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Setting the Standards for Appointment of a Chapter 11 Trustee under 1104(A)(1) of the Bankruptcy Code: Can a Debtor Cooperative Remain in Possession - Cajun Electric Power Cooperative, Inc. v. Central Louisiana Electric Co.

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SETTING THE STANDARDS FOR APPOINTMENT OF A CHAPTER 11 TRUSTEE UNDER § 1104(A)(1) OF THE BANKRUPTCY CODE: CAN A DEBTOR COOPERATIVE REMAIN IN POSSESSION?

Cajun Electric Power Cooperative, Inc. v. Central Louisiana Electric Co. 74 F.3d 599 (5th Cir. 1996)*

*Glenda M. Raborn***

I. INTRODUCTION

The Bankruptcy Reform Act of 1978[1] redefined debtors' rights in the context of a Chapter 11 reorganization. Through this legislation, Congress created a reorganization provision fundamentally based on the presumption that the debtor, after filing a petition for relief, should remain in possession of the estate.[2] Opposite this presumption, Congress acknowledged the importance of allowing creditors the opportunity to pursue appointment of a trustee when a debtor is failing to preserve the estate's assets for the benefit of creditors or where the debtor is compromising effective reorganization.[3]

Under § 1104(a)(1) of the Bankruptcy Code, Congress enumerated specific factors relevant to the appointment of a trustee in a Chapter 11 reorganization.[4] The statute reads in part: "The court shall order the appointment of a trustee . . . for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management . . . or similar cause."[5] The illustrative language of § 1104(a)(1) raises two issues: 1) what interpretive rationales are courts using to apply the statute; and 2) what constitutes "similar cause" in instances where "fraud, dishonesty, incompetence, or gross mismanagement" are not present?

In *Cajun Electric Power Cooperative, Inc. v. Central Louisiana Electric Co.*,[6] the United States Court of Appeals for the Fifth Circuit affirmed a lower court's appointment of a trustee in a Chapter 11 proceeding under § 1104(a)(1) because of certain "conflicts of interest" within the debtor's board of directors.[7] Cajun

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* Full citation is as follows: 69 F.3d 746 (5th Cir. 1995), *withdrawn in part on reh'g by* 74 F.3d 599 (5th Cir. 1996).

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1. 11 U.S.C. § 1101 (1994).
2. 11 U.S.C. § 1107(a) (1994).
3. 11 U.S.C. § 1104(a)(1) (1994).
4. *Id.*
5. *Id.* Section 1104(a)(2), known as the best interests standard, weighs the cost of appointment of a trustee against the value of the protection received. 11 U.S.C. § 1104(a)(2) (1994). Generally, it is uncommon for grounds to exist for appointment of a trustee under § 1104(a)(2) and not also under § 1104(a)(1). Consequently, this Note will focus on the statutory language and interpretations of §1104(a)(1).
6. 69 F.3d 746 (5th Cir. 1995), *withdrawn in part on reh'g by* 74 F.3d 599 (5th Cir. 1996).
7. *Id.*

Electric Power Cooperative was operating as a member-owned electrical cooperative.[8] Under this organizational structure, much of Cajun's managing board consisted of representatives of its twelve member companies who, in addition, purchased electricity from Cajun.[9] The appellate court concluded that these conflicts of interest, which stemmed primarily from Cajun's cooperative structure, were "inherent conflicts" and constituted "cause" to appoint a Chapter 11 trustee.[10] The court stated that "[o]nce cooperative members begin working at cross-purposes, . . . the appointment of a trustee may be the only effective way to pursue reorganization."[11] In implicitly finding the presence of inherent conflicts, absent any finding that the incumbent management was overtly wasting the assets of the estate, the Fifth Circuit's opinion in *Cajun* extended the interpretation of § 1104(a)(1) and established a policy of appointing a trustee in cases involving businesses with conflicts of interest, including member-owned cooperatives.

This Note will examine the standards set forth in § 1104(a)(1) of the Bankruptcy Code for appointment of a Chapter 11 trustee. After a review of the legislative history of § 1104(a)(1), this Note will explore the interpretive rationales emerging in the judicial constructs, as well as the notion of a common theme underlying the "similar cause" standard. Finally, this Note will analyze the potential effect of the Fifth Circuit's decision on the cooperative business structure in future Chapter 11 proceedings.

II. FACTS AND RELEVANT ISSUES

In 1979, Cajun Electric Power Cooperative, a nonprofit electric cooperative, entered into a Joint Ownership Participation and Operating Agreement with Gulf States Utilities (hereinafter "GSU") for the construction of a nuclear power plant (River Bend Nuclear Power Facility).[12] The terms of the Joint Ownership Agreement required Cajun to pay thirty percent of the construction and operating costs of the facility in exchange for a thirty percent undivided ownership interest in River Bend.[13] During contract negotiations, GSU allegedly proposed a total project cost of $980 million.[14] By project's end, actual costs totaled $4.4 billion. Cajun was obligated for more than $1.4 billion of that amount.[15]

Cajun filed suit against GSU in 1989, requesting rescission of the Joint Ownership Agreement, asserting GSU fraudulently induced Cajun into entering into the contract.[16] The district court held that Cajun failed to prove fraudulent inducement and upheld the Agreement.[17] The judicial posture of the Joint Ownership Agreement litigation cinched Cajun's financial instability.

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8. *Id.*
9. *Id.* at 747.
10. *Id.* at 750.
11. *Id.* at 751.
12. Cajun Elec. Power Coop., Inc. v. Gulf States Utils., Inc., 940 F.2d 117, 118 (5th Cir. 1991).
13. *Id.*
14. *Id.* at 119.
15. *Id.*
16. *Id.*
17. Cajun Elec. Power Coop., Inc. v. Gulf States Utils., Inc., 1995 WL 875446 at *1 (M.D. La. Oct. 24, 1995).

Cajun's ultimate blow came when the Louisiana Public Service Commission ordered the electric cooperative to reduce the rates Cajun was charging its members.[18] With lower rates, Cajun could no longer service its $4 billion total liabilities.[19] On December 21, 1994, the day the rate decrease went into effect, Cajun filed a voluntary petition for relief under Chapter 11.[20]

Within days of the filing of Cajun's petition, the Rural Utilities Service (hereinafter "RUS"), an agent of the federal government and one of Cajun's largest creditors, filed a motion on behalf of several utility companies requesting appointment of a Chapter 11 trustee, pursuant to § 1104(a) of the Bankruptcy Code.[21] The RUS argued that a disinterested trustee would protect the interests of the creditors and the estate, and alleviate the conflicts of interest inherent in Cajun's board of directors.[22] The motion alleged specific instances of conflicts of interest affecting Cajun's managerial functions: 1) individual members of the board of directors disagreed whether to appeal the Louisiana Public Service Commission's order to lower its rates; 2) the fiduciary duty owed by Cajun to its members could not be satisfied while owing a similar duty to the estate and its creditors; 3) management's failure to collect money owed by member cooperatives; and 4) the debtor's primary interest in protecting the lower rates it was charging members rather than attempting to maximize the value of the estate.[23] These conflicts, according to the RUS, demonstrated that the need for a trustee outweighed the presumption that a Chapter 11 debtor should remain in possession.[24] Moreover, only through appointment of a trustee would the assets of the estate be preserved for the benefit of Cajun's creditors.[25]

III. BACKGROUND AND HISTORY OF THE LAW

A. Antecedent Reorganization Provisions

Under the Bankruptcy Act of 1898, two chapters governed business reorganizations.[26] Chapter X was established to direct large, public company reorganizations, whereas Chapter XI was intended for reorganizations of smaller companies.[27]

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18. Cajun Elec. Power Coop., Inc. v. Central La. Elec. Co., 69 F.3d 746, 747 (5th Cir. 1995).

