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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE:	§	
	§	**Chapter 11**
ARCAPITA BANK B.S.C.(c), *et al.*,	§	
	§	**Case No. 12-11076-shl**
Debtors.	§	**Jointly Administered**
IN RE:	§	
	§	**Chapter 11**
FALCON GAS STORAGE CO., INC.	§	
	§	**Case No. 12-11790-shl**
Debtor.	§	**(Jointly Administered under Case No. 12-11076)**

MOTION TO CONVERT THE FALCON CASE OR, IN THE ALTERNATIVE, APPOINT A TRUSTEE IN THE FALCON CASE

TO THE HONORABLE SEAN H. LANE
UNITED STATES BANKRUPTCY JUDGE:

Tide Natural Gas Storage I, LP and Tide Natural Gas Storage II, LP (together, "Tide"), by their undersigned counsel, hereby file this Motion to Convert the Falcon Case or, in the

Alternative, Appoint a Trustee in the Falcon Case (this "Motion"). In support thereof, Tide respectfully submits as follows:

I. JURISDICTION

1. The Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

II. BACKGROUND

2. Arcapita Bank B.S.C.(c) ("Arcapita") and certain affiliates filed for chapter 11 protection on March 19, 2012. On April 5, 2012, the United States Trustee appointed an official committee of unsecured creditors (the "Committee") in the Arcapita case. The Committee consists of creditors of Arcapita and AIHL, but not Falcon Gas Storage Company, Inc. ("Falcon"). Falcon filed for bankruptcy on April 30, 2012.

3. Subsequent to Falcon's bankruptcy filing, counsel for Arcapita filed the Motion for an Order Pursuant to Section 105(a) of the Bankruptcy Code Directing that Certain Orders in the Chapter 11 Cases of Arcapita Bank B.S.C.(c) et al. Be Made Applicable to Subsequent Debtor [Falcon]. The Court granted this motion over Tide's objection, on June 12, 2012, ordering joint administration of the Falcon case with the Arcapita case, but not substantively consolidating the cases.

4. On February 8, 2013, the Debtors filed their (i) Disclosure Statement in Support of the Joint Plan of Reorganization of Arcapita Bank B.S.C.(c) and Related Debtors under Chapter 11 of the Bankruptcy Code ("Disclosure Statement"), (ii) Joint Plan of Reorganization of Arcapita Bank B.S.C.(c) and Related Debtors under Chapter 11 of the Bankruptcy Code ("Joint Plan"), and Motion for an Order (I) Approving the Disclosure Statement and the Form and Manner of notice of the Disclosure Statement Hearing, (II) Establishing Solicitation and

Voting Procedures, (III) Scheduling a Confirmation Hearing, and (IV) Establishing Notice and Objection Procedures for Confirmation of the Debtors' Joint Chapter 11 Plan ("Disclosure Statement Motion").

5. The Joint Plan consists of several "subplans" including the subplan for Falcon Gas Storage Co. Inc. (the "Falcon Plan").

6. Contemporaneously with the filing of this Motion, Tide has filed its Objections to Disclosure Statement In Support of Falcon's Plan. As described more fully therein, the Falcon Plan is not confirmable as a matter law. Furthermore, the Falcon Plan evidences a real and actual conflict of interest among Falcon's decision makers and the Falcon estate. This conflict of interest necessitates the appointment of an independent third party to administer the Falcon estate. Accordingly, Tide files this Motion.

III. RELIEF REQUESTED

7. Tide requests that, pursuant to 11 U.S.C. § 1112(b), the Falcon case be converted to a case under chapter 7 of the Bankruptcy Code. In the alternative, Tide requests that the Court appoint a trustee in the Falcon case pursuant to 11 U.S.C. § 1104(a).

