UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:	**Jointly Administered under Case No. 08-45257**
Petters Company, Inc., et al.,	**Court File No. 08-45257**
Debtors.	
	Court File Nos.:
(includes:	
Petters Group Worldwide, LLC;	**08-45258 (GFK)**
PC Funding, LLC;	**08-45326 (GFK)**
Thousand Lakes, LLC;	**08-45327 (GFK)**
SPF Funding, LLC;	**08-45328 (GFK)**
PL Ltd., Inc.;	**08-45329 (GFK)**
Edge One, LLC;	**08-45330 (GFK)**
MGC Finance, Inc.;	**08-45331 (GFK)**
PAC Funding, LLC;	**08-45371 (GFK)**
Palm Beach Finance Holdings, Inc.)	**08-45392 (GFK)**
	Chapter 11 Cases **Judge Gregory F. Kishel**

UNITED STATES TRUSTEE'S REPLY TO OBJECTION BY RITCHIE SPECIAL CREDIT INVESTMENTS, LTD., RHONE HOLDINGS II, LTD., YORKVILLE INVESTMENTS I, L.L.C., RITCHIE CAPITAL STRUCTURE ARBITRAGE TRADING, LTD., AND RITCHIE CAPITAL MANAGEMENT, L.L.C., TO APPOINTMENT OF DOUGLAS A. KELLEY AS TRUSTEE FOR ALL OF THE DEBTORS IN THESE JOINTLY ADMINISTERED PROCEEDINGS

COMES NOW the United States Trustee, through his undersigned attorney, and files his reply to the Objection of Ritchie Special Credit Investments, Ltd., Rhone Holdings II, Ltd., Yorkville Investments I, L.L.C., Ritchie Capital Structure Arbitrage Trading, Ltd., and Ritchie Capital Management, L.L.C. (collectively "Ritchie") for appointment of Douglas A. Kelley as Trustee in these jointly administered proceedings. In support of his reply, he states the

following:

1. A hearing has been scheduled in this matter on January 27, 2009, at 2:00 p.m., in Courtroom 2A, United States Courthouse, 316 North Robert Street, St. Paul, MN 55101, before the Honorable Gregory F. Kishel, United States Bankruptcy Judge for the District of Minnesota.

2. The United States Trustee has standing to file this reply pursuant to 11 U.S.C. § 307 and 28 U.S.C. § 586(a)(3).

3. The petitions commencing the Chapter 11 cases of Petters Company, Inc. and Petters Group Worldwide, LLC ("PGW") were filed on October 11, 2008. The petitions commencing the Chapter 11 cases of PC Funding, LLC; Thousand Lakes, LLC; SPF Funding, LLC; PL Ltd., Inc.; Edge One, LLC and MGC Finance, Inc. were filed on October 17, 2008. The petitions commencing the Chapter 11 cases of PAC Funding, LLC and Palm Beach Finance Holdings, Inc. were filed on October 17, 2008 and October 19, 2008, respectively. An order for joint administration of the above-entitled cases was entered on October 22, 2008.

4. On December 1, 2008, Thomas Joseph Petters; Petters Company, Inc.; and Petters Group Worldwide, LLC, were indicted on federal criminal charges which included mail fraud, wire fraud, money laundering, and conspiracy to commit those offenses. The indictment alleges that the two companies were actively involved with each other and with their principal, Thomas Joseph Petters, in devising and perpetuating the scheme and artifice to defraud.

5. On December 2, 2008, the United States Trustee filed his motion seeking an order directing the appointment of a chapter 11 trustee. The Court held a hearing on the motion on December 16, 2008. The Court granted the United States Trustee's motion and also "held that the issue of whether a trustee should be appointed for Debtor Petters Group Worldwide, LLC,

with a different person or persons to be appointed as trustee(s) for the other Debtors, was not ripe until the United States Trustee had first exercised his authority under 11 U.S.C. § 1104(a), as to all of the Debtors." DE # 111. On December 24, 2008, the United States Trustee appointed Douglas A. Kelley ("Kelley") as Chapter 11 Trustee of these jointly administered cases, and sought approval of his appointment with this Court. DE # 114.

