

1 UNITED STATES COURT OF APPEALS
2 FOR THE SECOND CIRCUIT
3

4 August Term 2008
5 (Argued: September 17, 2008 Decided: May 1, 2009)
6 Docket No. 07-1508-bk

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9 IN RE: BAYOU GROUP, LLC,

10
11 Debtor.

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15 DIANA G. ADAMS, United States Trustee,

16
17 Appellant,

18
19 -- v. --

20
21 RECEIVER JEFF J. MARWIL, for the Bayou Group Official
22 Committee of Unsecured Creditors, and BAYOU GROUP,
23 LLC,

24
25 Appellees.*

26
27 -----x

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29 B e f o r e : WALKER, KATZMANN, GIBSON,** Circuit Judges.

30 Appeal by the United States Trustee from a judgment entered
31 in the United States District Court for the Southern District of
32 New York (Colleen McMahon, Judge), affirming a decision of the
33 United States Bankruptcy Court for the Southern District of New

1 * The Clerk of Court is directed to amend the official caption
2 as set forth above.

1 ** The Honorable John R. Gibson, of the United States Court of
2 Appeals for the Eighth Circuit, sitting by designation.

1 York (Adlai S. Hardin, Bankruptcy Judge) rejecting the United
2 States Trustee's petition to appoint a trustee to manage the
3 debtor. We hold that the district court did not err in denying
4 the United States Trustee's appeal from the bankruptcy court's
5 decision, where the district court had already appointed new
6 management of the debtor and the United States Trustee showed no
7 cause for removal of this management.

8 AFFIRMED.

9
10 MICHAEL E. ROBINSON, (William
11 Kanter, of counsel),
12 Attorneys, Appellate Staff,
13 Civil Division, Department of
14 Justice, Washington, D.C.,
15 (Peter D. Keisler, Assistant
16 Attorney General, Ross E.
17 Morrison, Assistant United
18 States Attorney, on the
19 brief), for Michael J. Garcia,
20 United States Attorney for the
21 Southern District of New York,
22 New York, N.Y., (Roberta A.
23 DeAngelis, Acting General
24 Counsel, Walter W. Theus, Jr.,
25 Department of Justice
26 Executive Office for United
27 States Trustees, Lisa L.
28 Lambert, Assistant United
29 States Trustee, of counsel),
30 for Appellant.

31 GARY J. MENNITT, (H. Jeffrey
32 Schwartz, Elise Scherr Frejka,
33 Jonathan D. Perry, of
34 counsel), Dechert LLP, New
35 York, N.Y., for Appellee Bayou
36 Group LLC et al.

37
38 RICHARD A. KIRBY, (Scott P.

1 Lindsay, Maria Goodman, of
2 counsel), Kirkpatrick &
3 Lockhart Preston Gates Ellis
4 LLP, Washington, D.C., for
5 Appellee Official Committee of
6 Unsecured Creditors.

7 JOHN M. WALKER, JR., Circuit Judge:

8 Appellant Diana G. Adams, United States Trustee (the "U.S.
9 Trustee"), appeals from a judgment of the District Court for the
10 Southern District of New York (Colleen McMahon, Judge) that
11 affirmed a decision of the Bankruptcy Court (Adlai S. Hardin,
12 Bankruptcy Judge) rejecting the U.S. Trustee's application under
13 11 U.S.C. § 1104 to appoint a trustee to manage the Bayou
14 entities ("Bayou," or "the Bayou entities") after the Bayou
15 entities filed for Chapter 11 protection. Prior to the
16 bankruptcy, the district court had appointed Jeff J. Marwil
17 ("Marwil") as receiver to manage Bayou. On appeal, the U.S.
18 Trustee argues, as she did below, that Marwil's duties as
19 receiver ended upon Bayou's filing for bankruptcy protection, and
20 therefore the bankruptcy court should have appointed her as the
21 trustee.

