

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Norfolk Division**

In re:

Wainwright Building, LLC,
Debtor.

Case No. 11-74703-FJS
Chapter 11

**MOTION OF THE UNITED STATES TRUSTEE TO APPOINT A TRUSTEE OR , IN
THE ALTERNATIVE, TO DISMISS THIS CASE, OR CONVERT IT TO CHAPTER 7**

W. Clarkson McDow, Jr., the United States Trustee for Region Four, by counsel, moves the Court for entry of an order appointing a chapter 11 trustee, or, in the alternative, dismissing the case or converting this case to a proceeding under chapter 7. In support of his Motion, the U.S. Trustee states:

1. The debtor filed a Chapter 11 petition on October 21, 2011, and no trustee has been appointed. The debtor has continued its business as a debtor-in-possession, pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.
2. The debtor is owned by George Hranowskyj and Eric Menden. The designated representative of the debtor is Eric Menden.
3. On April 19, 2012, this Court denied confirmation of the debtor's Amended Chapter 11 Plan. The Court afforded the debtor an opportunity to file an amended plan.
4. On April 18, 2012, George Hranowskyj was charged in the United States District Court for the Eastern District of Virginia, Norfolk Division, with allegedly participating in an historic tax credit fraud scheme.¹ Hranowskyj was arrested and taken into custody on April 19, 2012. Hranowskyj has not entered a plea.
5. On April 20, 2012, the United States District Court entered an order accepting the guilty plea of Eric Menden. Menden pled guilty to a three count criminal information, charging

¹ The indictment charges violations of 18 U.S.C. § 1349 (Conspiracy to Commit Wire Fraud); 18 U.S.C. §§ 981 & 982 and 21 U.S.C. § 853(p) (Criminal Forfeiture); 18 U.S.C. §§ 1343 and 2 (Wire Fraud), and 18 U.S.C. §§ 1957 & 2 (Unlawful Monetary Transactions).

him with conspiracy to commit wire fraud, making false statements and conspiracy to commit bank fraud. Menden faces a maximum penalty of five years in prison for each count when he is sentenced on July 23, 2012.

6. On April 20, 2012, Menden and the United States submitted to the district court a Statement of Facts, stipulating that "the allegations in the information and the following facts are true and correct, and, had the matter gone to trial, the United States would have proven them beyond a reasonable doubt." *See Statement of Facts*, filed herewith as *Exhibit A*.

7. According to the Statement of Facts, Menden committed crimes of fraud and dishonesty.

8. Menden admitted engaging in a scheme to defraud the United States, the Commonwealth of Virginia, and corporate investors, using historic rehabilitation tax credits as the vehicle. Menden and his business partner purchased and renovated properties located at 345 Granby Street, 742 West Princess Anne Road, 430 Boush Street and 3700 Hampton Boulevard in Norfolk and applied for federal and state historic tax credits related to these properties. In furtherance of the scheme, Menden (and others) created false invoices, false bank documents, false certificates of occupancy, false checks and other false documents. Corporate investors paid Menden and his business partner approximately \$8.7 million for illegitimate tax credits. As a result, the United States of America lost approximately \$6.2 million, and the Commonwealth of Virginia lost approximately \$6.3 million. *See Statement of Facts*, ¶¶ 1-47.

9. Menden admitted that, from January 2008 through August 2011, he and others engaged in a scheme to defraud the Bank of the Commonwealth by means of materially false and fraudulent pretenses.² He and his business partner performed favors for insiders at the Bank of Commonwealth in exchange for preferential lending treatment. They assisted insiders in concealing the extent of the bank's non-performing assets by buying bank-owned properties. When the bank failed on September 23, 2011, Menden and his business partner owed the bank approximately \$41 million. The total approximate loss related solely to their loans is at least \$13,263,443.

²For example, in connection with the renovation of the James Madison Hotel, at 345 Granby Street in Norfolk, Menden admitted submitting false construction draw requests to the bank. With the help of a bank conspirator, Menden and his business partner cashed many six-figure checks drawn on this construction account, using the funds for their own personal purposes. Menden admitted committing crimes in connection with the Troubled Asset Relief Program (TARP). After the bank agreed with the Federal Reserve and other regulators that it would not extend, renew or restructure any loans to Menden and his business partner, bank insiders continued to sell and attempt to sell underperforming bank-owned property to Menden through nominee borrowers.

