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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH, CENTRAL DIVISION

In re CASTLE ARCH REAL ESTATE INVESTMENT COMPANY, LLC, Debtor.	Bankruptcy Case No. 11-35082 JTM (Chapter 11) **PRINCE YEATES' OBJECTION TO DISCLOSURE STATEMENT**

Prince, Yeates & Geldzahler ("**Prince Yeates**"), which holds (subject to final approval by the Court) an administrative expense claim against the estate of Castle Arch Real Estate Investment Company, LLC ("**CAREIC**"), hereby objects to the disclosure statement (the "**Disclosure Statement**") to the chapter 11 plan (the "**Plan**") filed by D. Ray Strong (the "**Trustee**") in his multiple capacities as trustee for CAREIC and as manager of CAOP Managers ("**CAOP Managers**"), Castle Arch Opportunity Partners I, LLC ("**CAOP I**"), Castle Arch Opportunity Partners II, LLC ("**CAOP II**"), Castle Arch Kingman, LLC ("**CAK**"), Castle Arch Secured Development Fund, LLC ("**CASDF**"), and Castle Arch Smyrna, LLC ("**CAS**") (together the ("**CAREIC Affiliates**").

1. The Trustee Should Not Be Permitted To Treat CAREIC And Its Affiliates As Having Already Been Consolidated For Purposes of Determining Whether The Confirmation Requirements Of § 1129 Are Met.

In the Plan, the Trustee proposes substantive consolidation of the CAREIC estate with the estates of four out of six of the CAREIC Affiliates. Even though substantive consolidation is effective only upon confirmation of the Plan, the Trustee proposes to treat the consolidation as having occurred for purposes classifying claims, voting, and "cram down."[1] But, until consolidated through entry of a confirmation order, each estate remains separate. So whether the Plan is confirmable must be determined based upon whether the confirmation requirements of § 1129 are met with respect to each unconsolidated estate.

2. The Trustee Should Be Required To Provide An Estimate Of Administrative Expenses For Each Estate And To Disclose The Cash Assets Available For Payment On The Effective Date.

Under the Plan, unless holders of administrative expense claims object, they are deemed to waive their statutory right under § 1129(a)(9) to be paid in full on the effective date and, thus, become beneficiaries of the consolidated "**Legacy Trust**" with other unsecured creditors of CAREIC, CAOP Managers, CAK, CASDF, and CAK (called the "**Legacy Debtors**" in the Plan).[2] For holders of administrative expenses to evaluate whether to enforce their statutory rights under § 1129(a)(9) or waive them under the default provisions of the Plan, the Trustee should be required to disclose (1) an estimate

[1] *See* Disclosure Statement IV.C.1. at 36.

[2] *See* Plan § 4.2(b) at 21.

of all administrative expenses, including attorneys' fees and accountants' fees for each estate and (2) the cash (or cash receivables) available to pay such administrative expenses upon the effective date of the Plan. Again, because the estates are not consolidated until after confirmation, this information should be provided with respect to each of the individual estates.

3. The Trustee Should Be Required To Explain Why CAOP I And CAOP II Are Not Being Consolidated.

Of CAREIC and the CAREIC Affiliates only two are unquestionably solvent—CAOP I and CAOP II.[3] The Trustee proposes consolidation of the insolvent CAREIC Affiliates (i.e., the Legacy Debtors) on grounds that certain "Consolidation Facts" exist.[4] The Trustee does not explain, however, whether the same Consolidation Facts exist with respect to CAOP I and CAOP II and why, if they do exist, the Trustee has determined that they should not (in the interests of fairness and promoting equitable distributions) also be consolidated. Since CAOP I and CAOP II have substantial unencumbered cash, this issue is of particular importance to holders of administrative expenses who are being asked to waive their rights under § 1129(a)(9) because of insufficient cash to pay such claims in full on the effective date.

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[3] CAS may also be solvent depending on the viability of its $10,000,000 guarantee claim against CAREIC. The Trustee has suggested that this guarantee obligation may be ignored because no written guarantee has been located. *See* Disclosure Statement § II.B.1(d) at 16. This assertion, however, may not be legally sufficient to ignore a guarantee obligation that is otherwise evidenced by writings (including Private Placement Memoranda and Board Minutes) and which was acknowledged by CAREIC pre-petition.