22 We agree with the district court that the bankruptcy court's
23 pre-petition order effectively appointed Marwil as both receiver
24 and manager of Bayou, and thus conclude that there was no
25 management vacancy for the U.S. Trustee to fill. Because the
26 U.S. Trustee has provided no reason, based on Marwil's
27 performance or qualifications, to replace him, we affirm the

1 judgment of the district court that affirmed the bankruptcy
2 court's denial of the U.S. Trustee's petition.

3 **BACKGROUND**

4 The Bayou entities are a group of hedge funds and related
5 entities that were operated as fraudulent schemes, and are now
6 debtors-in-possession in Chapter 11 proceedings under the
7 Bankruptcy Code. Following Bayou's collapse in August 2005,
8 Bayou's managers pled guilty to various federal criminal fraud
9 charges, and were ordered to forfeit Bayou's assets.

10 On March 27, 2006, the Unofficial On-Shore Creditors'
11 Committee (the "Committee"), Bayou creditors holding more than
12 \$130 million in claims, sought to "mitigate the massive losses
13 suffered by the creditors and others" through the appointment of
14 a "federal equity receiver" to pursue the litigation claims. See
15 Adams v. Marwil (In re Bayou Group, L.L.C.), 363 B.R. 674, 678
16 (S.D.N.Y. 2007) (internal quotation marks omitted). The
17 Committee asked the district court to appoint Marwil as both
18 "non-bankruptcy federal equity receiver and exclusive managing
19 member" for the Bayou entities. Id. at 680 (internal quotation
20 marks and emphasis omitted). Following a two-day hearing that
21 fully discussed "the subject of [Bayou's] corporate governance,"

1 id. at 679-80, the district court, without objection,¹ entered an
2 order (the "Order") "authoriz[ing], empower[ing], and
3 direct[ing]" Marwil to perform a number of "duties and
4 responsibilities," including the responsibility for "Corporate
5 Governance." Order ¶ 7(e). Marwil was directed to be "the sole
6 and exclusive managing member and representative of each of the
7 Bayou Entities[,] [possessing] . . . without limitation, the
8 authority to petition for protection under the Bankruptcy Code,
9 11 U.S.C. §§ 101 et seq." Id. The Order specified that the
10 appointment was "warranted under Section 10(b) of the Securities
11 Exchange Act of 1934 and SEC Rule 10b-5 thereunder, state law
12 claims of fraud and breach of a fiduciary duty, Federal Rule of
13 Civil Procedure 66, and the facts and circumstances of this
14 case." Id. at Introduction, ¶ 3. The Order further stated that
15 the district court's authority to appoint Marwil was "[p]ursuant
16 to 28 U.S.C. §§ 754 and 959, Federal Rule of Civil Procedure 66
17 and [the] [c]ourt's inherent authority." Id. ¶ 1.

18 Following the April 28 order, Marwil undertook his
19 responsibilities as managing member of Bayou. On May 30, Marwil
20 caused each Bayou entity to file a separate voluntary petition

1 ¹ The United States received notice of the Committee's action,
2 and witnessed the finalization of the Order. See Bayou, 363 B.R.
3 at 678. Numerous government agencies attended the district court
4 hearings, including the U.S. Attorney, the SEC, and the Commodity
5 Futures Trading Commission. None objected to the terms of the
6 Order, or to the appointment of Marwil. See id. at 680.

1 for relief under Chapter 11 of the Bankruptcy Code. 363 B.R. at
2 680. Thereafter Marwil brought more than 125 adversary
3 proceedings seeking disgorgement from redeeming investors that
4 have resulted in excess of \$20 million in recovered assets.
5 Marwil's efforts have been endorsed by all of Bayou's creditors,
6 including the Official Committee of Unsecured Creditors (the
7 "Official Creditors' Committee"), which was organized by the U.S.
8 Trustee shortly after Marwil's appointment.