10. The crimes to which Mendenlead guilty involve fraud and dishonesty. Cause exists to appoint a chapter 11 trustee and to dismiss the case or convert it to a proceeding under chapter 7, as the best interest of the estate and creditors dictate.

Fiduciary Duties of the Debtor in Possession

11. When a debtor files for bankruptcy under chapter 11, all of its assets are transferred to a new legal entity — the estate. 11 U.S.C. § 541(a); *O'Dowd v. Trueger (In re O'Dowd)*, 233 F.3d 197, 202 (3rd Cir. 2000). The debtor becomes the “debtor-in-possession” and is responsible for administering the estate. 11 U.S.C. § 1107(a). The debtor-in-possession serves as a fiduciary to the estate and its creditors. *In re United Healthcare Sys., Inc.*, 200 F.3d 170, 177 n. 9 (3rd Cir. 1999). The fiduciary obligations of the debtor-in-possession include “open, honest and straightforward disclosure to the Court and creditors . . . and the duty to protect and conserve property in its possession for the benefit of creditors.” *In re Marvel Entm’t Group, Inc.*, 140 F.3d 463, 474 (3rd Cir. 1998) (internal citations omitted). The debtor-in-possession owes a duty of loyalty, which includes the avoidance of “self-dealing, conflicts of interest and the appearance of impropriety.” *In re Bowman*, 181 B.R. 836, 843 (Bankr. D. Md. 1995).

In that fiduciary role, the debtor must “refrain from acting in a manner which could damage the estate, or hinder a successful reorganization.” *Marvel*, 140 F.3d at 471 (quoting *Petit v. New England Mortgage Services, Inc.*, 182 B.R. 64, 69 (D. Me. 1995)).

Statutory Framework Appointment of trustee

12. A bankruptcy court may appoint a chapter 11 trustee “for cause, including fraud, dishonesty, incompetence, or gross mismanagement in the affairs of the debtor by current management, either before or after the commencement of the case.” 11 U.S.C. § 1104(a)(1). A court may also appoint a trustee “if such appointment is in the interests of the creditors.” 11 U.S.C. § 1104(a)(2).

1104(a)—Cause

13. Both a debtor’s pre-petition and post-petition conduct are considered in determining whether “cause” exists for the appointment of a trustee. *In re Oklahoma Refining Co.*, 838 F.2d 1133 (10th Cir. 1988).

“The clearest examples [where appointment of a trustee is warranted] are those in which the debtor or its managers have engaged in serious fraud or dishonesty, or have grossly mismanaged the business.” 7 Collier on Bankruptcy ¶ 1104.02[1] (Alan N. Resnick & Henry J. Sommer, eds, 15th ed. Rev.2007).

The plain language of § 1104(a)(1) and the law of the Fourth Circuit direct this court to consider pre-petition conduct when determining if cause exists to appoint a trustee. Section 1104(a)(1) plainly contemplates the consideration of pre-petition misconduct, providing that the misconduct giving rise to cause may exist “either before or after the commencement of the case.” 11 U.S.C. § 1104(a)(1).

In *Fraidan v. Weitzman (In re Fraidan)*, 43 F.3d 1466, (4th Cir. 1994), the Fourth Circuit affirmed the bankruptcy court’s decision to appoint a chapter 11 trustee based upon the pre-petition conviction of the chapter 11 debtor for theft and related dishonesty. The debtor was found guilty of theft while acting as a foreclosure trustee.

In attacking the appointment of a trustee, Fraidan argued that he had not engaged in any misconduct in the bankruptcy case. The Fourth Circuit found that the bankruptcy court had considered the evidence that the debtor acted properly during the bankruptcy case, but nonetheless correctly found that his pattern of dishonesty, reflected in the convictions, justified the appointment of a trustee. *And see Gomez v. U.S. Trustee*, 2010 WL 582706 (W.D.Va. 2010)(affirming order of bankruptcy court appointing trustee after debtor was convicted of crimes of fraud and dishonesty)(all three offenses to which Gomez pled guilty involved some measure of fraud, deception, and/or dishonesty).

