrap metal – including catalytic converters, industrial catalysts, and other industrial waste – to extract the material containing precious metals for sale downstream to its own customers or trading houses. Because these metals are found in varying amounts with each recycled material, Mairec developed a sampling method for determining what percentage of the total materials from each supplier contain a precious metal. Samples are taken from large shipments of metals to be recycled, which are referred to as "Lots," processed separately (e.g., ground down to powder), sampled, and then "assayed." The supplier is paid a fixed contractual rate (percentage) based on the determination of the precious metal content found by laboratory testing of the sample taken. After the supplier is paid, Mairec ships, and sometimes sells, the processed material to refineries to further concentrate the precious metals.

To offset risk and lock in prices for the precious metals, Mairec sometimes "hedges" (e.g., sells in advance by locking in a price now for a future date) on behalf of their customers on the current market price to trading houses. This strategy helps Mairec

[7] When the Court was ready to enter a decision in this matter on May 3, 2019, counsel for Mairec communicated with the Court that Mairec and the Committee sought additional time to discuss their differences and requested the Order be held until May 13, 2019 at 10:00 a.m. (ECF No. 225). The UST indicated no objection to this request. (ECF No. 233). At 9:55 a.m. on May 13, 2019, Mairec filed correspondence on behalf of itself and the Committee asking for a further extension, with no details regarding any progress, and the two parties could not agree on the length of any extension. (ECF No. 236). The request for further delay was denied. (ECF No. 237).

and its customers avoid losing significant profit. Mairec maintains an operating account with Wells Fargo as well as metal pool accounts held by the refiners, which contain an inventory of metals Mairec has processed that can be transferred or liquidated into cash.

The German company Mairec Edelmetallgesellschaft mbH ("MG") owns 100% of the common stock of Mairec. Julia Maier and Thomas Maier are the owners of MG and reside in Germany. Julia Maier is also the President of MG.

366 International, Inc. ("366") was a large supplier of material to Mairec. Mark Hartig, Mairec's former Controller, testified at the hearing that through his position and various duties he had access to certain files and generated monthly financial reports for Julia Maier. While conducting these reports in July 2018, Hartig noticed uncharacteristic changes in Mairec's profits and abnormal discrepancies between percentages of precious metals in the assay results reported to customers compared to payment to Mairec based on the percentage from the refinery's results. Hartig testified that he learned that certain employees of Mairec may be contaminating samples of materials related to 366 in a manner that benefitted Mairec and harmed 366. Hartig was advised that Mikhail Khaimov (Mairec's President), Alex Eigenseer (the plant manager), and Julia Jagupov (the lab supervisor) instructed certain Mairec employees to contaminate the samples, many at Mairec's operation were aware of it, and the contamination had occurred since 2015.

On August 30, 2018, Khaimov tendered a resignation letter to Mairec. The board accepted Khaimov's resignation as of August 31, 2018, and temporarily appointed Julia Maier as President of Mairec. Thus, Julia Maier served as President and board member of Mairec as well as President and shareholder of its owner, MG. Michael Zoeller was

Mairec's Treasurer, and Julia and Thomas Maier its Directors. Zoeller was also the Controller of MG and Michael Zendel was a Vice President of MG.

In September 2018, Hartig advised 366 that it did not receive correct payments for certain materials delivered and tested at Mairec's facility. MG retained the law firm of Smith, Gambrell & Russell LLP ("SGR") to begin an investigation into the alleged contamination. MG also sent Zendel to Mairec to assist. In October 2018, Zendel was elected by Mairec's directors (Julia and Thomas Maier) to serve as its Vice President; thus, he simultaneously served as Vice President for Mairec and MG. As a result of the investigation, Eigenseer and Jagupov were terminated by Mairec.