APPOINTMENT OF CHAPTER 11 TRUSTEE

6. The United States Trustee has established the requisite "cause" under 11 U.S.C. § 1104(a) for the appointment of a trustee in these jointly administered cases. This Court has agreed that the appointment of a chapter 11 trustee is necessary for the proper administration of these bankruptcy cases. DE # 111. However, as discussed below, Ritchie's Motion, insofar as it seeks the appointment of a separate chapter 11 trustee in Petters Group Worldwide, LLC, must be denied. Kelley meets the "disinterestedness" test of the Bankruptcy Code and Ritchie has not established sufficient actual prejudice to it arising from any purported conflicts of interest if a common trustee were allowed to remain in place.

7. The United States Trustee exercised the discretion given to him by the Federal Rules of Bankruptcy Procedure for the appointment of a trustee in jointly administered cases. Fed. R. Bankr. P.2009(c)(2) states: "[i]f the appointment of a trustee is ordered, the United States Trustee may appoint one or more trustees for the estates jointly administered . . ." Fed. R. Bankr. P. 2009(c)(2). Rule 2009(c)(2) grants to the United States Trustee the sole discretion to appoint a single trustee or multiple trustees in jointly administered cases. Prior to making his appointment, and as required by Fed. R. Bankr. P. 2007.1©, the United States Trustee consulted with the following parties in interest regarding the appointment: Unsecured Creditors'

Committee; Opportunity Finance, LLC; CONSOR Domain Assets, LLC; Palm Beach Finance Partners, LP; Palm Beach Partners II, LP; Interlachen Harriet Investment Unlimited; IOC Distribution, Inc.; A1 Plus, Inc.; Petters Aviation, LLC; Elite Landings, LLC; Ritchie entities and Petra Fixed Income Fund, LLC. DE #114.

8. As the party challenging the appointment of a common trustee in these cases, the burden rests upon Ritchie to establish actual prejudice to it arising from any conflict of interest the common trustee may have vis-a-vis the other jointly administered entities. Fed. R. Bankr. P. 2009 (d) states: "[o]n a showing that creditors . . . of the different estates will be prejudiced by conflicts of interest of a common trustee **who has been . . . appointed**, the court shall order the selection of separate trustees for estates being jointly administered." (emphasis added). Fed. R. Bankr. P. 2009(d). If the appointment is that of a single trustee, a party in interest may challenge such appointment upon a showing of prejudice to creditors arising from conflicts of interest of a common trustee. *Id*. For the following reasons, the objection of Ritchie to the appointment of Kelley as trustee for all Debtors or, in the alternative, require a separate trustee for PGW should be denied.

ARGUMENT

I. Kelley is no longer a "Receiver" for these bankruptcy entities.

Ritchie's objection to the appointment of Kelley as trustee for all of these Debtor entities totally misstates his role. The entire premise for the United States Trustee's motion for the appointment of a chapter 11 trustee in these cases centered on the inherent tension between the traditional duties of a court-appointed equity receiver and a trustee (or debtor-in-possession) in bankruptcy. As was explained in his motion seeking the appointment of a trustee, a bankruptcy

court cannot order the appointment of a receiver under the Bankruptcy Code. "A court may not appoint a receiver under . . . title [11]." *11 U.S.C. § 105(b).* Although it may be conceded that Kelley, as receiver under the District Court's order, had the authority to file the petitions initiating these bankruptcy cases, once they were filed, his authority as receiver terminated by operation of law. *In re Madison Ave. Ltd. Partnership*, 213 B.R. 888, 894-95 (Bankr. S.D.N.Y. 1997) ("Since no section of the Code includes a receiver who remains in possession within the definition of trustee, the receiver does not take on the obligations and duties of a Chapter 11 trustee or the somewhat different ones of a debtor-in-possession. Simply put, the receiver has absolutely no responsibility . . . to perform any other duties which are the prerogative and burden of a debtor-in-possession and a trustee.")