19. *Id.* While Cajun was responsible for $1.4 billion resulting from the cost of constructing River Bend, the company's total indebtedness was estimated at $4 billion.

20. *In re* Cajun Elec. Power Coop., Inc., 191 B.R. 659, 661 (M.D. La. 1995), *vacated*, 69 F.3d 746 (5th Cir. 1995).

21. *Id.*

22. *Id.* at 662. Cajun's conflicts of interest became apparent when several board members faced deciding whether to appeal the LPSC's order to lower the rates. Clearly, if they voted to appeal the rate decrease, they would be raising the price of electricity charged to the customers for whom they worked. However, if the prices were lowered, Cajun would be unable to service its debt. As a result, several members of the board resigned. The remaining members voted to appeal the rate decrease. *Cajun*, 69 F.3d at 747.

23. *Cajun*, 191 B.R. at 662.

24. *Id.*

25. *Id.*

26. Barry L. Zaretsky, Symposium, *Trustees and Examiners in Chapter 11*, 44 S.C. L. REV. 907, 917 (1993).

27. *Id.*

Since Chapter X governed reorganizations of larger businesses with more complicated debt and equity compositions, concerns for the investing public were paramount.[28] In an effort to protect these investors and exercise control over the debtor, Chapter X required appointment of a trustee.[29] Under this legislation, the trustee had authority to operate the debtor's business, supply creditors and stockholders with information, and examine the debtor's activities.[30] In addition, the trustee was responsible for consulting with stockholders and creditors to create a reorganization plan.[31] The trustee, therefore, provided structure to the case by serving as "the focal point about which formulation of the plan revolve[d]."[32]

Business reorganizations under Chapter XI generally involved more simplistic debt and equity structures.[33] The concern for regulating the debtor's affairs became secondary since public investors were less likely to be significantly affected.[34] As such, appointment of a disinterested trustee was not available under Chapter XI.[35] The debtor usually remained in possession of the estate, managing the operation and developing and implementing a reorganization plan.[36] Although Chapter XI included a provision for appointment of a receiver, the debtor normally remained in possession absent a specific reason to divest him of control of the business.[37]

While Chapter X permitted current management to remain after appointment of a trustee, in most instances management was unseated by the appointment.[38] Recognizing that management would be displaced in Chapter X, debtors were influenced to attempt reorganization under Chapter XI where they could maintain possession and control of the estate.[39] However, numerous debtors, not eligible to file under Chapter XI, theorized that if appointment of a trustee was mandatory, they would not undertake reorganization proceedings until forced to do so.[40] Often, these efforts occurred too late to save the business.[41] As a result, the mandatory trustee provision became a cumbersome and rather deterring aspect of Chapter X reorganization.[42]

B. Legislative History of § 1104(a)(1)

Undoubtedly, no decision in a Chapter 11 proceeding will be more crucial to the results achieved than the court's determination to either allow the debtor to

28. *Id.*
29. *Id.*
30. *Id.* at 919.
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.* at 920.
36. *Id.*
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.* at 921.
42. *Id.*

remain in possession or to order appointment of a trustee.[43] Because of the critical nature of the decision, the standards for appointment of a trustee naturally produced highly divergent views in Congress.[44]

Section 1104(a)(1) of the Bankruptcy Code finds its origin in proposals and recommendations submitted by the Commission on the Bankruptcy Laws of the United States and the National Conference of Bankruptcy Judges.[45] The Commission, being dissatisfied with the capricious nature in which many decisions to appoint Chapter 11 trustees were dealt, recommended that appointment of a trustee be discretionary except in cases where the debtor was a corporation with a debt burden of $1 million or more and three hundred or more security holders.[46] For business entities fitting this description, the Commission suggested that appointment of a trustee be presumptive, unless the bankruptcy court found the protection provided by a trustee unwarranted or the expense involved in the appointment disproportionate to the protection afforded.[47]

Following the Commission's proposal, the National Conference of Bankruptcy Judges outlined an alternative Bankruptcy Act.[48] The Judges' plan differed in many areas from the Commission's proposal; however, with respect to the appointment of a trustee, the recommendations were analogous.[49] Both offered the court considerable discretion in determining whether to appoint a trustee, as well as a presumption in favor of appointment in larger cases.[50] Consequently, the Securities and Exchange Commission (hereinafter "SEC") stepped forward in opposition to both proposals, asserting that elimination of the mandatory appointment of trustees for public companies would leave investors' interests unprotected.[51] The SEC claimed that the proposed legislation created excessive delays, heightened the disruption associated with filing a bankruptcy petition, and essentially failed to acknowledge the privileges of a disinterested trustee.[52] The SEC recommended deleting those portions of the Commission's and Judges' proposals concerning discretionary appointment of a trustee and inserting a provision requiring "mandatory, immediate appointment of a trustee."[53]

Ultimately, Congress rejected the SEC's proposal, but the recommendations contained therein had an explicit impact on the legislative history of § 1104(a).[54] In the following years, Senate bill S.2266 and House bill H.R.8200 materialized.

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43. 5 COLLIER ON BANKRUPTCY ¶ 1104.01[4] (Lawrence P. King, 14th ed. 1994).
44. *Id.*
45. Robert J. Berdan and Bruce G. Arnold, *Displacing the Debtor in Possession: The Requisites for and Advantages of the Appointment of a Trustee in Chapter 11 Proceedings*, 67 MARQ. L. REV. 457, 463 (1984).
46. *Id.*
47. *Id.* at 464.
48. *Id.* at 465.
49. *Id.*
50. *Id.*
51. *Id.* at 466.
52. *Id.*
53. *Id.* The SEC's provision was modeled after § 156 of Chapter X of the Bankruptcy Act.
54. *Id.*

1. Senate Bill S.2266

At the Ninety-fourth Congress, Senator DeConcini introduced S.2266.[55] The bill resembled the SEC's recommendation, modifying the proposals of the Commission and Judges by mandating appointment of a trustee in any case involving a "public company."[56] Public company was defined to include any debtor who, within twelve months prior to filing the petition, had outstanding liabilities of $5 million or more, exclusive of liabilities for goods, services, or taxes, and no fewer than one thousand security holders.[57] In addition, the bill stated that the court "may" order the election of or appoint a trustee "for cause" and "shall" order appointment of a trustee if it would serve the interests of the estate and security holders.[58]

2. House Bill H.R.8200

The House bill provided that

> upon the request of a party in interest or the United States trustee, a trustee could be appointed, but only upon a showing that "1) the protection afforded by a trustee is needed; and 2) the costs and expenses of a trustee would not be disproportionately higher than the value of the protection afforded."[59]

Since the proposed bill did not mandate appointment of a trustee,[60] there was concern, as indicated in the accompanying House Report, that frequent appointment of trustees might delay debtors' bankruptcy filings until they were beyond the point of successful reorganization.[61] To alleviate this concern, the Report suggested courts undertake a cost-benefit analysis to determine whether the protection afforded by a trustee would be greater than the cost of such appointment.[62]

Ultimately, the House and Senate compromised on the issue of independent third parties in bankruptcy proceedings.[63] Consequently, the Senate's proposal for a mandatory trustee in public company cases was abandoned. Congress, instead, settled on a provision allowing a party in interest to request appointment of an independent examiner.[64] Thus, even in instances of the Senate's described "public company" cases, as long as a party in interest petitioned the court, an examiner, rather than a trustee, would be appointed. This resolution represents a concession to the Senate's insistence of an independent third party in public company cases.