IV. BASIS FOR RELIEF

A. The Falcon Case Should Be Converted - § 1112(b)(1)

8. Section 1112(b)(1) of the Bankruptcy Code provides that:

> on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1112(b)(1). Section 1112(b)(4) provides a non-exhaustive list of factors that constitute cause. *See In re 221-06 Merrick Blvd. Assocs. LLC,* 2010 Bankr. LEXIS 4431, *2 (Bankr. E.D.N.Y. Dec. 3, 2010). Pursuant to 11 U.S.C. § 1112(b)(4)(A), substantial or

continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation constitute cause for conversion. 11 U.S.C. § 1112(b)(4)(A).

9. Courts have held that a negative cash flow postpetition and an inability to pay current expenses satisfy the "continuing loss" element of § 1112(b)(4)(A). *See In re BH S&B Holdings, LLC*, 439 B.R. 342, 348 (Bankr. S.D.N.Y. 2010) ("Both the Debtors' financial statements reflecting continuing losses and the Debtors' intention to liquidate establish that there is no likelihood of rehabilitation. The Court is also satisfied that conversion to chapter 7 is in the best interests of the creditors and the bankruptcy estates"); *In re Adbrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003) (applying what is now the § 1112(b)(4)(A) standard as then set forth in 1112(b)(1)); *see also In re 3868-70 White Plains Road, Inc.*, 28 B.R. 515 (Bankr. S.D.N.Y. 1983) (noting that negative cash flow and an inability to pay current expenses has prompted conversion). Use of estate property by the debtor's shareholders and insiders in order to fund postpetition expenses constitutes a continuing loss to or diminution of the estate. *In re Nugelt, Inc*., 142 B.R. 661, 667 (Bankr. D. Del. 1992).

10. With respect to the second element of § 1112(b)(4)(A), rehabilitation does not mean the same thing as reorganization for purposes of chapter 11 because a reorganization may include an orderly or complete liquidation. *Adbrite*, 290 B.R. at 216; *In re Rundlett*, 136 B.R. 376, 380 (Bankr. S.D.N.Y. 1992). In this context, rehabilitation means to put back in good condition and reestablish on a sound basis. *See In re Lizeric Realty Corp.*, 188 B.R. 499, 503 (Bankr. S.D.N.Y. 1995); *see also In re Kanterman*, 88 B.R. 26, 29 (S.D.N.Y. 1988). The rehabilitation standard looks to whether the debtor will be able to establish cash flow from which its current obligations can be met. *See Adbrite*, 290 B.R. at 216, citing *Rundlett*, 136 B.R. at 380.

11. Falcon fails both elements of § 1112(b)(4)(A). As a non-operating entity, Falcon has no positive net cash flow at all, and as a chapter 11 debtor, Falcon is accruing large liabilities for administrative expenses. The result is a continuing diminution of the estate and an unlikely ability to fund rehabilitation as proposed in the recently filed Falcon Plan. For example, according to Falcon's most recent monthly operating report (January 1, 2013, to January 31, 2013, filed at Dkt. No. 834), Falcon maintained a cash balance of $618,336.00 as of January 31, 2013. Since Falcon has no operations, its net income for the month of January was –$4,130 (December 2012 was –$10,075). Also, during the first interim fee period, King & Spalding, as special counsel for Falcon related to the District Court Action/Tide litigation, has sought and attained interim approval of $234,796.00 in fees purportedly attributable to the Falcon estate. During the second interim fee period, King and Spalding has sought and attained approval of another $425,167.00 purportedly attributable to the Falcon estate. In the months since, King & Spalding has continued to bill large sums for Falcon related work with creditors seeing few tangible results: November 2012—$104,766.29; December 2012—$127,125.83; January 2013—$99,547.63. In sum, from only July 1, 2012, through January 31, 2013, King & Spalding has billed $1,000,402.75 related to the District Court Action/Falcon estate, and nothing of note has happened in the Falcon case. This sum does not include any "overhead" that Arcapita may seek to attribute to the Falcon estate. Considering Falcon's cash against accrued chapter 11 expenses, Falcon is already administratively insolvent and the estate continues to diminish. "Although section 1112(b)(4) does not list administrative insolvency as cause to convert or dismiss a chapter 11 case, a court may still consider this factor." *In re BH S&B Holdings, LLC*, 439 B.R. 342, 349 (Bankr. S.D.N.Y. 2010).