This distinction between Kelley in his role as receiver for Petters individually and other Petters entities and Kelley in his role as a potential trustee in these bankruptcy cases is underscored by the District Court in its *Second Amended Order for Entry of Preliminary Injunction, Appointment of Receiver, and other Equitable Relief,*[1] *Section IV, ¶ B. 2. c.*, (noting "(a)ny bankruptcy cases so commenced by the Receiver shall during their pendency be governed by and administered pursuant to the requirements of the United States Bankruptcy Code, 11 U.S.C. section 101 *et seq.*, and the applicable Federal Rules of Bankruptcy Procedure"). In short, Kelley as trustee is duty-bound to administer these estates according to the dictates of the Bankruptcy Code. He is no longer a "receiver" and, contrary to the assertion of Ritchie, is not

[1] Docket Entry # 127, Civ. No. 08-5348, *United States of America v. Thomas Joseph Petters, et al.*, United States District Court, District of Minnesota ("Receivership Order"). [Also attached as Exhibit A to *Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for All of the Debtors in these Jointly Administered Proceedings*. DE # 132.]

placed "in the untenable position of having to advance the interests of two distinct groups seeking recovery from the same assets."[2] Kelley is not a "receiver" over these bankruptcy cases or their respective estates.

If this Court approves the appointment of Kelley as trustee for these bankruptcy cases, he becomes obligated to follow the mandates of Title 11 of the United States Code. The district court who appointed him receiver recognized this requirement when it amended the Receivership Order to require "(a)ny bankruptcy cases . . . shall during their pendency be governed by and administered pursuant to the requirements of the United States Bankruptcy Code, 11 U.S.C. section 101 *et seq.*, and the applicable Federal Rules of Bankruptcy Procedure." *Receivership Order, Section IV, ¶ B. 2. c.* In no event, however, would Kelley's obligations as trustee of these bankruptcy estates be materially adverse to his obligations as receiver in the district court.

II. The allegations of fraud perpetrated by PGW are the same as those against PCI.

Ritchie attempts to distinguish itself as a creditor, and not a victim, of PGW. Its objection suggests that "PCI was the vehicle for the fraud — not PGW." However, the indictment returned by the grand jury charges both entities with a variety of federal offenses. "From at least in or about 1995 and continuing through in or about September 2008, in the State of Minnesota and elsewhere, the defendants, THOMAS JOSEPH PETTERS, PETTERS

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[2] Ritchie's objection also misapprehends Kelley's role as receiver in the district court action, suggesting that he owes a fiduciary duty to the victims of Petters' fraud and serving as "an agent for the Government." In this regard, it is incorrect — "a receiver is the agent only of the court appointing him; he represents the court rather than the parties. He is the custodian of property which is under the control of the court." *Ledbetter v. Farmers Bank & Trust Co.*, 142 F.2d 147, 150 (4th Cir. 1944). *Greenleaf Apartments, Ltd. v. Soltesz (In re Greenleaf Apartments*, *Ltd.)*, 158 B.R. 456, 459 ("[A] receiver is a court appointed officer who is controlled exclusively by the court . . . [H]e is not to be regarded as an agent or representative of either party to an action.") (citations omitted).

COMPANY, INC., AND PETTERS GROUP WORLDWIDE, LLC, aided and abetted by persons and affiliated business entities, . . . did knowingly and unlawfully devise and participate in a scheme and artifice to defraud and to obtain billions of dollars in money and property by means of materially false and fraudulent pretenses, representations, and promises." *Indictment, ¶ 4.* in *United States of America v. Thomas Joseph Petters, et al.*, United States District Court, District of Minnesota. Criminal No. 08-364. In fact, counts 1 through 7 of the indictment charge both PCI and PGW with aiding and abetting mail fraud in violation of 18 U.S.C. Sections 1341 and 2. *Id.* at ¶ 10. Counts 8 through 10 of the indictment charge both PCI and PGW with aiding and abetting wire fraud in violation of 18 U.S.C. Sections 1343 and 2. *Id.* at ¶ 13. Count 11 alleges that Thomas Joseph Petters, PCI and PGW "**did knowingly and willfully combine, conspire, and agree with each other and with** . . . **others known and unknown to the Grand Jury**, to commit offenses against the United States, that is, mail fraud and wire fraud as described in Counts 1 through 10 above, in violation of Title 18, United States Code, Sections 1341 and 1343." (emphasis added) *Id*. at ¶ 15. Count 12 of the Indictment alleges that Petters individually, along with both PCI and PGW, were involved in a money laundering conspiracy in violation of 18 U.S.C. § 1956(h). *Id*. at ¶20.