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55. 7 COLLIER ON BANKRUPTCY ¶ 1104.03[2] (Lawrence P. King, 15th ed., 1998).
56. *Id.*
57. *Id.*
58. Zaretsky, *supra* note 26, at 924.
59. *Id.*
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.* at 925.
64. *Id.*

The compromised legislation suggests that a firm rule requiring either appointment of an independent third party or refusal of such appointment in every reorganization case would neither foster efficient reorganization nor protect creditors from fraud, mismanagement, or self-dealing.[65] Congress' efforts evidence an attempt to balance the need for a disinterested party to protect creditors' and investors' interests with the desire to promote reorganization by encouraging debtors to initiate proceedings while there is still opportunity for recovery.[66]

C. Appointment of a Trustee "For Cause"

Pursuant to § 1104(a)(1), a party in interest may seek appointment of a trustee for cause, including "fraud, dishonesty, incompetence, or gross mismanagement" of the debtor's business affairs before or after filing the petition.[67] The enumerated factors, however, are not exhaustive.[68] According to the rules of construction of the Bankruptcy Code, the words "includes" and "including" are not limiting.[69] Furthermore, courts have dismissed attempts to limit the "for cause" analysis to cause "in the nature of fraud, dishonesty, incompetence or gross mismanagement."[70]

Debtors' actions satisfying the "for cause" standard are not easily classifiable.[71] However, there are a number of instances in which courts have appointed trustees upon a showing of fraud,[72] dishonesty,[73] irreconcilable conflicts of interest,[74] commingling of assets,[75] and failure to pay taxes.[76] In other cases, courts have appointed a trustee where the debtor in possession has failed to make payments to a secured party[77] or has made unauthorized payments on account of pre-petition indebtedness.[78]

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65. *Id.* at 926.
66. *Id.*
67. Berdan & Arnold, *supra* note 45, at 475.
68. *Id.* at 476.
69. 11 U.S.C. § 102(3) (1994).
70. *See, e.g., In re* Casco Bay Lines, Inc., 17 B.R. 946, 950 (Bankr. 1st. Cir. 1982).
71. Berdan & Arnold, *supra* note 45, at 478.
72. *See, e.g., In re* Bonded Mailings, Inc., 20 B.R. 781, 784 (Bankr. E.D.N.Y. 1982) (fraudulent conduct designed to impede secured party's effort to enforce judgment by shifting assets between corporate debtors).
73. *See, e.g., In re* Deena Packaging Indus., Inc., 29 B.R. 705, 707-08 (Bankr. S.D.N.Y. 1983) (debtor failed to disclose relevant financial data).
74. *See, e.g., In re* L.S. Good & Co., 8 B.R. 312, 315 (Bankr. N.D. W. Va. 1980) (inter-company transactions created conflicts of interest and undermined presumption that management could make impartial decisions in evaluating claims).
75. *See, e.g., In re* Brown, 31 B.R. 583, 585 (Bankr. D.D.C. 1983) (commingling of corporate and individual matters by using corporate funds to finance personal litigation); *In re* Philadelphia Athletic Club, Inc., 20 B.R. 328, 334 (Bankr. E.D. Pa. 1982) (funneling of monies from corporation for personal use by owner).
76. *See, e.g., In re* Brown, 31 B.R. 583, 585 (Bankr. D.D.C. 1983) (debtor failed to withhold taxes from employee wages); *In re* La Sherene, Inc., 3 B.R. 169, 173 (Bankr. N.D. Ga. 1980) (failure to remit $20,000 in employment tax withholdings to the Internal Revenue Service).
77. *See, e.g., In re* McCall, 34 B.R. 68, 69 (Bankr. E.D. Pa. 1983) (failure to make monthly payments to mortgagee for more than a two year period constituted gross mismanagement or incompetence).
78. *See, e.g., In re* Eastern Consol. Utils., Inc., 3 B.R. 591, 592 n.3 (Bankr. E.D. Pa. 1980) (debtor used funds to pay pre-petition debts after commencement of the case).

Notably, courts have recognized the importance of management's ability to earn the confidence of both secured and unsecured parties and are not disinclined to appoint a trustee in instances in which the debtor lacked credibility[79] or displayed an inability to effectuate a plan of reorganization.[80] Courts have also appointed a trustee to investigate and report whether a case should be converted,[81] and in cases where the debtor was thrown out of possession[82] or where an individual Chapter 11 debtor died.[83]

The courts are, however, in unison on one issue. The time frame for a court's review of a debtor's actions encompasses conduct both before and after commencement of the case.[84] Courts have stressed that "neither pre-petition repentance nor a post-petition change of heart . . . will obviate the need for the appointment of a trustee," and promises of future improvements in management are supposition and irrelevant in determining whether past behavior necessitates appointment of a trustee under § 1104(a)(1).[85]

D. Judicial Construction and Analysis of § 1104(a)(1)

The structure and legislative history of § 1104(a) exhibits a distinct Congressional intent to allow a debtor to remain in possession of the estate.[86] Courts, in recognizing this presumption, have displayed reluctance in appointing a trustee.[87] The judicial trend in analyzing this Code section reflects an appreciation for the "fresh start" policy underlying much of the Bankruptcy Code and an investigative methodology suggested by the section's legislative history.[88]

Additionally, courts have drawn a sharp distinction between the analysis required for appointing a trustee pursuant to § 1104(a)(1) as opposed to § 1104(a)(2).[89] For cases involving § 1104(a)(1), which require appointment "for cause," the courts' discretion is necessarily more deliberate.[90] Moreover, courts have displayed discerning analysis of the statute and require the movant to establish "cause" under a "clear and convincing" standard.[91] Section 1104(a)(2), on the other hand, emphasizes the court's equity power to engage in a cost-benefit analysis to ascertain whether appointing a trustee would serve the interests of the creditors and security holders.[92]

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79. *See, e.g., In re* La Sherene, Inc., 3 B.R. 169, 176 (Bankr. N.D. Ga. 1980) (debtor was inexperienced in operational and managerial facets which consequently hindered relations with suppliers).

80. *See, e.g., In re* L.S. Good & Co., 8 B.R. 312, 315 (Bankr. N.D. W. Va. 1980) (debtor was unable to effectuate a plan for reorganization).

81. *See, e.g., In re* Steak Loft of Oakdale, Inc., 10 B.R. 182, 186 (Bankr. E.D.N.Y. 1981) and *In re* Hotel Assocs., Inc., 7 B.R. 130, 132 (Bankr. E.D. Pa. 1980) (citing instances where a trustee was appointed to examine debtor's financial history and report to the court whether the case should be converted to Chapter 7).

82. *See, e.g., In re* Casco Bay Lines, Inc., 17 B.R. 946, 951-52 (Bankr. 1st Cir. 1982).

83. *See, e.g., In re* Martin, 26 B.R. 39, 40 (Bankr. S.D. W. Va. 1982) (supporting the argument that death of individual debtor in a non-joint Chapter 11 proceeding establishes cause to appoint a trustee).

84. Berdan & Arnold, *supra* note 45, at 477.

85. *Id.*

86. *Id.* at 469.

87. *Id.* at 470.

88. *Id.* at 471.

89. *Id.* at 472.

90. *Id.*

91. *Id.* at 473.

92. *Id.*

The judiciary's analysis of § 1104(a)(1) developed incrementally. Initially, courts seemed restricted by the language of the Code. A subsequent shift in the interpretation of the statute, however, opened the door to varying constructions and utilization of the court's broad discretion.