On October 23, 2018, 366 filed a Complaint against Mairec, MG, and Khaimov in the United States District Court for the District of South Carolina.[8] The Complaint alleges in part that Mairec committed fraud by adding contaminates to 366's samples, thereby lowering the estimated value of those samples and the percentage to be paid to 366 on its Lots, and seeks damages in excess of $16,000,000.00. On the same day, 366 also filed a motion for a prejudgment writ of attachment, which was denied without prejudice. In November 2018, PGM of Texas, LLC ("PGM"), another supplier, filed a motion to intervene in the 366 litigation, asserting it was injured by the same conduct alleged by 366, and is owed approximately $3,000,000.00 in damages. Additional parties also assert they were injured by this alleged misconduct by Mairec and assert damages of approximately $1,300,000.00.[9]

[8] *366 Process Service, Inc. v. Mairec Precious Metals U.S., Inc. et al.*, C/A No. 18-02874-BHH (D.S.C. Oct. 23, 2018).

[9] ECF No. 1, filed Mar. 1, 2019. According to Mairec's Schedule E/F, other claims arising from this litigation are held by: Davis Recycling in the amount of $847,000.00; Ford Component Sales, LLC in an unknown amount and marked as unliquidated; and LKQ Corporation in the amount of $500,000.00. These claims are marked as disputed.

As a result of the District Court action and the allegations made against Mairec, the majority of Mairec's other customers terminated their relationships. Mairec also lost relationships with refineries and had to ship its material to MG for refinement. Mairec's only customer as of the petition date was, and continues to be, VW. The parties have an agreement whereby Mairec processes VW's catalytic converters, sends the powder to a refiner, and returns the metals to VW via a metals account subject to certain contractual pricing terms. Mairec sends VW's Lots to MG for refining and testing and is paid a fee for processing the metals. The contract with VW expires on December 31, 2019.

In late 2018, Gary Leibowitz was retained by Julia Maier as Mairec's President to serve as counsel for Mairec.[10] SSG Advisors, LLC ("SSG") was engaged by Mairec in early December 2018 to act as its investment banker to attempt to market and sell Mairec's business as a going concern. Mairec intended to hire a CRO and new board, have SSG market the business, file for Chapter 11 relief in January, and close on a sale of Mairec by March 2019. In pursuit of that plan, Leibowitz consulted with major creditors regarding candidates for CRO and new board members and began discussions with potential new board members for Mairec in January 2019.

On January 15, 2019, Mairec hired Aurora Management Partners, Inc. to provide David Baker to act as CRO. The engagement letter with Aurora is signed by Julia Maier as Chairman of the Board for Mairec. Even after the CRO was retained, Julia Maier and MG exercised control over Mairec. For example, a services agreement dated January 21, 2019, between Mairec and MG (the "Services Agreement") was executed by Thomas Maier on behalf of MG and Julia Maier on behalf of Mairec without significant

[10] Leibowitz is a member of the firm Cole Schotz P.C.

consultation with the CRO. The Services Agreement states it is retroactive to March 1, 2015, to memorialize a verbal agreement reached between the contracting parties on that date and includes provisions that are unfavorable to Mairec, including: limiting the liabilities of MG; allowing MG to offset amounts owed; allowing for unilateral termination of the Agreement; and having jurisdiction in Germany and German law control the Agreement. When Baker was made aware of the Services Agreement prepetition, he voiced his protest and stated he would quit if it remained valid. However, there is nothing in the record to indicate the Services Agreement does not remain in place. Indeed, MG has submitted to Mairec retroactive invoices pursuant to the Services Agreement for services that date back to 2017, and Mairec continues to use some of the services of MG described in the Agreement.

Bankruptcy and sale plans were stalled by MG several times for its own benefit because MG wanted to ensure that its relationships with its lenders were secured before Mairec filed bankruptcy. In late January/early February 2019, Leibowitz resigned due to disagreements with Julia and Thomas Maier regarding delays in Mairec's plans.