12. With regard to the ability to rehabilitate, Falcon is not and cannot meet its current obligations. Under the Falcon Plan and Disclosure Statement currently on file, there is no description of how Falcon will meet its accrued liabilities or its forecasted liabilities. There is no plan to establish cash flow; there is only the hope of prevailing in the District Court Action and that hope may not be realized for another "2 to 3 years," after another "$5 million" in defense costs, and even then, Falcon may lose entirely and receive *nothing.* (Disclosure Statement Art. III(H)(5)). The Falcon Plan appears to call for gambling $5 million of unfunded attorneys' fees for a chance to reach a verdict in the District Court Action. This is not a plan for rehabilitating Falcon to a sound basis, as is required to overcome a section 1112(b) motion. In fact, "case law is clear that the mere hope of prevailing on potential litigation claims is not a sufficient basis to defeat a showing of cause to convert." *In re BH S&B*, 439 B.R. at 350 (citing *In re FRGR Managing Member LLC*, 419 B.R. 576, 583 (Bankr. S.D.N.Y. 2009) ("[M]ost cases reject the need to evaluate the merits of a debtor's litigation claims in deciding whether to dismiss or convert a chapter 11 case."); *In re Ameribuild Const. Mgmt., Inc*., 399 B.R. 129, 134 (Bankr. S.D.N.Y. 2009)).

B. The Falcon Case Should Be Converted – Other Cause

13. A finding of cause is not limited to the grounds stated in § 1112(b)(4). *See See In re 221-06 Merrick Blvd. Assocs. LLC,* 2010 Bankr. LEXIS 4431, *2 (Bankr. E.D.N.Y. Dec. 3, 2010); *Adbrite*, 290 B.R. at 216 (citations omitted); *see also Michigan Nat'l Bank v. Charfoos (In re Charfoos)*, 979 F.2d 390, 392 (6th Cir. 1992) (bad faith may serve as a ground for dismissal although it is not expressly mentioned under § 1112(b)). Because the list of grounds for converting or dismissing a Chapter 11 case under § 1112(b)(4) is illustrative, not exhaustive, the court may consider other grounds and use its equitable powers to reach an appropriate result. *See*

C-TC 9th Ave. Partnership v. Norton Co. (In re C-TC 9th Ave. Partnership), 113 F.3d 1304, 1311 (2d Cir. 1997).

14. For example, courts have based decisions to convert or dismiss on the debtor's dereliction of its fiduciary duty to creditors. When a corporation files for protection under chapter 11, the officers and managing employees have a fiduciary duty to creditors and shareholders. This creates an "obligation to treat all parties, not merely the shareholders, fairly." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 355-56, 105 S. Ct. 1986, 85 L. Ed. 2d 372 (1985); *see also In re Hampton Hotel Investors, L.P.*, 270 B.R. 346, 358 (Bankr. S.D.N.Y. 2001) (lack of ability and inclination to comply with the fiduciary duties of a debtor in possession constitute cause under § 1112(b)); *Babakitis v. Robmo (In re Robino)*, 243 B.R. 472, 486 (Bankr. N.D. Ala. 1999) (a debtor's willful failure to act as a fiduciary constitutes cause); *In re Fed. Roofing Co., Inc.*, 205 B.R. 638, 642-43 (Bankr. N.D. Ala. 1996) (debtor-in-possession's maintenance of ongoing financial transaction with insider is a breach of fiduciary duty and constitutes cause for relief under § 1112(b)).

