**Hearing Date: December 17, 2008 at 3:00 p.m. (ET)**
**Objection Deadline: December 16, 2008 at 5:00 p.m. (ET)**

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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| In re: | ) | Chapter 11 |
| TERRA NOSTRA RESOURCES CORP., | ) | Bankr. Case No.: 08-14708 (JMP) |
| Debtor. | ) | |

**DEBTOR'S OBJECTION TO MOTION OF THE AD HOC COMMITTEE OF NOTEHOLDERS FOR ENTRY OF AN ORDER (I) LIMITING CERTAIN ACTIONS OF THE DEBTOR DURING THE GAP PERIOD PURSUANT TO SECTIONS 105 AND 303(F) OF THE BANKRUPTCY CODE; (II) APPOINTING AN INTERIM CHAPTER 11 TRUSTEE; AND (III) SCHEDULING A FINAL HEARING ON (A) THE APPOINTMENT OF A CHAPTER 11 TRUSTEE ON A PERMANENT BASIS OR, ALTERNATIVELY, (B) TERMINATING THE DEBTOR'S EXCLUSIVITY PERIODS**

Debtor Terra Nostra Resources Corp. (the "Debtor"), by and through its undersigned proposed counsel, hereby objects to the motion (the "Motion") of the ad hoc committee of noteholders (the "Noteholders") for the entry of an order (i) limiting certain actions of the Debtor during the gap period pursuant to Sections 105 and 303(f) of the Bankruptcy Code; (ii) appointing an interim Chapter 11 trustee; and (iii) scheduling a final hearing on (a) the appointment of a Chapter 11 trustee on a permanent basis or, alternatively, (b) terminating the Debtor's exclusivity periods, and in support thereof respectfully represents as follows:

## FACTUAL BACKGROUND[1]

1. As set forth in the Affidavit of Yi Ping (Y.P.) Chan (the "Chan Aff."), a copy of which is attached hereto as Exhibit A and is incorporated herein by reference, the Debtor is a Nevada corporation whose primary assets are its ownership interests in joint ventures Shandong Terra-Nostra Jinpeng Copper Co. Ltd. ("STJMC") and Shandong Quanxin Stainless Steel Co. Ltd. ("SQSS" and, together with STJMC, the "China JVs"). Chan Aff., ¶ 3.

2. The China JVs are located in the highly industrialized coastal province of Shandong, midway between Beijing and Shanghai. Chan Aff., ¶ 4. The Debtor's partner in the China JVs is Ke Zhang (the "JV Partner"). Id.

3. As set forth in the Affidavit of Donald C. Nicholson (the "Nicholson Aff."), a copy of which is attached hereto as Exhibit B and is incorporated herein by reference, the China JVs had $285 million in revenues in FY 2007. Nicholson Aff., ¶ 3.

The Debtor's Capital Structure

4. Other than the Noteholders, the Debtor believes that it has approximately 40 creditors with claims totaling approximately $3.1 million. Nicholson Aff., ¶ 4. Neither the Noteholders nor any of the Debtor's other creditors have liens on the Debtor's interests in the China JVs. Id.

5. As of September 22, 2008, the Debtor had 66,383,315 issued and outstanding shares of common stock. Nicholson Aff., ¶ 5. The Debtor believes that there are approximately 3,000 beneficial owners of the common stock. Id. Since January 2005, the Debtor has raised over $25 million in equity financing. Id.

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[1] The background information set forth in Paragraphs 2-14 of the Motion regarding the Debtor and the notes is generally accurate and, for the sake of brevity, is not repeated in this Objection.

The Debtor's Inability to Repatriate Funds

6. Net profits resulting from the operation of the China JVs may only be repatriated to the Debtor following (1) the filing of the appropriate calendar year tax returns with the People's Republic of China (PRC) government and (2) subsequent PRC governmental approval, which takes an estimated six months. Chan Aff., ¶ 5.

7. Moreover, the PRC government generally prohibits repatriation of profits on the heels of a capital contribution. Nicholson Aff., ¶ 6. This restriction effectively prevented, and may continue to prevent, the Debtor from repatriating profits from STJMC, which completed its capital contribution in December 2007. Id. The Debtor may, however, have been able to repatriate profits from SQSS with the unanimous approval of SQSS's Board of Directors, subject to the filing of tax returns and requisite government approvals. Id.

8. The JV Partner is responsible for the audit of SQSS and for preparing and filing SQSS's tax returns. Nicholson Aff., ¶ 7. In March 2008, the Debtor began requesting reports from the JV Partner about the status of the SQSS audit and the corresponding tax returns, which were due by June 30, 2008. Id.

9. When it became clear that the audit would not be completed and the tax returns would not be filed on a timely basis, the Debtor intensified its efforts to compel the JV Partner to fulfill his duties. Nicholson Aff., ¶ 8. Those efforts were unsuccessful, and, to the Debtor's knowledge, the SQSS audit has not been completed and the 2007 tax returns have not been filed with the PRC government. Id.

10. The Debtor does not know why the JV Partner has failed to complete the audit and file the tax returns, but, as a result, SQSS is currently unable to repatriate profits to the Debtor. Nicholson Aff., ¶ 9.