On February 15, 2019, 366 renewed its motion for prejudgment writ of attachment in the District Court action, asserting Mairec was planning to liquidate and repatriate to Germany its primary asset. Baker testified that in late February 2019, creditors communicated to Mairec that due to delays, an involuntary bankruptcy petition may be filed against Mairec. A corporate resolution, effective March 1, 2019, was executed by Julia Maier and Thomas Maier as the directors of Mairec and by Julia Maier as President of MG, which provided "that all current members of the Board shall resign immediately," approved retention of Baker and Aurora as CRO, fixed the number of board members at

three, and appointed Ralph Strayhorn, III, Matthew R. Kahn, and Michael A. Almond to serve as independent members of the board. Resignations from Julia Maier as President of Mairec, Thomas Maier as Director, and Michael Zoeller as Treasurer were tendered to the new board, effective as of March 1, 2019.[11] There was no evidence of a formal resignation by Michael Zendel as Vice President of Mairec.

Mairec filed a voluntary petition for Chapter 11 relief on March 1, 2019. In addition to the voluntary petition, Mairec filed Schedule D showing no secured creditors, Schedule E/F listing $43,642,287.00 in liabilities, Schedule G, and Schedule H. No other schedules and statements were filed at that time. Laura Kendall, who works for Aurora, testified that the amount of $1,647,795.00 listed for MG on Mairec's Schedule E/F was derived from invoices MG provided for retroactive services pursuant to the Services Agreement. The listing for MG is not marked as disputed or unliquidated.

Upon a motion of Mairec, and due to the CRO's difficulty obtaining Mairec's books and records housed with MG, the deadline to file the remaining schedules and statements was extended to April 2, 2019. On that date, Mairec filed Schedule A/B showing total assets of $36,398,103.00, derived mostly from accounts receivable ("A/Rs") ($19,461,678.00)[12] and an operating account maintained at Wells Fargo ($8,342,148.00). The Schedule A/B includes a notation regarding these assets, stating these figures are "[u]naudited and subject to change through further analysis of transaction data obtained through the Debtor's parent company, and information obtained through claim reconciliation."

[11] While the evidence indicated no formal resignation was tendered by Julia Maier for her position as director of Mairec, it appears Mairec's board now consists of only Strayhorn, Kahn, and Almond.
[12] Schedule A/B indicates that $10,306,154.00 in A/Rs are more than 90 days past due.

At hearings on first day motions, counsel for Mairec represented that prior management of Mairec had been removed pre-petition, the business was to continue to operate with the independent board and CRO, and Mairec intended to consummate a quick sale of assets. The Court authorized Mairec's post-petition retention of the CRO.[13] The Court also approved Mairec's employment of SSG as its investment banker. The UST appointed the current Committee and the Court authorized the appointment of counsel for the Committee pursuant to § 327. In late March 2019, the Committee members, the CRO, and their respective counsel met to discuss a roadmap for the case but could not reach an agreement.

Julia and Thomas Maier signed a Unanimous Consent post-petition on behalf of MG providing:

> [MG], as the sole shareholder of [Mairec], wishes to clarify and affirm that neither the undersigned nor [MG] have exerted or will exert any dominion or control over the [Mairec] or its operations during the pendency of [Mairec's] chapter 11 bankruptcy.
>
> NOW, THEREFORE, BE IT RESOLVED AND CLARIFIED, that the undersigned individually and on behalf of [MG] irrevocably transfer all management authority and control of the [Mairec] to [Mairec's] new, independent Board of Directors and the CRO during the pendency of [Mairec's] chapter 11 bankruptcy; and
>
> RESOLVED that neither the undersigned, individually, nor [MG] may in any way alter [Mairec's] management structure during the pendency of [Mairec's] chapter 11 bankruptcy.

However, officers of MG and former officers of Mairec have been entwined in Mairec's business post-petition.