1104(b)—Best Interests

14. The “best interests” standard of section 1104(b) is broad indeed. “The Court has particularly wide discretion under subsection (a)(2), [which] sets forth a flexible standard for appointment of a trustee even when no cause exists.” *In re Bellevue Place Associates*, 171 B.R. 615, 623 (Bankr. N.D.Ill. 1994). Among the factors courts consider in determining whether to appoint a chapter 11 trustee under section 1104(a)(2) are: (1) the trustworthiness of the debtor; (2) the debtor’s past and present performance and prospects for the debtor’s reorganization; (3) confidence, or lack thereof, of the business community and creditors in present management; and (4) the benefits derived by appointment of a trustee, balanced against the costs of appointment. *See In re Colorado-Ute Elec. Ass’n, Inc.*, 120 B.R. 164, 176 (Bankr. D.Colo. 1990).

Procedural Matters

15. The proper burden of proof for the appointment of a chapter 11 trustee is preponderance of the evidence. *Tradex Corp. v. Morse (In re Tradex Corp.)*, 339 B.R. 823 (D. Mass. 2006). Once the court has found that cause exists for the appointment of trustee, it has no discretion and must appoint a trustee. *In re Oklahoma Refining Co.*, 838 F.2d 1133 (10th Cir. 1988).

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A 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. *Committee of Dalkon Shield Claimants v. A.H. Robins Co., Inc.*, 828 F.2d 239, 240 (4th Cir.1987)(citing *In re General Distributors, Inc.*, 42 B.R. 402 (Bankr.E.D.N.Y.1984)).

Further, “[i]n considering what is in the interests of creditors in connection with [a section 1104(a)(2) motion], ‘a bankruptcy judge has broad discretion to take judicial notice of the entire file ... and the outcome of previous proceedings brought before the court.’” *In re U.S. Mineral Products Co.*, 105 Fed.App’x. 428, 431 (2004 WL 1758499, p.2) (3rd Cir. 2004), quoting from Barry Russell, *Bankruptcy Evidence Manual* § 201.6 (2004).

If a bankruptcy court orders the appointment of a chapter 11 trustee pursuant to section 1104(a), then 11 U.S.C. § 1104(d) requires the United States Trustee, after consulting with parties in interest and subject to the court’s approval, to appoint a “disinterested person” to serve in that capacity.

Cause to Convert or Dismiss under section 1112(b)

16. Cause also exists to convert or to dismiss this case under 11 U.S.C. section 1112. If cause is established, the court must dismiss the case or convert the case to Chapter 7, whichever is in the best interest of the estate and creditors, or appoint a Chapter 11 trustee if such appointment is instead in the best interest of creditors and the estate. *See generally* 11 U.S.C. § 1112(b); *In re Sydnor*, 431 B.R. 584 (Bankr.D.Md.2010).

17. Cause exists to dismiss or convert the case, pursuant to section 1112, and to appoint a Chapter 11 Trustee, as the best interest of creditors and the estate dictate.

WHEREFORE, the United States Trustee prays that the Court appoint a chapter 11 trustee, or convert the proceeding to one under chapter 7 or dismiss the case, whichever is in the best interest of the creditors and the estate, and grant him such other and further relief as is just.

Respectfully Submitted,

W. Clarkson McDow, Jr.
United States Trustee
Region Four
By: /s/ Cecelia Ann Weschler

Debera F. Conlon
Assistant U.S. Trustee

Cecelia Ann Weschler
Trial Attorney

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CERTIFICATE OF SERVICE

I certify that on April 23, 2012, service on all attorney Users in the case was accomplished through the Notice of Electronic Filing, pursuant to CM/ECF Policy 9 of the United States Bankruptcy Court for the Eastern District of Virginia, Case Management/Electronic Case Files (CM/ECF) Policy Statement, Version 09/04/09.

/s/ Cecelia Ann Weschler