9 On June 20, approximately eight weeks after Marwil's
10 appointment, the U.S. Trustee moved in the bankruptcy court for
11 an order appointing a Chapter 11 trustee to replace Marwil and
12 oversee Bayou's bankruptcy proceedings. The bankruptcy court
13 orally denied the U.S. Trustee's motion, both as an impermissible
14 collateral attack on the Order, and because the district court
15 had appointed Marwil not only as receiver of the Bayou entities,
16 but also as "new management of the[] debtors" with the authority
17 and capacity to manage the bankruptcy proceedings as the debtor-
18 in-possession. 363 B.R. at 682 (internal quotation marks
19 omitted). The bankruptcy court said:

20 Mr. Marwil is not simply a custodian. . . . [I]t is
21 crystal clear that the purpose of Judge McMahon's
22 order was to appoint somebody who was in fact and
23 law the equivalent of a new board of directors, new
24 CEO, new president, new CFO as a debtor-in-
25 possession [I]t is perfectly clear to me
26 that he's really not just a receiver or a custodian

1

2
3 Id. (alterations and second and third omissions in original, and
4 internal quotation marks omitted).

5 On February 2, 2007, the district court, affirming the
6 bankruptcy court, held that the Order "clearly contemplated
7 appointing Marwil as both a receiver and as Bayou's corporate
8 management," and that Marwil's "corporate management appointment
9 was not merely derivative of his receivership appointment" but
10 instead was made pursuant to "federal receivership statutes" as
11 well as "federal securities law[s] and [the district] court's
12 inherent authority." Id. at 683. The district court found that
13 Marwil, as the "sole and exclusive managing member and
14 representative of [Bayou]," had the "sole and exclusive power and
15 authority to manage and direct the business and financial affairs
16 of [Bayou], including without limitation, the authority to
17 petition for protection under the Bankruptcy Code . . . and in
18 connection therewith be and be deemed a debtor-in-possession for
19 [Bayou]." Order ¶ 7(e). The district court further held that,
20 by filing for bankruptcy, Marwil transformed his status from
21 "corporate governor" to debtor-in-possession, and therefore, that
22 Marwil was "under no obligation to turn over Bayou's property to
23 a bankruptcy trustee." 363 B.R. at 687.

24 The U.S. Trustee then appealed to this court.

25 **DISCUSSION**

1 On appeal, the U.S. Trustee argues that the district court
2 misinterpreted its own order by permitting Marwil to continue as
3 managing member of Bayou after he caused the Bayou entities to
4 file for Chapter 11 protection. According to the U.S. Trustee,
5 "both the bankruptcy court and the district court were wrong to
6 conclude that Marwil was not a 'custodian' merely because he had
7 been granted the 'corporate governance powers' of a 'managing
8 member and representative' of the Bayou Entities." Appellant Br.
9 18. The U.S. Trustee further contends that, because Marwil was
10 only appointed by the district court to be the custodian of the
11 Bayou entities, and because custodians are prohibited under the
12 Bankruptcy Code from managing a debtor's property after
13 commencement of a bankruptcy proceeding, see 11 U.S.C. § 543(a),²
14 there was a "vacuum of lawful management" at Bayou to oversee the
15 bankruptcy proceedings, Appellant Br. 9, and therefore,

1 ² Section 543(a) provides that:

2 A custodian with knowledge of the
3 commencement of a case under [the Bankruptcy
4 Code] concerning the debtor may not make any
5 disbursement from, or take any action in the
6 administration of, property of the debtor,
7 proceeds, product, offspring, rents, or
8 profits of such property, or property of the
9 estate, in the possession, custody, or
10 control of such custodian, except such action
11 as is necessary to preserve such property.
12

13
14 11 U.S.C. § 543(a).

1 appointment of a bankruptcy trustee is necessary in this case.