Ritchie's attempt at minimizing the role of PGW in the fraudulent scheme stands in stark contrast to the allegations in the indictment. According to the indictment, the actions of PGW and PCI were intertwined in this complex criminal scheme to defraud victims. The Grand Jury found probable cause to believe that both entities were instrumentalities in Petters' criminal enterprise.

Ritchie's characterization of its relationship with PGW as being that of a "true creditor"

is also belied by the underlying documentation (as reflected in Exhibits D-1, D-2 and D-3 to *Appointed Trustee's Response to Appointment of Douglas A. Kelley as Trustee for All of the Debtors in these Jointly Administered Proceedings*. DE #132. According to the financial history of the money "loaned" to PGW, the entire $146 million was wired directly by Ritchie into the bank account of PCI at M&I Bank. "This demonstrates how loosely funds were distributed around the various Petters companies, although notably no funds appear to have gone to PGW. Virtually all of these funds went immediately to pay other investors." DE # 132 at p. 6. In this sense, it appears to be more likely that Ritchie finds itself not to be a true creditor as it suggests, but rather another victim of Petters' vast Ponzi scheme. [In such cases, appellate courts have consistently determined that innocent victims should share equally in any recovered funds because equity demands equal treatment.[3] *See generally United States Securities and Exchange Commission v. The Infinity Group Company*, 226 Fed. Appx. 217 (3d Cir. 2007) (*per curiam*) (*unpublished*) (collecting cases).

III. Kelley, as District Court Receiver, does not initiate nor prosecute any forfeiture action.

Contrary to the assertion of Ritchie, Kelley is not "an agent for the Government," nor does he have the ability to forfeit assets. That power resides with the United States Attorney. The indictment against Petters, PCI and PGW does allege specific forfeiture provisions; however, there appear to be several misconceptions regarding the forfeiture process itself. Criminal forfeiture is *in personam* in nature; in other words, the judgment is personal as to that defendant. Therefore, before the Government can forfeit any property, it must first obtain a

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[3] Ritchie is attempting to bootstrap itself into a better position *vis a vis* other similarly situated parties. Such manipulation to Ritchie's benefit at this early stage of these cases would result in an inequitable and inefficient administration of these bankruptcy estates.

criminal conviction on a count which provides for the forfeiture of assets. *United States v. Vampire Nation*, 451 F.3d 189, 202 (3d Cir. 2006) (a criminal forfeiture order is a judgment *in personam* against the defendant; this distinguishes the forfeiture judgment in a criminal case from the *in rem* judgment in a civil case); *United States v. Lazarenko*, 476 F.3d 642, 647 (9th Cir. 2007) (criminal forfeiture operates *in personam* against a defendant; it is part of his punishment following conviction).

In criminal forfeiture procedure, the conviction of a defendant is not the end of the story for purposes of vesting the Government with title to the forfeited property. The law provides a mechanism for the determination of the rights of third parties to the property. *United States v. Pellulo*, 178 F.3d 196, 202 (3d Cir. 1999) (criminal forfeiture occurs in two steps: (1) the jury determines the forfeitability of the property and the district court enters an prder of forfeiture and (2) third parties assert their interests in an ancillary proceeding). The process governing this "ancillary proceeding" is governed by 21 U.S.C. §§ 853(k) and (n) which ensures an orderly process and protects the district court's exclusive jurisdiction. *United States v. Puig*, 419 F.3d 700 (8th Cir. 2005) (the ancillary proceeding is "only avenue by which a third party claimant may seek to assert an interest in property that has been included in an indictment alleging that the property is subject to forfeiture"). It is also important to note that the purpose of the ancillary proceeding is to adjudicate a third party's interest in the property being forfeited, not to adjudicate personal claims against the defendant or interest in other property of the defendant that is **not** being forfeited. *United States v. Totaro*, 345 F.3d 989, 993-94 (8th Cir. 2003) (the ancillary proceeding is the forum in which the court determines what portion of the property belonged to a third party so that it may be protected from forfeiture; it is not a civil forfeiture

proceeding in which any interest of a third party may be forfeited). For a general overview of the procedure for litigating third party claims in the ancillary proceeding, *see United States v. Wittig*, 525 F. Supp. 2d 1281 (D. Kan. 2007).