1. Initial Interpretations

a. *In re General Oil Distributors, Inc.*

Illustrative of the initial analysis of § 1104(a)(1) is the opinion in *In re General Oil Distributors, Inc.*[93] In 1984, the United States Bankruptcy Court for the Eastern District of New York denied a motion by creditors to appoint a trustee where the debtor, though exhibiting no post-petition wrongdoing, had displayed pre-petition incompetence, violations of fiduciary obligations, and dishonesty on the part of managers.[94]

In reviewing the motion, the court analyzed both the language of § 1104(a)(1) and authoritative judicial opinions.[95] According to the court, the words "shall appoint a trustee" in § 1104(a) delineated its discretion.[96] While the concepts of gross mismanagement, dishonesty, and incompetence encompass a wide spectrum of conduct, the court held these actions must rise to a level sufficient to justify appointment of a trustee under § 1104(a)(1).[97] The court further determined that although § 1104(a)(1) does not compel balancing the costs and benefits of appointing a trustee, the judiciary cannot ignore any competing benefit or harm an appointment may place upon the estate.[98] In applying this concept, the court held that "appointment of a trustee in this case would impose a substantial financial burden on an estate already burdened by large administration expenses."[99] Notably, the court emphasized the theme of Chapter 11 in that a debtor should receive a fresh start, and stated that "current management should be permitted to identify and correct past mistakes."[100]

b. *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*

In 1987, the United States Court of Appeals for the Fourth Circuit rendered a decisive opinion in *Committee of Dalkon Shield Claimants v. A.H. Robins Co.*[101] The appellate court held cause did not exist to appoint a trustee where the debtor was found in civil contempt for violating an order barring selective payment of pre-petition debts without court approval.[102] The court concluded that no

93. 42 B.R. 402 (Bankr. E.D.N.Y. 1984).
94. *Id.*
95. *Id.* at 408.
96. *Id.*
97. *Id.*
98. *Id.* at 409 (citing *In re* Main Line Motors, Inc., 9 B.R. 782, 784 (Bankr. E.D. Pa. 1980), *aff'd*, No. 80-4444 (E.D. Pa. 1981)).
99. *Id.* at 410.
100. *Id.* at 409.
101. 828 F.2d 239 (4th Cir. 1987).
102. *Id.*

instances of fraud, incompetence, or mismanagement were present and therefore cause did not exist within the meaning of § 1104(a)(1).[103] Moreover, the court stated that the illustrative language of § 1104(a)(1) comprises a wide variety of conduct and courts have broad discretion in interpreting these concepts to establish cause.[104] In reviewing the debtor's situation, including the consequences of appointing a trustee, the court reasoned that "to require appointment of a trustee, regardless of the consequences, in the event of an act of dishonesty by the debtor, however slight or immaterial, could frustrate the purpose of the Bankruptcy Act."[105] Furthermore, § 1104(a)(1) must be interpreted to achieve harmony with the Act in its entirety.[106]

2. An Interpretive Shift

a. *In re Sharon Steel Corp.*

In 1989, the United States Court of Appeals for the Third Circuit held, in an oft-cited opinion, that a trustee may be appointed if a debtor in possession is mismanaging the affairs of the estate.[107] Sharon Steel, a steel manufacturer in Pennsylvania, was faced with $742 million in liabilities, $478 million in assets, and anxious creditors when the corporation filed a voluntary Chapter 11 petition.[108] During the subsequent months, it became evident that Sharon's management (who was acting as debtor in possession) had maintained poor records, made several questionable financial transactions, and a number of improper prepetition transfers.[109] The creditors' committee petitioned the bankruptcy court for appointment of a trustee.[110] The court, agreeing with the creditors, entered an order removing the debtor from control of the estate and appointed a trustee to administer the reorganization.[111]

In upholding the appointment, the Third Circuit stated that "section 1104(a) decisions must be made on a case-by-case basis" and analogized Sharon to a sinking ship running aground on the shoals of bankruptcy as a result of poor management techniques.[112] After reviewing the questionable transactions by Sharon's management, the court determined their actions rose to the level of "cause," necessitating appointment of a trustee under § 1104(a)(1).[113]

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103. *Id.* at 241.
104. *Id.*
105. *Id.* at 242.
106. *Id.* Other opinions denying appointment of a trustee used a similar analysis. *See, e.g., In re* Fisher & Son, Inc., 70 B.R. 7 (Bankr. S.D. Ohio 1986) (holding cause had not been established despite shareholder's occupation of estate property without payment of rent); *In re* Stein and Day, Inc., 87 B.R. 290 (Bankr. S.D.N.Y. 1988) (declining appointment of a trustee where creditor failed to show fraud, incompetence, or gross mismanagement of debtor's affairs); and *In re* John D. Gotta, 47 B.R. 198 (Bankr. W.D. Wis. 1985) (creditor failed to allege any of the statutorily listed grounds as cause for appointment of a trustee).
107. *In re* Sharon Steel Corp., 871 F.2d 1217 (3d Cir. 1989).
108. *Id.* at 1218.
109. *Id.* at 1220.
110. *Id.* at 1218.
111. *Id.* at 1219.
112. *Id.* at 1226.
113. *Id.* at 1228.

3. Subsequent Construction of § 1104(a)(1)

a. *In re Ionosphere Clubs, Inc.*

A particularly well publicized opinion displacing a debtor in possession was the Eastern Air Lines decision involving the removal of Frank Lorenzo as chairman of the airline's board of directors.[114] On March 9, 1989, Eastern Air Lines filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.[115] Roughly one year later, a committee of unsecured creditors moved for appointment of a Chapter 11 trustee to replace the debtor in possession and attempt reorganization.[116]

The creditors' committee argued that Eastern's financial losses, inability to project the outcome of operations, and repeated default on reorganization agreements constituted grounds for trustee appointment.[117] In its analysis, the bankruptcy court cited the legislative history of § 1104(a)(1) indicating Congress' expectation of a certain degree of mismanagement in all insolvency cases.[118] The court concluded that a certain degree of pre-petition mismanagement may not be sufficient grounds to appoint a trustee, but continuing mismanagement after the filing date evidences the need for a disinterested third party.[119] Additionally, the court discussed Congress' rationale for adopting a flexible standard for appointing trustees.[120] According to the court, this standard functions to achieve the twin goals of 1) protection of the public interest and the interests of creditors and 2) facilitation of a reorganization that will benefit both creditors and debtors.[121]

The bankruptcy court concluded several of Eastern's actions constituted incompetence within the meaning of § 1104(a)(1).[122] Particularly, these were the instances set forth in the committee's motion, as well as Eastern's general failure to meet the terms of any of the plans of reorganization.[123] Furthermore, the court recognized Eastern's duty, as a debtor in possession, to act as a fiduciary to its creditors "to protect and conserve property" for the benefit of creditors and "to refrain from acting in a manner which could damage the estate or hinder a successful reorganization of the business."[124] Accordingly, the court stated that if a debtor cannot fulfill these fiduciary obligations, appointment of a Chapter 11 trustee may be the only way to effectively accomplish the twin goals of the Code.[125]

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114. *In re* Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990), *rev'd,* 123 B.R. 166 (Bankr. S.D.N.Y. 1991), *aff'd,* 22 F.3d 403 (2nd Cir. 1944).
115. *Id.* at 166.
116. *Id.*
117. *Id.*
118. *Id.* at 168.
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.* at 170.
123. *Id.*
124. *Id.* at 169.
125. *Id.*

b. *Wabash Valley Power Association v. Rural Electrification Administration*

Though not a case directly concerning appointment of a trustee, in *Wabash Valley Power Association v. Rural Electrification Administration*[126] (hereinafter "REA"), the Seventh Circuit suggested in *dicta* that where a debtor's interests are being served at the expense of its creditors, removal of the debtor from possession may be necessary to protect creditor interests.[127]

Wabash, a non-profit rural electric cooperative, was operating as a debtor in possession when it filed an action seeking declaratory judgment that REA could not unilaterally increase Wabash's wholesale electricity rates.[128] In a poignant aside, the court noted that a debtor in bankruptcy is expected to maximize the value of the estate.[129] In this instance, according to the court, Wabash's opposition to a rate increase served the interests of Wabash's members at the expense of the interests of its creditors.[130] Circuit Judge Easterbrook noted, "[W]e are surprised that the bankruptcy judge has allowed Wabash to operate as debtor in possession, when the clash of interests between creditors and its current management is so obvious."[131]

c. *In re Colorado-Ute Electric Association*

In late 1990, the United States Bankruptcy Court for the District of Colorado heard motions for appointment of a trustee in a case involving a bankrupt electric utility.[132] Colorado-Ute Electric Association, a privately owned non-profit electric association, was engaged in the business of generating and transmitting electric energy for wholesale distribution to its fourteen rural electric cooperative members.[133] The utility was managed by a board of directors consisting of individuals nominated by the board of each member cooperative and elected by Colorado-Ute's membership at the annual board meeting.[134] In June 1989, after several failed efforts to raise electric rates to increase revenue, a number of the utility's largest creditors filed an involuntary petition for relief under Chapter 11.[135] Colorado-Ute did not contest the petition.[136]