2 For the following reasons, we disagree.

3 **I. Standard of Review**

4 Where, as here, a district court acts in its capacity as an
5 appellate court in a bankruptcy case, the district court's
6 decisions are subject to plenary review by this court. Dairy
7 Mart Convenience Stores, Inc. v. Nickel (In re Dairy Mart
8 Convenience Stores, Inc.), 411 F.3d 367, 371 (2d Cir. 2005). We
9 thus review independently the factual findings and legal
10 conclusions of the bankruptcy court, accepting its findings of
11 fact unless they are clearly erroneous and reviewing its
12 conclusions of law de novo. Babitt v. Vebeliunas (In re
13 Vebeliunas), 332 F.3d 85, 90 (2d Cir. 2003).

14 As an initial matter, the parties dispute whether the
15 interpretation of the Order by the courts below constituted a
16 finding of fact or conclusion of law. The U.S. Trustee claims
17 that, because the case hinges on a legal interpretation of the
18 Order, the bankruptcy and district court conclusions must be
19 reviewed de novo, see Appellant Br. 11 (citing Lebovits v.
20 Scheffel (In re Lehal Realty Assocs.), 101 F.3d 272, 276 (2d Cir.
21 1996)), while the Official Creditors' Committee asserts that the
22 scope of Marwil's authority is a question of fact, reviewable
23 under the clearly erroneous standard, see Br. of Appellee
24 Official Committee of Unsecured Creditors in Opp'n ("Official

1 Creditors' Committee Br."), at 14-15 (citing Fisher v. First
2 Stamford Bank & Trust Co., 751 F.2d 519, 522 (2d Cir. 1984)). We
3 have no need to resolve this dispute, however, because we agree
4 with the determinations of the courts below.

5 **II. Appointment Of A Trustee Is Not Warranted Under 11 U.S.C. §**
6 **1104(a).**
7

8 Upon request of the U.S. Trustee, "the court shall order the
9 appointment of a trustee" to oversee Chapter 11 proceedings. 11
10 U.S.C. § 1104(a). However, the court may appoint a trustee "only
11 in certain circumstances." See Smart World Techs., LLC v. Juno
12 Online Servs., Inc. (In re Smart World Techs., LLC), 423 F.3d
13 166, 174 n.10 (2d Cir. 2005). Specifically, a trustee may only
14 be appointed pursuant to a § 1104 motion "for cause, including
15 fraud, dishonesty, incompetence, or gross mismanagement of the
16 affairs of the debtor by current management," or "if such
17 appointment is in the interests of creditors." 11 U.S.C. §
18 1104(a)(1)-(2).

19 "[T]he standard for § 1104 appointment is very high"
20 In re Smart World, 423 F.3d at 176; see also 7 Collier on
21 Bankruptcy, ¶ 1104.02[2][a] (noting that appointment of a trustee
22 in a Chapter 11 case is an "extraordinary" remedy). The U.S.
23 Trustee has the burden of showing by "clear and convincing
24 evidence" that the appointment of a trustee is warranted. In re
25 Adelphia Commc'ns Corp., 336 B.R. 610, 656 (Bankr. S.D.N.Y.
26 2006). In determining whether a § 1104 appointment is warranted

1 or in the best interests of creditors, the bankruptcy court must
2 bear in mind that the appointment of a trustee "may impose a
3 substantial financial burden on a hard pressed debtor seeking
4 relief under the Bankruptcy Code," by incurring the expenditure
5 of "substantial administrative expenses" caused by further delay
6 in the bankruptcy proceedings. See Midlantic Nat'l Bank v.
7 Anchorage Boat Sales, Inc. (In re Anchorage Boat Sales, Inc.), 4
8 B.R. 635, 644 (Bankr. S.D.N.Y. 1980).