Generally speaking, an entity must have an identifiable interest in the specific property to be forfeited before it has the requisite standing under 21 U.S.C. § 853(n)(2) to assert a claim in the ancillary proceeding. *United States v. Timley*, 507 F.3d 1125, 1131 (8th Cir. 2007) (attorney who filed an attorney's lien on client's property had standing to contest its forfeiture under section 853(n)(2)); *United States v. Douglas*, 55 F.3d 584, 589 (11th Cir. 1995) (third party who has reduced his claim to a judgment lien on the forfeited property may file a claim). But until the entity has perfected the lien, it is merely an unsecured creditor with no interest in a particular asset. *United States v. McCorkle*, 143 F. Supp. 2d 1311, 1322-23 (M.D. Fla. 2001) (judgment creditor who did not reduce judgment to a lien on any specific asset was simply an unsecured creditor); *United States v. Fuchs*, 2005 WL 440429, at *2 (N.D. Tex. 2005) (person who has obtained a civil judgment against the defendant, but who has not perfected a judgment lien against any specific asset, is an unsecured creditor without standing to contest the forfeiture of the defendant's property in the ancillary proceeding).

Alternatively, victims can also petition the Attorney General under an administrative process for remission of assets forfeited to the Government. *In re W.R. Huff Asset Management Co.*, 409 F.3d 555, 564 (2d Cir. 2005) (21 U.S.C. § 853(i)(2) gives the Government the authority to compromise a criminal forfeiture with the defendant and third parties); *United States v. Hayes*, 2006 WL 1228972, at *5 n. 4 (W.D. La. 2006) (in rejecting third party claim of one of defendant's victims, court notes that the Government plans to allocate the proceeds of the sales

of the forfeited property on a pro rata basis to all of the victims, including the one whose claim was denied). In sum, pursuant to 21 U.S.C. § 853(i) and 28 C.F.R. Part 9, any victims of Petters' fraudulent scheme may petition the Attorney General for remission or mitigation of the forfeiture. *United States v. Gordon*, 2005 WL 2759845, at *3 (S.D.N.Y. Oct. 19, 2005).

The mandate of the Receivership Order[4] that Kelley "(c)oordinate with representatives of the United States Attorney's office and Court personnel as needed to ensure that any assets subject to the terms of this Order are available for criminal restitution, forfeiture, or other legal remedies . . ." does not create any materially adverse conflicts *vis a vis* Kelley's obligations to these bankruptcy estates. The mere allegation of forfeiture in the indictment against Petters, PCI and PGW does not mandate the appointment of a separate trustee for PGW. Kelley, in his role as "receiver" for the non-bankruptcy entities, is not empowered to pursue or control what, or which, assets may be subject to either restitution or forfeiture. The power to prosecute any forfeiture against any asset rests exclusively with the United States Attorney.[5] Ritchie cannot establish any prejudice to it which would necessitate either the appointment of a separate trustee for PGW or the denial of Kelley to serve as trustee of these bankruptcy cases.

IV. Ritchie's reliance upon *In re BH&P Inc.* is misplaced.

Ritchie argues that an appointment of a separate trustee for PGW is mandated because of a conflict of interest between it and PCI; however, this position appears to be inconsistent with the position Ritchie took when it sought the appointment of a single receiver for both PGW and

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[4] *Section IV, ¶ 6.*

[5] The statutory authority of the United States Attorney to seek forfeiture of assets does not *ipso facto* make the United States a creditor in these bankruptcy cases.

PCI in the Circuit Court of Cook County, Illinois. In that proceeding, Ritchie sought the appointment of a "William Procida as Receiver for the Collateral, including PGW and PCI and all its operations, with all of the usual powers of a receiver, . . ." *See Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for All of the Debtors in these Jointly Administered Proceedings*, Exhibit C-2. DE # 132. The state court granted Ritchie's request and appointed William Procida "Receiver of the Petters Entities," which was defined to include PGW and PCI. *Id.* Exhibit C-4.