In addition to any ongoing business relationship, Mairec's financial and business records are housed on MG's computer system, and the CRO has experienced difficulties

[13] This is one of four CRO-type retentions that Baker is currently undertaking.

obtaining information regarding Mairec's finances. These difficulties arise from both the condition of the books and records themselves, which had not been reconciled since 2017, as well as MG's failure to promptly cooperate and provide information to the CRO. At the hearing, it was reported that Mairec now has the information needed for marketing. However, the absence of sufficient financial and business records has slowed Mairec's ability to progress efficiently. Almond, the new Chairman of the Board of Mairec, traveled to Germany in April 2019 to retrieve some of Mairec's information from MG to finalize SSG's data room and allow the CRO to fully operate Mairec. Zendel (Vice President of MG and Mairec) assisted with, and it is anticipated that he will continue to assist with, the marketing and sale of Mairec, including site visits with potential purchasers. Zendel also assisted the CRO with equipment repairs, engineering issues, and locating refiners.

Although initial cash flow reports indicated Mairec would continually lose money post-petition, Mairec provided updated reports that removed certain costs and made other adjustments to indicate an increase in cash flow. The evidence indicates that although improvements have been made while under the CRO's direction, even when Mairec has a significant revenue, it yields a small profit, if any, which is negated by the professional fees.[14]

Mairec scheduled no significant secured creditors[15] and has funded post-petition operations without post-petition borrowing through cash and assets on hand at filing, cash flow from the VW contract, and post-petition collection of some A/Rs. However, because

[14] *See* ECF No. 191, filed Apr. 23, 2019. The March monthly operating report indicates a net profit of $16,203.00 prior to payment of any professional fees, which were $277,140.00; however, $946,551.00 in revenue was required to generate that profit amount.

[15] The claims register and docket indicate some secured claims, but there is no lender with a lien on a significant portion of the assets.

Mairec's business has changed, these A/Rs have not been replenished by post-petition A/Rs at the same level. The profitability, if any, of Mairec's contract with VW has not been established. The revenue stream from this contract is currently insufficient to pay Mairec's ongoing obligations as well as the professional fees of this case.

Fees for Mairec's bankruptcy counsel, Committee fees, and CRO compensation continue to accrue without substantial progress toward a sale by the anticipated goal of June 2019.[16] The CRO fees incurred significantly exceed amounts budgeted, at least in part due to unanticipated complexity and increased scope of work.

The board members are paid $30,000.00 per month for their service. Almond and Strayhorn testified and articulated a plan the board formulated for decision-making. This plan was appropriate, but vague and aspirational – amounting essentially to using available resources to maintain business operations of Mairec until a sale can be accomplished, with a goal of maximizing the return to creditors and preserving a viable business for the benefit of the local community and the employees of the company. They expressed concern and a lack of confidence regarding the Committee's suggested path for this case.

Mairec filed the Examiner Motion after the issue of a trustee was raised, stating therein that there is an "alleged fraud," and "as a result of the [SGR] investigation, Hartig and lab technicians were terminated, and others who may have failed to comply with testing protocols were transferred, fired, or asked to resign."[17] The Examiner Motion asks for the

[16] At the hearings held in late April, the parties contemplated approval by the Court of a June sale, yet as of this date no pleadings have been filed to initiate that process.

[17] This implies that Hartig was involved in the alleged fraud; however, his testimony and the evidence received at the hearing do not support such an implication. Hartig credibly testified that he was terminated on October 25, 2018, for reasons unrelated to participation in any act of contamination. The pleadings correctly footnote the fact that Hartig is now an employee of 366 and copied Mairec's computer records before he left the company. Hartig credibly testified regarding the circumstances of his former and current employment and has turned over all information in is possession by consent. *See* ECF No. 180, entered Apr. 18, 2019.

appointment of a limited, special purpose examiner to investigate and pursue the allegations of fraud raised by the UST.