9 In the instant case, the U.S. Trustee has not met the "very
10 high" standard for a § 1104 appointment. The U.S. Trustee has
11 not attempted to show that Marwil has engaged in "fraud,
12 dishonesty, incompetence, or gross mismanagement of" Bayou's
13 affairs. In fact, the record is quite to the contrary. As
14 Bayou's managing member, Marwil has brought more than 125
15 adversary proceedings and recovered more than \$20 million for
16 Bayou's creditors. In her brief, the U.S. Trustee effectively
17 concedes the absence of any reason to doubt Marwil's competence
18 to manage Bayou's bankruptcy proceedings. See Appellant Br. 25
19 ("It is also important to note that Marwil's service as a
20 custodian, standing alone, did not automatically disqualify him
21 from being appointed or elected as a Chapter 11 trustee."); see
22 also Appellees Br. 15 n.6 (describing Marwil's extensive
23 credentials and expertise in bankruptcy proceedings). Section
24 1104 motions have been denied even where the U.S. Trustee has

1 demonstrated some potentially questionable conduct by existing
2 management of a debtor, see In re North Star Contracting Corp.,
3 128 B.R. 66, 69-70 (Bankr. S.D.N.Y. 1991); here, there is none.³

4 Nor has the U.S. Trustee shown, or even attempted to show,
5 that the removal of Marwil is "in the interests of creditors."
6 No creditor supports the motion,⁴ and the Official Creditors'
7 Committee, which first petitioned for Marwil's appointment,
8 opposes it. While appellees have pointed out ways in which
9 Marwil's removal would hamper the bankruptcy proceedings, see
10 Appellees Br. 18-19, the U.S. Trustee has not indicated how
11 replacing Marwil would facilitate them, see, e.g., In re North
12 Star, 128 B.R. at 70 (denying appointment of trustee where
13 creditors' committee supported continued operations by current
14 management).

15 The U.S. Trustee's motion boils down to a claim that because
16 the district court's order only appointed Marwil as custodian for

1 ³ The U.S. Trustee makes no attempt to impute the pre-petition
2 fraudulent activity of Bayou's former management to Marwil. Such
3 an imputation would be improper, as "[w]hen considering whether
4 to appoint a trustee for cause, a court's focus is on the
5 debtor's current management, not the misdeeds of past
6 management." In re The 1031 Tax Group, LLC, 374 B.R. 78, 86
7 (Bankr. S.D.N.Y. 2007).

1 ⁴ Two original investors who withdrew all of their money out
2 of Bayou before its collapse, and who were defendants in an
3 adversary proceeding commenced by Marwil, were the only parties
4 to file a statement in support of the U.S. Trustee's § 1104
5 motion. See Bayou, 363 B.R. at 681.

1 the Bayou entities, once Marwil caused Bayou to file for
2 bankruptcy, Marwil's custodial relationship with Bayou ended as a
3 matter of law and there was no manager to run the entities under
4 Chapter 11. The U.S. Trustee argues that, unless a trustee is
5 appointed, Bayou lacks management to prosecute the bankruptcy
6 proceedings. We are not persuaded.

7 First, from a purely practical perspective, Bayou has been
8 effectively managed since Marwil was appointed by the district
9 court in April 2006. The U.S. Trustee has produced no evidence
10 that Marwil failed to fulfill this role either pre- or post-
11 petition. Thus, there has been no de facto management vacuum at
12 Bayou.

13 Next, we agree with the district and bankruptcy courts that
14 the Order appointed Marwil to be both Bayou's custodian and its
15 corporate manager. The Order provided Marwil with two hats - one
16 as custodian, and one as "sole and exclusive" managing member of
17 Bayou. While Marwil's "custodian" hat came off upon commencement
18 of the Chapter 11 proceedings, his "managing member" hat
19 remained. This dual role was specifically contemplated and
20 intended by both the Committee in requesting Marwil's
21 appointment, and the district court in granting it.⁵