[4] *See* Disclosure Statement IV.C.1. at 38-40.

4. The Trustee Should Be Required To Disclose His Conflicted Status.

On the first page of the Disclosure Statement, the Trustee discloses that he is the duly-appointed trustee in CAREIC's case and also the manager of each of the CAREIC Affiliates. Because of this dual role, the Trustee has been, and remains, on both sides of significant intercompany claims—including multi-million dollar avoidance claims—and is not disinterested.

The integrity of the bankruptcy process is premised upon the disinterestedness of trustees: it is a requirement for appointment,[5] it assures unbiased decision-making,[6] and it is the reason that court's defer to a trustee's business judgment.[7] If disinterestedness is lacking, judicial deference is not appropriate, and consequences may include removal[8] and denial of compensation.[9]

> Section 101 (14), defines a "disinterested person" as a person that
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> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any

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[5] §1104(a) and (d).

[6] *In re AFI Holding, Inc.*, 530 F.3d 832, 850 (9th Cir. 2008) ("A trustee/fiduciary must be free from any hint of bias.")

[7] *In re Novak*, 383 B.R. 660, 676 (Bankr. W.D. Mich. 2008) (the business judgment rule, "which is better described as a rebuttable presumption, protects a ***disinterested trustee*** from criticism concerning any decision made provided that it falls within the range of what an informed businessman would have rationally decided under the circumstances.") (emphasis added).

[8] *In re AFI Holding, Inc.*, 530 F.3d at 850-852 (affirming removal of the trustee under a totality of circumstances approach finding that a lack of disinterestedness may be based on "an appearance of impropriety" among other factors).

[9] *Gray v. English*, 30 F.3d 1319, 1324 (10th Cir. 1994).

> direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

Based on the "for any other reason" clause, courts hold that fiduciaries have an "interest materially adverse to the interest of the estate" if "in the slightest degree [they] might have some interest or relationship that would even faintly color the independent and impartial attitude required by the Code and the Bankruptcy Rules."[10] Many courts use a simple litmus test to apply this principle—namely, if it is "plausible" that an interest or relationship could cause a fiduciary to "act differently" than such fiduciary might act without it, then the fiduciary has an actual conflict and is not disinterested.[11] "The purpose of the rule is to prevent a conflict without regard to a person's integrity" because "[c]onflicting loyalties may arise even from remote or indirect associations."[12] The requirement is not just "to prevent actual evil in [a] particular case, but the tendency to evil in all cases."[13] Finally, the "baseline" for disinterestedness is "the need to avoid the

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[10] *In re Roberts,* 46 B.R. 815, 828 (Bankr. D. Utah 1985), *aff'd in relevant part and remanded in part on other grounds,* 75 B.R. 402 (D. Utah 1987) (quoting Colliers on Bankruptcy); *see also In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1256 (5th Cir. 1986); *In re Big Rivers Electric Corp.*, 355 F.3d 415, 433 (6th Cir. 2004); *In re AFI Holding, Inc.*, 530 F.3d at 846.

[11] *In re The Leslie Fay Companies, Inc.*, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994).

[12] *Roberts,* 46 B.R. at 829.

[13] *Id.* (quoting *In re Sambo's Restaurants, Inc.*, 20 B.R. 295, 297 (Bankr. C.D. Cal. 1982)).

appearance of impropriety"[14] which serves as an "independent [ground] for disqualification."[15]

In situations similar to those confronted by the Trustee in this case, trustees and professionals have been held to lack disinterestedness. For example, in *In re Interwest Business Equipment, Inc.*,[16] one attorney sought to represent three related corporate chapter 11 debtors. But because one debtor was managing another and all three had "substantial intercompany debts," the bankruptcy court held that the attorney had an actual conflict and could not, therefore, represent all three. The Tenth Circuit affirmed noting "[t]he jaundiced eye and scowling mien that counsel for the trustee should be casting on all who have recently done business with each corporation will likely not fall on counsel's other clients."[17]