In support of their motion for appointment of a trustee, Colorado-Ute's creditors cited gross mismanagement, incompetence, and a general lack of confidence in the managerial aptitude of the current staff.[137] In addition, the creditors assert-

126. 903 F.2d 445 (7th Cir. 1990).
127. *Id.* at 451.
128. *Id.* at 445.
129. *Id.* at 451.
130. *Id.*
131. *Id.*
132. *In re* Colorado-Ute Elec. Ass'n, 120 B.R. 164 (Bankr. D. Colo. 1990).
133. *Id.* at 166.
134. *Id.*
135. *Id.* at 169.
136. *Id.*
137. *Id.* at 172.

ed that the board of directors and members were divided due to an inherent conflict of interest resulting from the directors "wearing hats as both board members and creditor representatives of the co-op members."[138]

The court opined that § 1104(a) "represents a potentially important protection that the Court should not lightly disregard or encumber with overly protective attitudes towards debtors-in-possession."[139] Additionally, there need not be a specific finding of any of the enumerated wrongs stipulated in § 1104(a)(1) to find cause to appoint a trustee.[140] Consequently, the court held cause existed to replace the debtor in possession with a trustee.[141] The principal rationale cited by the court for finding cause was the conflict between and among Colorado-Ute and the board of directors.[142] The co-op members were divided on the issue of the rate increase and Colorado-Ute's former chairman and vice-chairman ultimately resigned due to the conflicts between what their respective co-ops desired and what was best for Colorado-Ute.[143] In conclusion, the court stated it could not "envision a way for the current management and board to resolve the inherent conflict between what is best for Colorado-Ute, its creditors and the co-op members."[144]

d. *In re Bellevue Place Associates*

In a 1994 decision, the United States Bankruptcy Court for the Northern District of Illinois held appointment of a trustee was necessary to fulfill fiduciary obligations owed to creditors and equity security holders.[145] The movant, a creditor, cited no instances of gross mismanagement, incompetence, or fraud, only that the debtor's fiduciary obligations were hampered by a "Management Agreement."[146] The debtor asserted that the terms of the "agreement," which was a contract involving himself and the manager of a hotel owned by him, usurped his ability to discharge duties, in particular fiduciary duties, to creditors and equity security holders as a debtor in possession.[147]

The court analyzed the language of § 1104(a)(1), stating that the grounds for appointment of a trustee are not limited to the "derelictions" specifically enumerated in the statute.[148] The court reasoned that the fiduciary duties of a debtor in possession prohibit debtors from acting in their self-interests to the exclusion of other protected interests.[149] In this instance, the court found that under the terms of the agreement, the debtor was under the control and direction of one

138. *Id.*
139. *Id.* at 173.
140. *Id.* at 174.
141. *Id.* at 175.
142. *Id.* The court also found a pervasive lack of confidence among Colorado-Ute's creditors in the debtor's ability to reorganize effectively.
143. *Id.*
144. *Id.* at 176.
145. *In re* Bellevue Place Assocs., 171 B.R. 615 (Bankr. N.D. Ill. 1994).
146. *Id.* at 623.
147. *Id.*
148. *Id.*
149. *Id.*

secured creditor.[150] Consequently, the court held that an inability to fulfill fiduciary obligations of a debtor in possession was sufficient to establish cause for appointment of a Chapter 11 trustee.[151]

IV. PROCEDURAL HISTORY OF THE INSTANT CASE

The United States District Court for the Middle District of Louisiana presided over Cajun Electric's bankruptcy proceedings.[152] In *In re Cajun Electric Power Cooperative, Inc.*, the district court, in reviewing the RUS's motion for appointment of a trustee, analyzed § 1104(a) of the Bankruptcy Code to determine whether appointment of a trustee was necessary to effectuate reorganization of the electric cooperative.[153] In addition, the court reviewed opinions from the United States Court of Appeals for the Seventh Circuit and the United States Bankruptcy Court for the District of Colorado.[154]

According to § 1104(a)(1), a court shall appoint a trustee "for cause, including fraud, dishonesty, incompetence, or gross mismanagement . . . or similar cause."[155] The district court reasoned that grounds for appointing a trustee for cause are not limited to those enumerated in § 1104(a)(1) and can consist of other factors, including actual conflicts of interest.[156] Additionally, upon reviewing § 1104(a)(2), the court determined that appointment of a trustee may be necessary, even if cause does not exist, if it would be in the best interests of the creditors.[157]

In addition to the above analysis, the district court examined opinions from the Seventh Circuit and the Bankruptcy Court for the District of Colorado[158] In *Wabash Valley Power Association v. Rural Electrification Administration,*[159] the Seventh Circuit suggested in *dicta* that appointment of a trustee would be appropriate where a debtor's interests are being served at the expense of its creditors.[160] Due to the factual similarity between *Wabash* and *Cajun,* both electric cooperatives, the district court was particularly persuaded by the Seventh Circuit's suggestion that conflicts of interest between management and creditors could provide cause to appoint a trustee in order to maximize the value of the debtor's estate.[161]

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150. *Id.* at 624.

151. *Id.*

152. *In re* Cajun Elec. Power Coop., Inc., 191 B.R. 659 (M.D. La. 1995). District Judge Frank Polozola presided over Cajun's bankruptcy proceedings as well as the contract litigation involving GSU previously mentioned in this Note. With regard to the other litigation, the reference was withdrawn.

153. *Id.* at 661.

154. *Id.* at 663.

155. 11 U.S.C. § 1104(a)(1) (1994).

156. *Cajun,* 191 B.R. at 661.

157. *Id.* The court noted that this section of the Code is particularly flexible because it allows for consideration of the following factors: 1) the debtor's trustworthiness; 2) the debtor's past and present performance and the potential for the debtor's rehabilitation; 3) the confidence level of the business community; and 4) the benefits derived from appointment of a trustee versus the cost of the appointment. *Id.*

158. *Id.* at 663.

159. 903 F.2d 445 (7th Cir. 1990).

160. *Id.* at 451. This excerpt was a passing observation, however, and the court cited no authority for its notation.

161. *Cajun,* 191 B.R. at 663.

Added support was found in the reasoning of *In re Colorado-Ute Electric Association.*[162] Colorado-Ute, also a rural electrification cooperative, was alleged to have conflicts of interest similar to Cajun.[163] The *Colorado-Ute* court found the conflicts between the board and its creditors "formidable" and appointment of a trustee necessary to alleviate the tensions.[164]

Ultimately, the district court concluded that the inherent conflicts between Cajun, its board members, and its creditors established cause to appoint a trustee in bankruptcy.[165] Disagreement over whether to appeal the order of the Louisiana Public Service Commission, management's failure to collect monies owed by member cooperatives, and Cajun's primary interest in protecting the lower rates it was charging members substantiated the court's decision. The court stated that "[t]he many conflicts of interest that Cajun's management, directors and members have with each other and with their creditors and the estate mandates that there be a trustee appointed to operate the estate in a fair and impartial manner."[166] Given the broad statutory language offering significant discretion to appoint a trustee and the available persuasive authority, the court concluded that appointment of a trustee was essential to effectively reorganize the estate. In summation, the court stated that "[i]f ever there was a need for a trustee in a Chapter 11 case, this is one."[167]