1 ⁵ See Bayou, Apr. 18, 2006 Hearing Tr. at 33:7-34:20; id. at
2 10:22-12:20 ("We anticipate that there is likely to be a
3 bankruptcy necessary for a number of the Bayou entities
4 There is still nobody to represent the Bayou entities in that
5 process and we believe the simplest way to go forward is to have

1 The U.S. Trustee next contends that, although the district
2 court had the authority to provide Marwil with "management powers
3 to run the affairs of" Bayou "prior to bankruptcy," it lacked the
4 authority to appoint Marwil as bankruptcy receiver under federal
5 law, and therefore, Marwil could not assume the responsibilities
6 as bankruptcy receiver after filing a Chapter 11 petition. Cf.
7 Eberhard v. Marcu, 530 F.3d 122, 132 (2d Cir. 2008)
8 ("[R]eceivership should not be used as an alternative to
9 bankruptcy"). However, Marwil's authority to manage the
10 bankruptcy proceedings stems not from his position as "federal
11 equity receiver" but from the language in the Order specifically
12 appointing Marwil as Bayou's "sole and exclusive managing
13 member," thereby vesting him with the authority to file and
14 manage Bayou's bankruptcy proceedings. The district court
15 plainly had authority to place Marwil in a management position
16 from which he could file and manage a Chapter 11 petition. See
17 SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1103 (2d Cir.
18 1972) ("[15 U.S.C. §§ 77v(a) and 78aa] confer general equity
19 powers upon the district courts [to fashion remedies for
20 securities laws violations]."); id. ("Once the equity
21 jurisdiction of the district court has been properly invoked by a
22 showing of a securities law violation, the court possesses the
23 necessary power to fashion an appropriate remedy."). The award

1 [Marwil] . . . administer the bankruptcy.").

1 of such ancillary relief was fully within the district court's
2 authority.

3 The U.S. Trustee also argues, for the first time in its
4 reply, that the district court lacked authority to appoint Marwil
5 because he is not authorized under Connecticut law to govern
6 Bayou. This argument was made too late, and in any event, it is
7 similarly unavailing. The district court's authority to appoint
8 Marwil as corporate manager stemmed from its inherent authority
9 to fashion remedies for violations of federal securities laws.
10 Moreover, as the district court noted, it could have appointed
11 Marwil as managing member of Bayou under Connecticut law, had it
12 chosen to do so. See Bayou, 363 B.R. at 685-86 (citing Morrow v.
13 Prestonworld, Inc., No. CV-445844S, 2002 WL 652369, at *6 (Conn.
14 Super. Ct. Mar. 22, 2002) (appointing custodian of corporation
15 and ordering that the "custodian shall exercise all the powers of
16 the board of directors and officers of [the subject corporation]
17 to the extent necessary to manage the affairs of the corporation
18 in the best interests of its stockholders")).

19 Finally, we reject the U.S. Trustee's claim that allowing
20 Marwil to prosecute Bayou's Chapter 11 proceedings "override[s]
21 the scheme contemplated by the Bankruptcy Code by supplanting the
22 authority of the U.S. Trustee in Chapter 11 cases." Appellant
23 Br. 21. As the district court noted, "nothing in the Code . . .
24 precluded [the Committee] from moving th[e] court to appoint

1 corporate governance for the Bayou entities, pre-petition.” 363
2 B.R. at 690. Marwil’s appointment was within both the spirit and
3 letter of the Bankruptcy Code, which contemplates appointment of
4 a trustee under circumstances not present in this case. Should
5 questions of malfeasance or incompetence on the part of Marwil
6 arise, the U.S. Trustee is free to move for appointment of a
7 trustee. Until that time, however, Marwil remains the debtor-in-
8 possession pursuant to the district court’s order.

9 **CONCLUSION**

10 For the foregoing reasons, the district court’s judgment
11 affirming the bankruptcy court’s denial of the U.S. Trustee’s
12 motion to appoint a trustee pursuant to 11 U.S.C. § 1104 is
13 hereby AFFIRMED.