Although the question of disinterestedness in *Interwest* was directed toward counsel, the same analysis applies to trustees. For example, in *In re BH&P, Inc.*,[18] one trustee was appointed in three chapter 7 cases: BH&P's case and the cases of two of its principals. The cases were ordered jointly administered, and the trustee "elected to

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[14] *In re Blinder, Robinson & Co., Inc.*, 131 B.R. 872, 879 n. 2 (D. Colo. 1991); *Roberts*, 46 B.R. at 829 (quoting *In re CODESCO, Inc.*, 18 B.R. 997, 999 (Bankr. S.D.N.Y. 1982)).

[15] *In re Cook*, 223 B.R. 782, 789 (10th Cir. BAP 1998).

[16] 23 F.3d 311 (10th Cir. 1994).

[17] *Id.* at 317.

[18] 949 F.2d 1300 (3d Cir. 1991).

administer the three estates as though they were a single entity."[19] Later, the trustee filed proofs of claims on behalf BH&P in the two individual cases.[20] When the trustee sought allowance of interim fees, a creditor objected on grounds that the trustee was not disinterested because he could not be a "creditor" and, at the same time, serve as the "trustee" in the individual cases.[21] The bankruptcy court denied fees on grounds that the trustee's "obligation to BH&P to pursue claims against [the individual debtors] created an interest materially adverse to the interests of the other unsecured creditors of [the individual debtors]."[22] Agreeing that this created an actual conflict, the Third Circuit affirmed.[23]

Here, the Trustee is clearly conflicted. He cannot aggressively pursue CAREIC's claims against the CAREIC Affiliates because he is the manager of the CAREIC Affiliates and would be charged with defending against his own claims. Similarly, although he has proposed a way to deal with his conflicts under the Plan,[24] these

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[19] 949 F.2d at 1303.

[20] *Id.* at 1304.

[21] *Id.*

[22] *Id.* at 1313.

[23] *Id.*

[24] The Trustee proposes to eliminate all conflicts between CAREIC and the Legacy Debtors through consolidation. For the claims among the Legacy Debtors and CAOP I and CAOP II, he proposes appointment of a "**Conflicts Referee.**" How this Conflicts Referee is supposed to deal with the conflicts is as yet undisclosed. The procedures are to be contained in the "**Plan Documents Supplement**" to be provided within ten days of the confirmation hearing. *See* Disclosure Statement § IV.E at 59.

proposals are not the product of a disinterested analysis.[25] And as noted by the Tenth Circuit in *Interwest,* it is "impossible to know if the terms of the [Plan] were affected by the joint representation."[26]

Whether the Trustee may continue as trustee of CAREIC and at the same time manage the CAREIC Affiliates has been questionable from the date of his appointment. Nevertheless, to effectively evaluate the Trustee's disinterested status and the effect on the administration of the estates, the Trustee should be required, at the very least, to disclose to creditors and parties in interest that he is possessed of serious conflicts and that the provisions of the Plan may have been affected by them.

DATED this 26th day of November, 2012.

PRINCE, YEATES & GELDZAHLER
A Professional Corporation

By: /s/ Adam S. Affleck
Attorneys for Former Debtor-In-Possession
Castle Arch Real Estate Investment
Company, LLC

[25] For example, the Trustee has not described to creditors and parties-in-interest how consolidation compares with non-consolidation. Nor has the Trustee provided a non-consolidation liquidation analysis so that creditors could make their own informed decision. Instead, the Trustee has simply stated his (presumably disinterested) conclusions that CAREIC and the Legacy Debtors "must be substantively consolidated as of the Petition Date . . . ." Disclosure Statement § IV.C.1. at 40.

[26] *Interwest,* 23 F.3d at 317.

CERTIFICATE OF SERVICE

I hereby certify that on the 26th day of November, 2012, I electronically filed the foregoing **PRINCE YEATES' OBJECTION TO DISCLOSURE STATEMENT** with the Clerk of the Court using the CM/ECF system which sent a Notice of Electronic Filing to all parties whose names appear on the electronic mail notice list for this case.

/s/ Adam S. Affleck

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