15. There is a clear conflict of interest among the parties running the Falcon case, and based on the proposed Falcon Plan and the Disclosure Statement, Falcon's decision makers do not intend to honor their obligation to "treat all parties, not merely the shareholders, fairly." *Weintraub*, 471 U.S. at 355-56. Falcon is controlled by Arcapita. The Official Committee of Unsecured Creditors ("Committee") in the Falcon case, which committee is tasked with protecting the interests of general unsecured creditors, is made up entirely of Arcapita creditors. The result of Arcapita, as equity, and Arcapita creditors, as the Committee, controlling the Falcon bankruptcy case is that these parties have a vested interest in minimizing Falcon creditor returns and maximizing Falcon equity returns.

16. The conflict of interest is manifest in the Falcon Plan, which is presented jointly by the Debtors and was negotiated with the Committee without conferring with or otherwise seeking any input from Falcon's creditors. For example, and without limitation, the Falcon Plan:

- settles Falcon's $15 million claim against Arcapita for one hundred dollars and allows Arcapita to enforce any intercompany claim against Falcon in full (Plan 4.7.1.3);
- allows Falcon to be merged with any other Debtor without any authorization of the court or any creditor of Falcon (Plan 7.6);
- makes Falcon liable on the new Exit Facility, New SCB Facility, and Sukuk Facility, all of which will satisfy creditors to whom Falcon has no liability (Plan 7.2.1, 7.2.2, 7.2.3, 7.2.4);
- allows Arcapita and its creditors to allocate administrative expenses to Falcon without any oversight (Disclosure Statement Art. VI(B)(2));
- improperly releases (i) the other Debtors, their current and former officers, directors, employees, managers, professionals, and agents of each of the foregoing, along with the successors, assigns and Affiliates, (ii) the Committee and its members, solely in their capacities as members of the Committee, (iii) Qatar Islamic Bank Q.S.C., QInvest LLC, Holders of Interests in any member of the Arcapita Group, and any Persons that have deposited funds with Arcapita Bank B.S.C.(c) (other than Placement Banks or their Affiliates. and (iv) a number of other parties, for "good and valuable consideration", yet Falcon has received nothing for such release (Plan 9.2);
- improperly requires Falcon's subordinated creditors to share *pari passu* with Falcon's equity (Plan 4.8.2.2); and
- inflates the worth of Falcon's equity to $515 million at the expense of Falcon's creditors (Plan 4.9.2.3).

17. Each of these concrete examples exemplifies the actual conflict of interest that is inherent when equity (both in the form of Arcapita and the Committee) controls the actions and plan formulation of a subsidiary. A disinterested third party such as a chapter 7 trustee is necessary to oversee the claims allowance process and the distribution of Falcon's assets to ensure that Falcon's creditors are treated fairly.

C. In the Alternative, a Trustee Should be Appointed

18. The grounds for appointment of a chapter 11 trustee are set forth in § 1104(a) of the Bankruptcy Code as follows:

> a 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, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
>
> (2) if the 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).

19. The examples of conduct listed in section 1104(a)(1) "do not constitute the entire catalogue of 'good cause,' but rather are only illustrative of what type of conduct may constitute cause warranting appointment of a trustee." *Altman v. Rafael Galleries, Inc. (In re Altman),* 2000 U.S. Dist. LEXIS 16235 at *18 (D. Conn. July 27, 2000) (citing *In re Marvel Entertainment Group, Inc*., 140 F.3d 463, 472 (3d Cir. 1998) (finding that section 1104(a)(1) does not promulgate exclusive list of causes for which a trustee may be appointed and a trustee might be appointed based on acrimony between debtor and creditor)). Relevant factors in determining cause include conflicts of interest, inappropriate relations between corporate parents and subsidiaries, misuse of funds, inadequate record keeping and reporting, fraud, dishonesty or lack of credibility. *See id.; see also In re Clinton Centrifuge, Inc*., 85 B.R. 980, 985 (Bankr. E.D. Pa. 1988).