V. INSTANT CASE

A. Cajun I

Cajun Electric appealed the district court's order appointing a Chapter 11 trustee.[168] In reviewing the lower court's decision under the abuse of discretion standard, the Fifth Circuit first considered whether the appointment could be justified under § 1104(a)(1).[169] As previously noted, the district court relied on Cajun's alleged conflicts of interest to meet the "for cause" standard.[170] The appellate court, however, stated that "[t]he district court gave several reasons for appointing a trustee, but they all stemmed from one conflict of interest: Cajun's inherent conflict between the interests of its member-customers, who want low

162. 120 B.R. 164 (Bankr. D. Colo. 1990).
163. *Id.*
164. *Id.* at 175.
165. *Cajun,* 191 B.R. at 663.
166. *Id.* at 662.
167. *Id.* at 664.
168. Cajun Elec. Power Coop., Inc., v. Central La. Elec. Co., 69 F.3d 746 (5th Cir. 1995). Due to the overlap of the appellate court's initial opinion with its final opinion, this Note will discuss both Fifth Circuit decisions in the Instant Case section.
169. *Id.* at 749.
170. *Id.* The district court cited the following examples of conflicts:

> (1) dispute over appealing the Louisiana Public Service Commission order setting rates; (2) failure to collect monies owed by its member-customers; (3) failure to allow members access to information and to participate in possible sales of Cajun's assets; (4) failure to take a position in litigation between the LPSC and the RUS over which entity had the power to regulate its rates; (5) the interests of some of Cajun's members in purchasing some of its assets; and (6) the existence and nature of the all-requirements contracts between Cajun and its member-customers.

Id. at n.13.

rates, and those of its creditors, who want to raise rates."[171] Moreover, the court rejected the trustee's appointment on the basis that the inherent conflicts stemmed from Cajun's cooperative organizational structure, a structure that Congress advocated for utility companies receiving loans from the RUS.[172] The appellate court reasoned that "[t]he fact that Congress and the RUS encouraged--if not required--Cajun to organize itself as a cooperative leads us to believe that any conflict inherently arising from Cajun's organization as a cooperative is insufficient to justify the appointment of a trustee."[173] The court further noted that "holding that these inherent conflicts constitute cause for appointing a trustee would create a *per se* rule permitting the appointment of a trustee in any case involving a cooperative," with no indication Congress intended such specific treatment.[174]

Appellee, Central Louisiana Electric Company, relied on *In re Colorado-Ute Electric Association* for the argument that conflicts inherent in any cooperative justify appointment of a trustee.[175] The appellate court, however, found the decision distinguishable. In *Colorado-Ute,* the district court found the debtor had committed a number of "bad acts."[176] Bad acts generally refer to debtor conduct that damages the estate or undermines the reorganization effort.[177] Specifically, the electric cooperative's management allegedly made a $20 million transfer on the eve of bankruptcy in an attempt to destroy a creditor's security interest.[178] In addition, the district court determined Colorado-Ute's board and management were not competent to reorganize an enterprise of that scale.[179]

In comparison, the Fifth Circuit found no such "bad acts" or incompetence concerns with Cajun's directors and managers.[180] The court concluded that the factors supporting appointment of a trustee under the *Colorado-Ute* rationale were not present in *Cajun* and as such, there was no cause for appointment of a trustee.[181]

In addition, the appellate court reviewed the district court's reliance on § 1104(a)(2), the best interests standard, for appointment of a trustee.[182] The court held that since Cajun's conflicts were not sufficient to justify appointing a trustee pursuant to § 1104(a)(1), they did not compel the appointment as in the best interests of the parties.[183] Furthermore, reasoning that the parties to the case would be the best judges of their own interests, the court stated that the debtor's

171. *Id.* (footnote omitted).
172. *Id.* at 750. As previously noted, the RUS was one of Cajun's largest creditors. *See supra,* notes 21-23 and accompanying text.
173. *Cajun,* 69 F.3d at 750.
174. *Id.*
175. *Id.*
176. *In re* Colorado-Ute Elec. Ass'n, 120 B.R. 164 (Bankr. D. Colo. 1990).
177. *See In re* Ionosphere Clubs, Inc., 113 B.R. 164 (Bankr. S.D.N.Y. 1990).
178. *Colorado-Ute,* 120 B.R. at 170.
179. *Id.* at 176.
180. *Cajun,* 69 F.3d at 750.
181. *Id.*
182. *Id.*
183. *Id.* at 751.

appeal, along with several creditors' appeals to the appointment of a trustee, evidenced that the parties' best interests were not being served.[184] The United States Court of Appeals for the Fifth Circuit vacated the district court's appointment of a trustee to administer the reorganization of Cajun Electric.[185]

Circuit Judge Emilio M. Garza submitted an opinion in which he concurred in part and dissented in part with the majority decision.[186] In particular, Judge Garza disagreed that in affirming the appointment of a trustee, a *per se* rule would be created under which any cooperative seeking Chapter 11 protection would be automatically subject to appointment of a trustee.[187] According to Garza, the conflicts present in *Cajun* were sufficient to support appointment of a trustee under § 1104(a)(1) in that they went beyond "inherent" conflicts under which all healthy cooperatives function.[188] In support of this proposition, he asserted that "healthy cooperatives do not fail to collect monies owed by member-customers or attempt to deny member-customers access to information."[189] Furthermore, he opined that the majority failed to make a distinction between conflicts "inherent" in any cooperative and those that "arise from" inherent conflicts.[190] Although the former would be protected by Congress' policy choice, the latter would not. He noted that under the majority view, a cooperative would be shielded from appointment of a trustee no matter how serious the internal conflicts were, if those conflicts could be traced to the cooperative structure.[191]

Judge Garza exhibited added concern as to whether healthy cooperatives, which are contemplating reorganization, consider strategies that appear to be designed to break-up and scavenge the assets of the debtor.[192] He noted that some of Cajun's member-customers had expressed an interest in purchasing the debtor's assets, either individually or by creating a joint venture with one or more other members.[193] Citing *Colorado-Ute*, Garza stated that "once cooperative members begin working at cross-purposes, to the extent Cajun's members have, the appointment of a trustee may be the only effective way to pursue reorganization."[194]

B. Cajun II

Appellee, Central Louisiana Electric Company, filed petitions for rehearing and suggestions for rehearing *en banc* before the United States Court of Appeals for the Fifth Circuit.[195] The appellate court granted rehearing.

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184. *Id.*
185. *Id.*
186. *Id.* (Garza, J., dissenting).
187. *Id.*
188. *Id.*
189. *Id.*
190. *Id.* at n.1.
191. *Id.*
192. *Id.* at 751. Garza suggested that Cajun's failure to collect monies owed by member-customers and the failure to allow members access to information and participation in sales of Cajun's assets demonstrated serious conflicts of interest.
193. *Id.*
194. *Id.*
195. Cajun Elec. Power Coop., Inc., v. Central La. Elec. Co., 74 F.3d 599 (5th Cir. 1996).