The evidence indicates the alleged fraud relates to and impacts, at a minimum, any analysis regarding the profitability and viability of Mairec's ongoing contract(s) and business, the value and collectability of its A/Rs and assets, claims it may have against various involved parties, and the claims reconciliation process. Although Mairec anticipates a sale within 60 days from the hearing, it is not clear that any investigation has occurred.[18] Any such investigation is outside the scope of the CRO's contractual engagement with Mairec and CRO testimony indicated a lack of action to determine what occurred and how it impacts this case. Mairec's board and current management have failed to act, other than filing the Examiner Motion.

The Committee members do not have confidence in the CRO's ability to effectively manage this case and make the best decision regarding Mairec's course of action going forward. They cite a lack of experience in this business and a lack of attention to or concern regarding issues they view as central to the success of this case, such as an analysis of the profitability of the contract with VW and disinterest in the impact of the pre-petition contamination. The Committee members allege the Maiers and MG are still asserting control over Mairec, at minimum citing control over the flow of information that the CRO and SSG need to progress. The Committee members appeared knowledgeable about Mairec's business model, operations, challenges, and options. They were also

[18] Although there was testimony about an investigation by SGR, it is unclear whether the resulting details of that investigation had been shared with any of the witnesses, other than a report that certain individuals' relationships with Mairec had ended. Further, Almond testified that he would have little confidence in that investigation.

knowledgeable about the Committee's role in this case and there is no evidence that they have exhibited any bad faith.

Reflecting on the evidence presented at the hearing, the parties agreed that Mairec has substantial value to offer a purchaser through a bankruptcy sale that should be accomplished promptly, resulting in a considerable disbursement to creditors. The parties seemed to agree that for the immediate future, business operations should be maintained while it is determined whether a sale as an ongoing business is possible. They also seemed to agree that the current obstacle to realizing value is uncertainty regarding how the case will proceed and who will be in charge. Any significant consensus appeared to end there. The proceedings exhibited distrust and animosity between the Committee and the CRO, the Committee and the board, and Committee counsel and counsel for Mairec. The CRO and Mairec counsel appeared vexed by the UST's filings and concern.

APPLICABLE LAW

This Court has subject matter jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A). Venue is properly before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

After considering the evidence, the Court's analysis in resolving the various matters is focused on § 1104(a), which provides:

> At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court **shall** order the appointment of a trustee –
>
> (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 . . . or
>
> (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.

11 U.S.C. § 1104(a) (emphasis added).

"The debtor-in-possession is a fiduciary of the creditors and, as a result, has an obligation to refrain from acting in a manner which could damage the estate, or hinder a successful reorganization." *In re Marvel Ent. Group, Inc.*, 140 F.3d 463, 471 (3d Cir. 1998). Therefore, the Chapter 11 debtor will generally remain in control of the estate, and the "appointment of a trustee should be the exception, rather than the rule." *In re Sharon Steel Corp.*, 871 F.2d 1217, 1225-26 (3d Cir. 1989) (citations omitted). "And 'there is a strong presumption in favor of allowing a chapter 11 debtor-in-possession to remain in possession.'" *In re Keeley & Grabanksi Land P'ship*, 455 B.R. 153, 162 (B.A.P. 8th Cir. 2011) (citing *In re Veblen West Dairy LLP*, 434 B.R. 550, 553 (Bankr. D.S.D. 2010)). As a result, the moving party must show that grounds for appointment exist by clear and convincing evidence. *In re Adelphia Commc's Corp*., 336 B.R. 260, 655-56 (Bankr. S.D.N.Y. 2006) (*citing Marvel*, 140 F.3d at 471).