20. The standard for appointment of a trustee pursuant to § 1104(a)(2) provides the court with more discretion, requiring it to balance the "factors and interests carefully," as

appointment of a trustee will create additional expenses for the estate. *In re North Star Contracting Corp*., 128 B.R. 66, 70 (Bankr. S.D.N.Y. 1991). In *In re McCorhill Publ'g, Inc*., 73 B.R. 1013 (Bankr. S.D.N.Y. 1987), the court was faced with a motion to convert or dismiss, or, in the alternative, to appoint a trustee or examiner. It noted that there was "no showing that the debtor was experiencing continuous losses or that reorganization was unlikely," and it therefore concluded that conversion or dismissal would be premature. *Id*. at 1018. Then, while recognizing that the appointment of a trustee is often considered extraordinary relief, it found a trustee to be "in the best interests of creditors and all parties in interest in order to investigate the financial affairs of the debtor." *Id.* at 1017. The McCorhill court based its decision on "questionable inter-company financial transfers" and the fact that "the principals of the debtor occupy conflicting position in the transferee companies . . .". *Id.; see also In re Bellevue Place Assocs*., 171 B.R. 615 (Bankr. N.D. Ill. 1994) (none of the factors enumerated in § 1104(a)(1) had been clearly established by the movant but cause existed where the debtor was unable to discharge its fiduciary duties).

21. As described above, there is an inherent conflict of interest in the fact that Arcapita and the Arcapita Creditors Committee are controlling the Falcon case and the Falcon Plan in their own favor and to the detriment of Falcon's creditors. Tide first warned of this possible conflict in May 2012, in its objection to the Debtors' motion to apply existing Arcapita orders to the later filed Falcon estate. At that time the conflict was only "potential" but now the conflict has become real and untenable as the relationship between corporate parent and corporate subsidiary imperils the rights of Falcon's creditors. If there is any doubt to the existence of a conflict, that doubt should be resolved in favor of disqualification. *In re Michigan Gen. Corp*., 78 B.R. 479, 484 (Bankr. N.D. Tex. 1987). Representation of a controlling party

and the debtor constitutes an actual conflict of interest. *See In re Kendavis Indus. Intern. Inc.*, 91 B.R. 742, 751 (Bankr. N.D. Tex. 1988). Similarly, there is a conflict where debtors have joint liability on many debts because it is in the interest of each debtor to have the other debtor estate pay the liability. *See In re Lee*, 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988). Courts must stick to the equitable principle that a fiduciary can only serve one master. *In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1256, n7 (5th Cir. 1986) (citing *Woods v. City National Bank,* 312 U.S. 262 (1941). Although it is often appropriate in the commercial world for corporate enterprise parents and subsidiaries to have a unity of interest and purpose, that commonality often ends when the corporate entities file bankruptcy. *See In re Amdura Corp.*, 121 B.R. 862, 868 (Bankr. D. Col. 1990). Where such entities are unable to pay their creditors, perhaps some more so than others, the authority of those entities to operate as a unit is circumscribed by the Code because there now exists a conflict between the interests of the parent and the subsidiaries. *Id*. at 869. Here, Arcapita is the parent corporation and controlling party of Falcon. It is in Arcapita and the Arcapita Creditor Committee's interests to minimize return to Falcon creditors and maximize return to Falcon's equity and the Falcon Plan, as discussed above, contemplates such. Any unity of interest or purpose amongst the corporate entity prior to the bankruptcy filing no longer applies under the circumstances here; instead, there is an inherent conflict between the interests of Arcapita and Falcon's estates. Under § 1104(a), cause exists to appoint a trustee.

PRAYER

WHEREFORE, Tide requests that the Court convert the Falcon case to a chapter 7 bankruptcy proceeding. In the alternative, Tide requests that the Court appoint a chapter 11 trustee to manage the affairs of the Falcon. Finally, Tide requests such other and further relief as the Court deems just.

Respectfully submitted,

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