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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

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U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:) Case No. 03-11098
)
PACIFIC FINANCIAL) Chapter 11
SERVICES OF AMERICA,)
) Judge Pat E. Morgenstern-Clarren
Debtor.)
) **MEMORANDUM OF OPINION**

Creditors The Huntington National Bank and The State of Ohio Department of Taxation and Department of Jobs and Family Services, joined by the United States Trustee, move under Bankruptcy Code § 1104 to appoint a Chapter 11 trustee to manage the Debtor's affairs. (Docket 19, 25). Two other creditors support the motion, although they did not participate in the evidentiary hearing held March 19, 2003. (Docket 30, 35). The Debtor opposes the motion. (Docket 31). For the reasons stated below, the motion is granted.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A).

THE EVIDENTIARY HEARING

The movants presented their case through the testimony of James Burns (records custodian for the law firm of McCarthy Lebit), Janet Wise (The State of Ohio Department of Jobs and Family Services), and Delbert Hanna (The State of Ohio Department of Taxation), together with cross-examination and exhibits. The Debtor presented its case through the testimony of Ada Briden (an employee of Midwest Fireworks Manufacturing Co., Inc. II), cross-examination, and exhibits.

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BANKRUPTCY CODE § 1104(a)

I.

When a business files for protection under Chapter 11 of the Bankruptcy Code, the management must adjust to fundamental changes. One such change is that the business is charged with new fiduciary responsibilities:

The filing entity is legally different from what it was the moment before filing, as it now assumes the mantle of a new juridical entity, a debtor-in-possession. As such it becomes an officer of the court subject to the supervision and control of the Bankruptcy Court and the provisions of the Bankruptcy Code.

In re V. Savino Oil & Heating Co., 99 B.R. 518, 524 (Bankr. E.D. N.Y. 1989). There is a strong presumption that a debtor will live up to this increased responsibility and should, therefore, be permitted to remain in control of its affairs. See *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 471 (3d Cir. 1998). Despite this presumption, the reality is that some debtors do not carry out their obligations. In those cases, the Bankruptcy Code provides the extraordinary remedy of appointing a Chapter 11 trustee to manage the debtor's business. *Id.*; 11 U.S.C. § 1104(a). Bankruptcy Code § 1104 "represents a potentially important protection that courts should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession." *In re V. Savino Oil & Heating Co.*, 99 B.R. at 525. That section provides:

(a) 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

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(2) if such appointment is in the interests of creditors . . . [and] other interests of the estate[.]

11 U.S.C. § 1104(a).

The party requesting the appointment has the burden of proving its case by clear and convincing evidence. *See In re Marvel Entm't Group, Inc.*, 140 F.3d at 471.

II.

When a party in interest is dissatisfied with the debtor-in-possession's conduct, one option under § 1104(a) is to seek to have a trustee appointed for cause. 11 U.S.C. § 1104(a)(1). While the statute specifies that cause includes fraud, dishonesty, incompetence, and gross mismanagement of the debtor's affairs, those factors are not exclusive. *See* 11 U.S.C. § 102(3).

Other relevant factors include:

- (1) Materiality of the misconduct;
- (2) Evenhandedness or lack of same in dealings with insiders or affiliated entities vis-a-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). “[W]hen a debtor fails to maintain complete and accurate financial records, or fails to substantiate undocumented transactions, so that there appears to be a confusion in the debtor’s accounting system, the courts have viewed these facts as gross mismanagement and have directed the appointment of a Chapter

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11 trustee.” *In re McCorhill Publ’g, Inc.*, 73 B.R. 1013, 1017 (Bankr. S.D. N.Y. 1987) (citations omitted). Additionally, a debtor’s failure to comply with its fiduciary duties and failure to be forthright in providing financial information are other indicia of cause for such an appointment. *See, for example, In re Sullivan*, 108 B.R. 555 (Bankr. E.D. Pa. 1989) (citing a debtor’s failure to file monthly operating reports, to report income, to remit payments of insurance proceeds, and to pay real estate taxes and quarterly fees as basis for finding of cause); *In re Cohoes Indus. Terminal, Inc.*, 65 B.R. 918 (Bankr. S.D. N.Y. 1986) (failure to provide financial information and to file proper schedules of assets and liabilities cited as cause).

III.