This presumption, however, is rooted primarily in practical considerations. "In the usual chapter 11 proceeding, the debtor remains in possession throughout reorganization because 'current management is generally best suited to orchestrate the process of rehabilitation for the benefit of creditors and other interests of the estate.'" *Marvel*, 140 F.3d at 471 (quoting *In re V. Savino Oil & Heating Co.*, 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989)). "The strong presumption also finds its basis in the debtor-in-possession's usual familiarity with the business it had already been managing at the time of the bankruptcy filing, often making it the best party to conduct operations during the reorganization." *Id.* (citing *Sharon Steel*, 871 F.2d at 1226). However, [i]n the appropriate case . . . the facts

may militate against retaining the debtor as debtor-in-possession." *Taub v. Adams*, C/A No. 10-CV-02600-CBA, 2010 WL 8961434, at *5 (E.D.N.Y. Aug. 31, 2010) (citing *Marvel*, 140 F.3d at 471 (finding presumption inappropriate where management of a company was already conducted by interests other than the debtor at time of bankruptcy filing)). Therefore, the Court's decision to appoint a trustee must be made on a case-by-case basis. *In re Breland*, 570 B.R. 643, 657 (Bankr. S.D. Ala. 2017) ("The decision whether to appoint a trustee is fact intensive and the determination must be made on a case-by-case basis.").

The Code further instructs that:

> [t]he United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor's chief executive or chief financial officer, or members of the governing body who selected the debtor's chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial reporting.

11 U.S.C. § 1104(e). The UST's statutory requirement to "bring such a motion does not alter the standard for deciding whether to grant the motion. Rather, § 1104(a)(1) & (2), and the cases interpreting these subsections, continue to control whether a trustee should be appointed." *In re The 1031 Tax Grp., LLC*, 374 B.R. 78, 87 (Bankr. S.D.N.Y. 2007).

If the Court determines that cause exists, appointment of a trustee is mandatory. *Id.* at 86 (quoting *V. Savino Oil & Heating*, 99 B.R. at 525). The "determination of cause . . . is within the discretion of the court and due consideration must be given to the various interests involved in the bankruptcy proceeding." *Dalkon Shield Claimants v. A.H. Robins Co.*, 828 F.2d 239, 242 (4th Cir. 1987). "[T]he fact that the debtor's prior management might have been guilty of fraud, dishonesty, incompetence, or gross management does not necessarily provide grounds for appointment of a trustee under § 1104(a)(1), as long as a

court is satisfied that current management is free from the taint of prior management." *1031 Tax Grp.*, 374 B.R. at 86 (citing *In re Microwave Products of Am.*, 102 B.R. 666, 671 (Bankr. W.D. Tenn. 1989)).

In addition to § 1104(a)(1)'s enumerated examples of conduct constituting cause, courts have found cause to appoint a trustee based on the following factors:

a. Materiality of the misconduct;
b. Evenhandedness or lack of same in dealings with insiders or affiliated entities vis-a-vis other creditors or customers;
c. The existence of pre-petition voidable preferences or fraudulent transfers;
d. Unwillingness or inability of management to pursue estate causes of action;
e. Conflicts of interest on the part of management interfering with its ability to fulfill fiduciary duties to the debtor;
f. Self-dealing by management or waste or squandering of corporate assets.

In re SunCruz Casinos, LLC, 298 B.R. 821, 830 (Bankr. S.D. Fla. 2003) (citing *In re Intercat, Inc.*, 247 B.R. 911, 921 (Bankr. S.D. Ga. 2000)). Additionally, "inappropriate relations between corporate parents and subsidiaries . . . inadequate record-keeping and reporting . . ." may constitute cause for appointment of a trustee. *In re Futterman*, 584 B.R. 609, 616 (Bankr. S.D.N.Y. 2018) (citing *In re Altman*, 230 B.R. 6, 16 (Bankr. D. Conn. 1999), *vacated in part on other grounds*, 254 B.R. 509 (D. Conn. 2000)).