A trustee for multiple estates with claims against one another need not be automatically removed. Removal must be based on some evidence of an actual conflict which prejudices the creditors of one of the estates. The court in *In re BH&P, Inc.*, 949 F.2d 1300 (3d Cir. 1991), rejected the notion that a trustee who, in a jointly administered case, asserts a claim on behalf of one estate against another, becomes a "creditor" as defined under 11 U.S.C. § 101(14)(A). The court held that section 101(14) should not be read to disqualify a trustee because of actions taken by the trustee in his representative capacity. Any trustee appointed under 11 U.S.C. § 1104 must be disinterested as defined under section 101(14)(A). The appointment of a separate trustee requires a showing that creditors will suffer actual prejudice by conflicts held by a common trustee. "Before a trustee may be removed, some actual injury must be shown." *Id*. at 1311.

The cases cited by Ritchie contain facts which established an identifiable conflict between two or more entities. Such is not the case here. The interrelatedness of these Debtor entities and affiliates of other Petters entities is obviously complex. "Upon reviewing the schedules, it becomes immediately obvious that the Debtor Entities, along with the dozens of other subsidiary entities of these Debtor Entities, and affiliates of other entities owned by

Thomas J. Petters, have accrued inter-company obligations, engaged in extensive transferring of funds between PCI, PGW and subsidiary entities of each, and incurred inter-company obligations on behalf of other entities at hundreds of million dollar levels." *Appointed Trustee's Response to Objection to Appointment of Douglas A. Kelley as Trustee for all of the Debtors in these Jointly Administered Proceedings*, DE # 132 at 10. The response of Kelley outlines his proposed "plan of action" — "The Appointed Trustee . . . expects to focus for an extended period of time on liquidating of assets, recovery of assets, pursuit of avoidance claims against non-affiliated entities, and pursuit of avoidance actions against non-affiliated third parties. The issue of whether potential conflicts ripen into actual conflicts may be dependent in large part, on the amount of money available for distribution at various entities. * * * At this time, if direct conflicts arise, steps will be taken with the input of parties in interest including the UST, to determine an appropriate manner to address these issues, which would likely include approval by this Court."[6] *Id*. at 12-13.

The selection of a common trustee in these jointly administered cases would not only be economical, but would avoid unnecessary duplication of actions and provide for an orderly administration of the cases. "[I]t has long been recognized that joint administration, and the appointment of a common trustee, are favored means to save expense." *In re Ben Franklin Retail Stores, Inc.*, 214 B.R. 852, 858 (Bankr. N.D. Ill. 1997). "Appointing a single trustee to investigate Petters' fraud and locate all available assets is in the collective best interest of the creditors, and it does not present a conflict of interest. *See International Oil*, 427 F.2d 187; *H&S Transp. Co.*, 55 B.R. at 791-92." *Response of the Unsecured Creditors Committee to Motions to*

[6] All of these functions are contemplated by 11 U.S.C. § 1106(a).

Appoint Chapter 11 Trustee, DE # 100 at 6.

CONCLUSION

The United States Trustee hereby requests that the Court enter an order approving the appointment of Douglas A. Kelley as trustee for these jointly administered cases and overruling Ritchie's objection to Kelley's Appointment as Chapter 11 Trustee, as well as its request for the appointment of a separate trustee in the bankruptcy case of Petters Group Worldwide, LLC, and for such other relief as may be just and equitable.

Dated: January 23, 2009

HABBO G. FOKKENA
United States Trustee
Region 12

By: /e/ Michael E. Ridgway
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Chapter 11 Cases
Judge Gregory F. Kishel

UNSWORN CERTIFICATE OF SERVICE

I, Audrey Williams, declare under penalty of perjury that on January 23, 2009, I served copies of the U.S. Trustee's Reply to Objection by Ritchie Special Credit Investments, Ltd., et al., to Appointment of Douglas A. Kelley as Trustee for all of the Debtors in these Jointly Administered cases electronically by Notice of Electronic Filing, and upon all parties who have requested service in these cases by filing the same via ECF with the Bankruptcy Court in the District of Minnesota, and upon the following by first class mail postage pre-paid:

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Executed on: January 23, 2009

/e/Audrey Williams
Audrey Williams
Office of the United States Trustee