As a second option, § 1104(a)(2) “creates a flexible standard, instructing the court to appoint a trustee when doing so addresses ‘the interests of the creditors, equity security holders, and other interests of the estate’.” *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989). Relevant considerations include: (1) the debtor’s trustworthiness; (2) the debtor’s past and present performance and its prospects for rehabilitation; (3) the confidence of creditors and the business community in the debtor; and (4) the benefits to be derived from the appointment of a trustee compared to the costs of the appointment. *See Schuster v. Dragone*, 266 B.R. 268, 273 (D. Conn. 2001); *In re Colorado-Ute Elec. Assoc.*, 120 B.R. 164, 176 (Bankr. D. Colo. 1990); *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 168 (Bankr. S.D. N.Y. 1990). The appointment of a trustee under § 1104(a)(2) is left to the bankruptcy court’s discretion. *See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 501 (6th Cir. 1990) (noting that § 1104(a)(2) tracks a provision for the appointment of an examiner and “in both cases the appointment is left to the bankruptcy court’s discretion.”).

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FACTS AND DISCUSSION

I.

The Debtor filed its case on September 27, 2002 in Nevada. The Nevada Bankruptcy Court transferred the case to the Northern District of Ohio on December 31, 2002.

Laurence Lomaz is the Debtor's sole shareholder, officer, and director. Lomaz also owns a corporation called Midwest Fireworks Manufacturing Co., Inc. II. ("Midwest II"). The Debtor claims that it owns or owned or has some interest in property located at 8550 Route 224, Deerfield, Ohio which has been leased to Midwest II. *See* Schedule A (Docket 11). Midwest II has not paid rent to the Debtor for this property for several years. Midwest II sold retail and wholesale fireworks, a cash only business, from that location until December 2002 when creditor Albert Gibel bulldozed several buildings on the property and obtained a restraining order preventing Midwest II from entering the property. Whatever records were in the buildings are not currently available.

II.

The movants and the Debtor agree that the Debtor has failed to take these steps since the bankruptcy filing:

- (1) file Operating Reports for September 2002, October 2002, November 2002, December 2002, January 2003, and February 2003;
- (2) conclude the Meeting of Creditors required by Bankruptcy Code § 341 due to the failure of Laurence Lomaz to cooperate in setting a date for his examination;
- (3) open a debtor-in-possession checking account;
- (4) pay the quarterly fees owed to the United States Trustee under 28 U.S.C. § 1930; and

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- (5) file accurate and complete schedules, despite the Court's instruction to do so no later than February 20, 2003.

The evidence also showed that the Debtor has not paid an assessment made by the State of Ohio in 1988. The total due as of the hearing date was \$3,518.68.

Four creditors expressly support the appointment of a trustee and none oppose it.

The Debtor offered explanations for some of its acts and failures to act. Specifically, the Debtor argued that it is close to filing operating reports and amended schedules. That does not, however, adequately explain why the Debtor has not done so to date and why it did not do so earlier. Granted, the Debtor has retained new counsel to represent it in the Northern District of Ohio. The Debtor's Nevada counsel who filed the petition, however, should have used the three months that the case was pending in Nevada to complete the schedules and operating reports that were due through the time the case was in Nevada. The Debtor also pointed out that its efforts have been impeded by the destruction of the Deerfield buildings and the inability to access that property. The Debtor did not, though, pin down what records were in the buildings and how that impaired the Debtor's ability to comply with its obligations under the Code. Additionally, the destruction took place in December 2002, when the Debtor was already delinquent in filing the operating reports and schedules.

The Debtor acknowledged that the U.S. Trustee fees have not been paid, but intends to pay them. The Debtor did not explain why they have not been paid to date. The Debtor also represented that Lomaz would appear for the 341 meeting, but again did not explain why he had failed to do so to date.

Ada Briden testified on behalf of the Debtor although she is not an employee, officer or director of the Debtor and is not particularly familiar with the Debtor's operations or the pre-filing operations of Pacific Financial Services of America. She has been employed by Midwest II

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for several years, working out of the Deerfield property. There are oil and gas wells on the property that are operated by a third party. Briden did not satisfactorily explain the financial arrangements under which the third party conducts this business. Briden testified that the Debtor does not have any employees, income or a checkbook. Prepetition, she occasionally wrote checks on a Pacific Financial Services of America account for Lomaz's signature, which checks were used to pay Midwest II's bills. As far as she knows, the Debtor does not pay state taxes. She never communicates with Lomaz about the Debtor. In sum, Briden had little useful information about the Debtor or its operations, past or present.