The opinion, in its entirety, reads as follows:

> After re-reading the stipulation on file in this case, we find the conflicts of interest within the members of the Board of Cajun Electric Power Cooperative, Inc., to be such that the court below was correct in the appointment of a trustee. We therefore withdraw all of the prior opinion found at 69 F.3d 746 [the majority opinion vacating appointment of a trustee] and we adopt the reasoning of the dissent in its place. The appointment of the trustee is therefore AFFIRMED.[196]

VI. ANALYSIS

A. Common Theme Underlying "Similar Cause"

The express terms of § 1104(a) indicate that a court "shall" appoint a trustee if there is a finding of "fraud, dishonesty, incompetence, or gross mismanagement."[197] The legislative history and structure of § 1104(a), however, evidence Congress' intent to allow *discretionary* appointment of a Chapter 11 trustee.[198] The illustrative nature of § 1104(a)(1) offers courts the opportunity to appoint a disinterested third party, at its discretion, in a variety of instances determined primarily through case-by-case analysis.[199] The enumerated factors in the statute indicate an overriding theme in the Code to displace the debtor where the viability of the business is threatened[200] or when the debtor is failing to preserve the organization's assets for the benefit of its creditors.[201] Moreover, by incorporating the encompassing term "similar cause" into the statutory scheme, Congress offered courts the opportunity to displace debtors whose actions do not comport with the enumerated factors under the statute but remain consistent with the theme of removing debtors who detrimentally affect the reorganization effort or are dissipating the estate's assets. Recognizing this ideology in the Code is fundamental to understanding that an attempt to define "similar cause" in terms more specific than a "theme" would undermine the discretionary authority of the court. In *Committee of Dalkon Shield Claimants,* for instance, the Fourth Circuit stated that "concepts of incompetence and dishonesty encompass a wide spectrum of conduct and courts have broad discretion in applying such concepts to show cause."[202] In addition to concepts of incompetence and dishonesty, courts necessarily have broad discretion to interpret "similar cause" in order to adequately protect the interests of both debtors and creditors.

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196. *Id.* at 600. Cajun filed a petition for a writ of *certiorari* before the United States Supreme Court on April 22, 1996.

197. 11 U.S.C. § 1104(a) (1994). Although use of the word "shall" circumscribes the court's discretion, the legislative history and judicial holdings illustrate the courts' authority to determine whether conduct shown rises to a level sufficient to justify appointment of a trustee. Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239 (4th Cir. 1987).

198. *See supra* notes 67-92 and accompanying text. A court's decision not to appoint a trustee is clearly within its discretionary authority unless the court finds "cause," in which case the court must appoint a trustee. *In re* Oklahoma Refining Co., 838 F.2d 1133, 1136 (10th Cir. 1988).

199. *See In re* Sharon Steel Corp., 871 F.2d 1217 (3d Cir. 1989).

200. *See In re* Microwave Prods. of Am., Inc., 102 B.R. 666 (Bankr. W.D. Tenn. 1989).

201. *See In re* Holly's, Inc., 140 B.R. 643 (Bankr. W.D. Mich. 1992).

202. *Committee of Dalkon Shield Claimants,* 828 F.2d at 241.

Case law indicates an evolution in the use of this discretionary authority since the enactment of the Code. These opinions suggest an ongoing attempt by courts to balance the statutory emphasis on preserving the assets of the business for the benefit of creditors with protecting debtors' rights to reorganize.[203] Early efforts resolved this tension in favor of retaining the debtor in possession. Recent cases, however, reflect a trend of judicial skepticism regarding debtors and a greater willingness to appoint a trustee. In 1984, the court in *In re General Oil Distributors, Inc.* declined to appoint a trustee, despite numerous findings of pre-petition wrongdoing, stating the philosophy of Chapter 11 offers debtors a "second chance" and management should, therefore, be permitted to correct past mistakes.[204] Similarly, in *Committee of Dalkon Shield Claimants,* a 1987 decision, the Fourth Circuit, in declining appointment of a trustee, appeared constrained by the terms of § 1104(a)(1), noting that a trustee is needed where fraud or mismanagement arise and appointment of a trustee for slight instances of dishonesty could frustrate the philosophy of the Bankruptcy Act.[205]

By 1989, however, the balance began to shift toward a more liberal use of the court's discretion to appoint a trustee. In *In re Sharon Steel,* the Third Circuit found cause to appoint a trustee, basing its decision on the language of the Code and interpreting therein a requirement of evident wrongdoing on the part of the debtor.[206] Although Sharon's management was involved in postpetition wrongdoing, its actions were no more egregious than that of debtors in earlier cases. The court's holding in *Sharon Steel* initiated the "bad acts" model, launching a line of cases theorizing that if management's conduct threatened the assets of the estate or jeopardized the business' potential for reorganization, cause was established pursuant to § 1104(a)(1).[207] In so doing, *Sharon Steel* marks a shift in the interpretation of § 1104(a)(1). Under *Sharon Steel,* appointment of a trustee is not only appropriate where management is explicitly impairing creditors' interests (the traditional definition of cause), but also where aspects of the debtor's situation present an impediment to reorganization.[208] Consequently, this construction opened the door for courts to interpret the statute broadly to permit appointment of a trustee in a variety of circumstances.

Subsequent cases, *Wabash Valley Power Association v. Rural Electrification Administration,*[209] *In re Colorado-Ute Electric Association,*[210] and *In re Cajun Electric Power Cooperative, Inc.,*[211] built on the *Sharon Steel* model, extending the

203. *See, e.g.,* Berdan & Arnold, *supra* note 45, at 471.

204. 42 B.R. 402, 409 (Bankr. E.D.N.Y. 1984). Despite the express language of § 1104(a)(1) requiring consideration of a debtor's conduct before and after filing the petition, the court found the presumption that a debtor should remain in possession outweighed the need for a trustee. *Id.*

205. *Committee of Dalkon Shield Claimants,* 828 F.2d at 242. See generally *Dewsnup v. Timm,* 502 U.S. 410, 411 (1992), for use of pre-Code practices as guidance in interpreting provisions in the Bankruptcy Code.

206. 871 F.2d 1217 (3d Cir. 1989).

207. *Id.*

208. *Id.*

209. 903 F.2d 445 (7th Cir. 1990).

210. 120 B.R. 164 (Bankr. D. Colo. 1990).

211. 69 F.3d 746 (5th Cir. 1995).

reasoning to situations where conflicts of interest frustrate the reorganization effort.[212] *Wabash* suggested that inherent conflicts could establish cause if the debtor was not acting to maximize the value of the estate.[213] *Colorado-Ute* and *Cajun* put that suggestion into motion. While the court in *Colorado-Ute* did not solely base its decision to appoint a trustee on the inherent conflicts issue, that was the principal rationale.[214] In *Cajun,* the Fifth Circuit completely relied on conflicts of interest inherent in Cajun's board and management to establish cause under § 1104(a)(1).[215] In both cases, the courts implied that the source of the conflicts was less important than the effect of the conflicts on the reorganization effort.

Although these later cases contradict earlier opinions, they are consistent with the theme underlying § 1104(a)(1). Earlier cases, in attempting to balance the Chapter 11 reorganization principle with the need to protect creditors and investors, pointedly sided with the fresh start philosophy and used its discretion narrowly. In the early to mid-1980s, courts aggressively protected the debtor in possession's prerogatives, displaying a principal concern with the presumption that a debtor continue in operation of the estate and a reluctance to displace management. Beginning with *Sharon Steel,* however, the early enthusiasm for the debtor in possession concept abated and subsequent decisions reflect a more dominant concern for protecting creditors, equity investors, and industries affected by bankrupt organizations from the risk of further loss. Construing § 1104(a)(1) broadly, as recent cases have done, comports with the legislative history of the statute and the statutory language and structure of the provision, both seeking to balance each party's interests and promote reorganization. With an estimated 171% increase in Chapter 11 bankruptcy filings between 1980 and 1989, courts were faced with staggering numbers of creditors requesting protection of their interests.[216] Added concern of abuse of Chapter 11 protection by debtors using the reorganization provision as a mechanism for solving business difficulties[217] undoubtedly prompted courts to reassess the language of the statute and offer innovative interpretations capable of protecting creditors' interests as efficiently as the interests of the debtor in possession.

B. Shortcomings of the Fifth Circuit Decision

In *Cajun,* the Fifth Circuit premised its decision on the illustrative language and underlying theme of § 1104(a)(1).[218] The opinion, however, (reproduced in its entirety above) offers little guidance to one looking for extensive discourse on

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212. *In re Ionosphere Clubs, Inc.,* although not a conflict of interest case, illustrates the court's awareness of a debtor impeding reorganization even if not engaged in bad acts. 113 B.R. 164 (Bankr. S.D.N.Y. 1990). Additionally, in *In re Bellevue Place Associates,* the court ventured into the area of fiduciary obligations, recognizing that failure to meet such duties can justify appointment of a trustee, thus continuing with the theme of the Code. 171 B.R. 615 (Bankr. N.D. Ill. 1994).