"[T]he court may appoint a trustee under subsection (a)(2) even though the party requesting such appointment is unable to establish the requisite 'cause' required for an order of appointment of a trustee under subsection (a)(1)." 7 *Collier on Bankruptcy* ¶ 1104.02 (16th ed. 2019). Unlike § 1104(a)(1), which provides for a mandatory appointment of a trustee upon a specific finding of cause, § 1104(a)(2) "envisions a flexible standard." *Keeley & Grabanski Land P'ship*, 455 B.R. at 165 ("A Bankruptcy Court has

particularly wide discretion to appoint a trustee under the flexible standard of § 1104(a)(2) of the Bankruptcy Code, even when no cause exists under § 1104(a)(1)." (citing *In re Bellevue Place Assocs.*, 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994))). The Court is given discretion to appoint a trustee "when to do so would serve the parties' and the estate's interests." *Marvel*, 140 F.3d at 474 (quoting *Sharon Steel*, 871 F.2d at 1226); *see also 1031 Tax Group*, 374 B.R. at 91 ("§ 1104(a)(2) reflects the 'practical reality that a trustee is needed'" (quoting *V. Savino Oil & Heating*, 99 B.R. at 527 n.11)).

Under § 1104(a)(2), the Court uses a cost/benefit analysis and general principles of equity to determine whether appointment of a trustee is in the best interests of the estate. *In re Bergeron*, C/A No. 13-02912-8-SWH, 2013 WL 5874571, at *9 (Bankr. E.D.N.C. Oct. 31, 2013) (citations omitted). Factors considered in balancing these interests are: (1) the trustworthiness of the debtor's management; (2) the debtor's historical performance and prospects for rehabilitation; (3) whether the business community and creditors' confidence in the debtor's management has been eroded; and (4) whether the benefits outweigh the costs. *Id.* (citations omitted). "Loss of confidence, or extreme acrimony, have each been held by courts to constitute elements relevant to the decision of whether it is in the best interests of creditors and others under section 1104(a)(2) to appoint a trustee." *In re Sundale, Ltd.*, 400 B.R. 890, 909 (Bankr. S.D. Fla. 2009) (citing *Marvel*, 140 F.3d 463).

> [A] loss of confidence may result from a simple inability to work with the current managers, which could interfere with the operation of the business and the negations of a reorganization plan. In such a case, the higher standard of fraud may not be met, but appointment of a trustee may still be in the interests of creditors, equity security holders and other parties in interest.

7 *Collier on Bankruptcy* ¶ 1104.02. "[W]hen significant tensions are present among the parties . . . appointment of a trustee may diffuse tensions and relieve suspicions about the

debtor's managers. This may be essential to successful completion of plan negotiations and ultimate reorganization of the debtor." *Id.*

DISCUSSION AND CONCLUSIONS

Based on the facts set forth above, the UST had "reasonable grounds" to file this Motion pursuant to § 1104(e). The Court understands from the evidence that the UST and Committee do not assert Mairec's CRO or current board have acted or are acting dishonestly. Rather, the UST and Committee assert there was an alleged fraud, members of the governing body who selected Mairec's current CRO and board may have participated, this conduct should be investigated and, if actionable, relief should be pursued. The UST and Committee also assert that despite attempts to distance prior management from current operations, prior management and MG have continued to exert control and are entwined in Mairec's business.

Even after the CRO was retained, the owners of Mairec delayed the appointment of new board members and filing for bankruptcy relief in order to protect MG's interests. It is not clear that Mairec's prior management has fully removed itself from Mairec's operations and decision-making, as they still enjoy control over information, records, and computer systems, and are consulted for business decisions on behalf of Mairec. Until days before these hearings (and approximately two months after the petition date), the CRO was unable to obtain from MG all of Mairec's financial and operational records in order to fully do its job. Further, MG exerts control through the post-petition business relationship with Mairec. Mairec is owed a significant past due amount by MG, yet they continue to do business together under a retroactive Services Agreement that appears to serve the interests of MG, if there is a valid agreement at all. Overall, MG has interfered with the

CRO's ability to take appropriate steps to begin to stabilize and improve Mairec's financial condition and progress it toward a sale.