Laurence Lomaz, the Debtor's president, shareholder, officer and director, presumably is the person who could have provided accurate information about the Debtor's operations, but he did not attend the hearing. Briden stated without further explanation that Lomaz was in Nevada. While Lomaz was not required to attend the hearing absent a subpoena, had he attended he could have filled in some of the missing information on the spot, such as the address of the Debtor's real property scheduled only as "condo, Ohio" and "house, Ohio." He could also have explained why the Debtor has not opened a debtor-in-possession checking account, why the Debtor's funds appear to be intermingled with funds of other related companies, why the Debtor does not collect rent on property it leases to other companies (including the Deerfield property and the oil and gas wells on it), and exactly what it is that the Debtor is currently doing to operate its business, especially given Briden's testimony that the Debtor does not have employees or income. Since Lomaz chose not to attend and sent an uninformed representative in his stead, the Court can only conclude that he lacks the necessary commitment to carry out the Debtor's responsibilities as a debtor-in-possession.

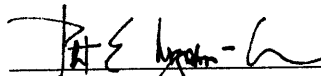
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To date, the Debtor has not timely carried out its responsibilities as the debtor-in-possession and did not present evidence at the hearing that would explain the failures and establish that they have been corrected. The Debtor has not provided the most basic financial information, leaving parties in interest in the dark as to the Debtor's business operations. The movants proved by clear and convincing evidence both that cause exists to appoint a Chapter 11 trustee and that such an appointment would be in the best interests of the creditors and the estate.

CONCLUSION

For the reasons stated, the motion to appoint a trustee is granted. A separate order will be entered reflecting this decision.

Date: 28 Mar 2003



Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Morris Laatsch, Esq.
Maria Giannirakis, Esq.
David Douglass, Esq.
James Ehrmann, Esq.

By: Joyce L. Gordon, Secretary

Date: 3/28/03

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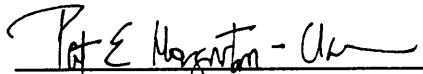
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:) Case No. 95-12349
)
PARIS CONNECTION BY CAROL, INC.,) Chapter 11
)
Debtor.) Judge Pat E. Morgenstern-Clarren
)
) **ORDER**
)

For the reasons stated in the Memorandum of Opinion filed this same date,

IT IS, THEREFORE, ORDERED that the Application of Eva Gabor International, Ltd.
for Payment of Administrative Expense is granted in part in the amount of \$2797.00 pursuant to
11 U.S.C. § 503(b)(4). The remainder of the Application is denied.

Date: 17 May 1996



Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served on: Lenore Kleinman, Esq. (by mail)
Glenn Forbes, Esq. (by mail)
Jerald Meyer, Esq. (by mail)

By: Joyce L. Gordon, Secretary

Date: 5/17/96

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
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U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
CLEVELAND

In re:) Case No. 03-11098
)
PACIFIC FINANCIAL) Chapter 11
SERVICES OF AMERICA,)
) Judge Pat E. Morgenstern-Clarren
Debtor.)
) **ORDER**

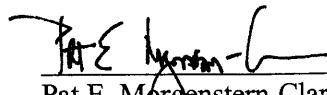
For the reasons stated in the Memorandum of Opinion filed this same date, the Joint Motion of The Huntington National Bank, The State of Ohio Department of Taxation and Department of Jobs and Family Services, as joined by the United States Trustee, to appoint a trustee under 11 U.S.C. § 1104 is granted. (Docket 19, 25).

IT IS, THEREFORE, ORDERED that a Chapter 11 Trustee is appointed and the United States Trustee is authorized to exercise his duties in making the appointment of such trustee, subject to the Court's approval;

IT IS FURTHER ORDERED that until such time as the Chapter 11 Trustee assumes his or her duties, the Debtor and its principal are prohibited from using, transferring or otherwise taking control over any funds belonging to the Debtor; and

IT IS FURTHER ORDERED that the Debtor and its principal, Laurence Lomaz, are to provide an accounting to the United States Trustee for any funds collected and any transactions that occur from the date of this Order until the Chapter 11 Trustee assumes his or her duties.

Date: 28 Mar 2003


Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

Served by mail on: Morris Laatsch, Esq.
Maria Giannirakis, Esq.
David Douglass, Esq.
James Ehrmann, Esq.

By: Joyce L. Gordon, Secretary
Date: 3/28/03