213. *Wabash,* 903 F.2d at 448.

214. *Colorado-Ute,* 120 B.R. at 176.

215. *Cajun,* 69 F.3d at 750.

216. BANKRUPTCY YEARBOOK AND ALMANAC 32 (Christopher M. McHugh, ed., 1996).

217. Elizabeth Warren and Jay Lawrence Westbrook, THE LAW OF DEBTORS AND CREDITORS 831 (1996).

218. *Cajun,* 69 F.3d at 750.

the rationale for appointment of a trustee where a debtor's conflicts of interest establish cause under § 1104(a)(1). As noted above, the Fifth Circuit's decision represents a logical progression in the court's efforts to protect creditors' interests. However, when given the opportunity to lay a solid foundation for future jurists to use in analyzing grounds for appointment of a trustee where conflicts of interest exist within a debtor, the court declined. Judge Emilio Garza's opinion appears to accept the premise that purely "inherent conflicts," standing alone, cannot constitute cause where Congress has encouraged that particular business structure. Given the importance of distinguishing "inherent" conflicts from "arising from" conflicts, it is dissatisfying that the court failed to provide any means for distinguishing inherent conflicts of interest from conflicts "arising from" inherent conflicts, or how severe the conflicts must be before they constitute "similar cause." [219]

In addition, the court neglected to consider whether appointment of an examiner could resolve the issue of Cajun's conflicts of interest.[220] Unlike a trustee, an examiner does not displace current management.[221] Instead, an examiner's statutory role is to investigate aspects of the underlying business operation, including allegations of fraud, misconduct, or irregularity in the management of the affairs of the debtor, and report any findings to the court.[222] Examiners are appointed under a similar rationale as trustees[223] and are often used by courts as a less intrusive mechanism for handling the affairs of an insolvent debtor.

C. Effect on Cooperative Businesses

There are approximately forty-seven thousand business cooperatives operating in the United States today.[224] These organizations benefit over one million consumers and employ a diverse group of individuals.[225] Cooperatives, in general, are founded upon similar organizational structures. In most instances, a cooperative is comprised of a group of people operating their own businesses who collectively form an organization to provide themselves with a particular service.[226] Co-op membership includes business firms as well as individuals.[227] These members own and operate the co-op and are the principal users of the organization's services.[228] Business cooperatives include such diverse entities as agricul-

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219. In fact, to the extent that any of the conflicts identified were actually "inherent" conflicts, it follows that the circuit court should have remanded the case for reconsideration with those factors excluded.

220. Under § 1104(c), the court may appoint an examiner upon request by a party in interest if the court does not order the appointment of a trustee. 11 U.S.C. § 1104(c) (1994). The legislative history suggests that appointment of an examiner may often be more appropriate than appointing a trustee. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. (1977).

221. 11 U.S.C. § 1104(c) (1994).

222. *Id.*

223. *Id.* In appointing an examiner, courts undertake a cost-benefit analysis (also used under § 1104(a)(2)) whereby the protection must be needed and the cost must not be disproportionate. *Id.*

224. Telephone Interview with Richard Hyne, National Cooperative Business Association (Mar. 10, 1997).

225. *Id.*

226. James B. Dean and Donald A. Frederick, *Business Cooperatives: Characteristics, Opportunities and Legal Foundation*, 22 COLO. LAW., No. 5, 953 (May 1993).

227. *Id.*

228. *Id.*

tural cooperatives, rural electric cooperatives, credit unions, insurance companies, and national corporations.[229]

The Fifth Circuit's decision in *Cajun* provided insufficient rationale to establish a *per se* rule requiring appointment of a trustee for Chapter 11 cooperatives.[230] As previously noted, the opinion failed to provide any mechanism for distinguishing inherent conflicts from conflicts "arising from" inherent conflicts.[231] Moreover, the court offered little guidance regarding how severe conflicts of interest must be before they constitute "similar cause." Because of the shortcomings of the Fifth Circuit opinion, subsequent decisions will turn on the facts of each case, requiring an inquiry into the level of inherent conflicts versus conflicts "arising from" inherent conflicts. Thus, the singular aspect of being a cooperative business will not automatically subject Chapter 11 cooperatives to appointment of a trustee.

Appointing a trustee based on conflicts of interest does, however, establish a significant pitfall for cooperatives seeking reorganization. Although the standard set forth in *Cajun* protects creditors of cooperative businesses as well as non-cooperative businesses, the policy establishes a deterrent for struggling co-ops in need of the safe harbor of Chapter 11. As previously noted, a compelling rationale underlying the 1978 Code was that the near automatic appointment of a trustee under the prior Bankruptcy Act deterred the timely filing of a petition, resulting in further loss to financially unstable debtors.[232] The standard promulgated in *Cajun* places cooperatives in a similar undesirable position.

The Supreme Court has declined to consider whether the Fifth Circuit's decision in *Cajun* complies with the language and interpretive limits of § 1104(a)(1).[233] Congress, however, remains an alternative source for instituting a special provision for some or all debtor cooperatives. Similar provisions have been drafted for single-asset real estate businesses,[234] small businesses,[235] and family farmers.[236] Legislative efforts must exhibit an awareness of a debtor's organizational structure and permit appointment of a trustee in instances of fraud, dishonesty, incompetence, gross mismanagement, and conflicts of interest sufficient to hinder reorganization. If Congress waives the opportunity to draft a provision for cooperative businesses, future opinions will undoubtedly reflect courts' efforts to carve out a policy by judicial fiat.

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229. *Id.* Some examples of national corporations include: The Associated Press, Florist and Telegraph Delivery Service (FTD), Ocean Spray, and True Value Hardware. *Id.*

230. Cajun Elec. Power Coop., Inc. v. Central La. Elec. Co., 74 F.3d 599 (5th Cir. 1996).

231. *Id.*

232. *See supra* notes 38-42 and accompanying text.

233. Cajun's petition for writ of *certiorari* was denied on October 8, 1996.

234. 11 U.S.C. § 362(d)(3) (1994).

235. 11 U.S.C. § 1121(e) (1994).

236. 11 U.S.C. § 1201 (1994).

VII. CONCLUSION

Section 1104(a)(1) of the Bankruptcy Code offers creditors the opportunity to pursue appointment of a Chapter 11 trustee "for cause."[237] The legislative history and statutory structure of § 1104(a)(1) evidence Congress' intent to provide courts with discretionary authority to appoint a trustee where a debtor is impairing creditors' interests or jeopardizing reorganization.[238] Recent opinions reflect a shift in the construction of the statute, suggesting a broad interpretation of the provision and a dominant concern for protecting creditors' interests.

In *Cajun Electric Power Cooperative, Inc. v. Central Louisiana Electric Co.*, the Fifth Circuit extended the interpretation of § 1104(a)(1) to allow for appointment of a Chapter 11 trustee when a debtor's inherent conflicts of interest hinder effective reorganization.[239] While this interpretation remains consistent with the underlying theme of § 1104(a)(1), the decision arguably contradicts the underlying purpose of the 1978 Code by establishing a profound deterrent for cooperative businesses seeking reorganization. Under the prior Bankruptcy Act, Congressional legislation corrected a similar problem with Chapter X.[240] Again, legislation could abrogate the deterrent facing cooperatives attempting reorganization. Absent legislative intervention, the judiciary remains the singular alternative for instituting an effective safe harbor policy for cooperative organizations.

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237. 11 U.S.C. § 1104(a)(1) (1994).
238. *See supra* notes 62-92 and accompanying text.
239. 74 F.3d 599 (5th Cir. 1996).
240. *See supra* notes 38-42 and accompanying text.