More importantly, the alleged fraud touches almost every aspect of this case yet remains unaddressed by current management. At a minimum, the fraud impacts any analysis regarding the profitability and viability of Mairec's ongoing contracts and business, the value and collectability of its A/Rs and assets, the claims reconciliation process, and the analysis of claims it may have against various parties. Mairec's prior management limited the CRO's role to exclude any investigation of the fraud and testimony confirmed that current management has not and is not engaged in investigation. This left the impression that such an investigation does not appear to be a priority for those in control of Mairec. There did not appear to be any action on behalf of Mairec to investigate the fraud for the benefit of the estate until the Examiner Motion was filed defensively. It is clear the major parties disagree on the progress of the case thus far and the priorities of current management, and question current management's ability to move forward effectively. These facts, taken together, demonstrate clear and convincing evidence that cause exists to appoint a trustee under § 1104(a)(1). The Code, therefore, instructs that a trustee *shall* be appointed.

Likewise, appointment of a trustee is in the best interests of the estate pursuant to § 1104(a)(2). In addition to the reasons mentioned above, clear and convincing evidence indicates the following. Although progress has been made by the CRO to rehabilitate the records and day-to-day operations of Mairec, the full picture of Mairec's past, present, and future performance is unclear. The historical numbers are not reliable if generated at a time when the company was committing acts to dishonestly increase profits. The present

performance indicates the contract with VW is not sufficient to cover Mairec's operational and ongoing professional expenses. Therefore, a prompt sale of Mairec's assets is contemplated. However, Committee members do not have confidence in the CRO's ability to effectively manage this case and move toward a sale due to the CRO's lack of experience in this business and lack of attention to or concern regarding issues they view as central to the success of this case (e.g., the profitability of the contract with VW and the impact of the pre-petition contamination). The Committee members appeared knowledgeable about Mairec's business model, operations, challenges, and options. With the benefit of that knowledge, they expressed a lack of confidence in the CRO's ability to make the best decision regarding Mairec's course of action in this case. Although the board's aspirational goals are appropriate, they did not appear to exert direct control over the method for executing any strategy.

A trustee, as an independent decision-maker, will remove uncertainty regarding the direction and control of this case and have the authority to move the case forward toward a sale. The trustee can diffuse the acrimony present between the parties, reduce the fees related to current disagreements, and provide a central contact and authority for potential purchasers. Current management has taken the case to this point from January 2019. While there will be a learning curve for a trustee, she or he will have the benefit of what has already been accomplished. This is not a situation where current management supplies years of expertise in running this business that will dissipate if a trustee is appointed. Rather, current management consists of professionals previously unrelated to Mairec who have only been in place for a few months. There is no reason to believe that current management or other professionals will not cooperate in any necessary transition.

The estate has already incurred and will continue to incur considerable professional fees for the CRO, board, and other professionals. There is no evidence that a trustee will significantly increase those expenses. As Mairec's Examiner Motion and the evidence indicate, some independent party is needed to investigate the alleged fraud and its impact on this case, and expenses will be incurred as a result. A trustee can accomplish this task. A trustee's review of claims will also alleviate any concerns of possible conflicts of interest in that pursuit. Overall, weighing benefits against costs, the appointment of a trustee appears to be the most effective way to move toward a prompt and decisive resolution of this case. As the evidence indicates that the business should continue to operate while the correct path is determined, the Court finds that appointment of a Chapter 11 trustee to operate the business will yield more flexibility and a better result than conversion to a case under Chapter 7.

Based on the foregoing, the Court finds that cause exists for appointment of Chapter 11 trustee under § 1104(a)(1), or alternatively, that appointment is in the best interests of the estate pursuant to § 1104(a)(2). Therefore, the UST's Motion is **GRANTED** and the UST authorized to appoint a Chapter 11 trustee pursuant to § 1104. As a result of this decision, the request to convert this case to Chapter 7 and the Remaining Motions are **DENIED**.

AND IT IS SO ORDERED.