The Debtor's Inability to Complete its Audit

11. In mid-August 2008, the Debtor learned that its independent public accountant, Schwartz Levitsky Feldman LLP ("SLF"), was having difficultly completing an audit of the Debtor's financial statements for the fiscal year ended May 31, 2008 (the "Form 10-K"), for three reasons. Nicholson Aff., ¶ 10.

12. First, SLF identified certain potential anomalies within the China JVs' financial reporting related to earnings and pre-paid expenses and concluded that it required additional testing to determine the nature and extent of those anomalies. Nicholson Aff., ¶ 11. The JV Partner, however, did not allow SLF to perform that additional testing, refusing to participate in meetings with SLF and denying SLF access to certain personnel, among other things. Id.

13. In late August 2008 and again in September 2008, the Debtor's management traveled to China to meet with the JV Partner in an effort to convince him to assist SLF in completing the audit. Nicholson Aff., ¶ 12. Following those meetings, the JV Partner did, in fact, provide SLF with additional assistance, but it was still insufficient to allow SLF to complete the audit. Id.

14. Second, to assist it in completing and cross-checking its audit of the Debtor, SLF required audited financial statements and tax returns from SQSS, which, as described above, the JV Partner had failed to prepare. Nicholson Aff., ¶ 13.

15. Finally, SLF informed the Debtor that it required payment of the previously agreed-upon $250,000 to complete the audit. Nicholson Aff., ¶ 14.

16. The Debtor did not have these funds available, was unable to file its Form 10-K by the August 29, 2008 extended deadline, and lost its trading position on the OTC Bulletin

Board, severely limiting its ability to raise additional capital. Nicholson Aff., ¶ 15.

Negotiations With the Noteholders

17. In September 2007, December 2007, March 2008, and June 2008, the Debtor made interest payments to the Noteholders totaling $63,205.68, $393,538.55, $629,669.49, and $631,601.65, respectively. Nicholson Aff., ¶ 16. In July 2008, the Debtor raised $2.5 million to pay Cheyne Capital Management (UK) LLP, which held a $5 million note. Id.

18. The Debtor anticipated raising $35-$50 million in equity financing to pay off the balance of the notes. Nicholson Aff., ¶ 17. That equity financing was not forthcoming, as a result of the audit problems described above, among other things, and the Debtor began defaulting on principal payments on the notes in July 2008. Id.

19. Representatives of the Noteholders made a due diligence trip to China in August 2008. Nicholson Aff., ¶ 18.

20. The Debtor and the Noteholders participated in various meetings and conference calls between September 9, 2008 and September 11, 2008. Chan Aff., ¶ 6.

21. On September 17, 2008, the Debtor sent a restructuring proposal to the Noteholders. Chan Aff., ¶ 7.

22. In late September 2008, with the approval and at the request of the Board, then-CEO and Chairman of James Po traveled to China to meet with the JV Partner and attempt to negotiate a restructuring of the notes. Nicholson Aff., ¶ 19.

23. Mr. Po discovered during that trip that, while STJMC's leased facility in Dongying was operating, the stainless steel facility was not operating and the Jinpeng facility had not resumed operations as planned. Chan Aff., ¶ 8.

24. In early October 2008, Mr. Po presented the Board with two non-binding letters of intent (the "LOIs") with the JV Partner, which were each subject to Noteholder and shareholder approval. Chan Aff., ¶ 9.

25. The LOIs provided for the sale of the Debtor's interest in SQSS for $15 million and the restructuring of STJMC to remove debt from its balance sheet. Chan Aff., ¶ 10. The proposal was intended to allow for the repayment of $5 million in proceeds to the Noteholders, jump-start operations, address the audit issues described above, and increase the Debtor's chances of raising equity financing. Id.

26. The Board authorized management to move forward and have definitive agreements drafted, which, subject to further review and approval by the Board, would then be presented to all necessary parties for approval. Nicholson Aff., ¶ 20.

27. The LOIs and Mr. Po's observations about the China JVs' operations were presented to the Noteholders on or about October 9, 2008. Nicholson Aff., ¶ 21; Chan Aff., ¶ 11. The Noteholders rejected the terms of the LOIs shortly thereafter. Nicholson Aff., ¶ 21.

28. On October 28, 2008, at the request of the Noteholders, director Don Nicholson traveled to China on behalf of the Debtor to meet with the JV Partner and representatives of the Noteholders. Nicholson Aff., ¶ 22. Mr. Nicholson later learned that, while he was there, the Noteholders' representatives had a number of meetings with the JV Partner from which Mr. Nicholson and the Debtor were excluded and about which they were not informed. Id. The Debtor requested information about those meetings, but the Noteholders did not provide it. Id.

29. These meetings culminated in a November 3, 2008 proposal by the Noteholders to the Debtor (the "November 3rd Offer"). Nicholson Aff., ¶ 23.

30. The Debtor believed, and continues to believe, that the November 3rd Offer undervalued the Debtor's interests in the China JVs and it rejected the offer. Chan Aff., ¶ 12.

31. Just prior to the bankruptcy filing, the Noteholders presented to the Debtor a proposal (the "Prepackaged Plan Proposal") similar to the November 3rd Offer, suggested a prepackaged bankruptcy case as a means of implementing that proposal, and provided the Debtor with a draft plan of reorganization and lock-up agreement. Nicholson Aff., ¶ 24. The Debtor requested further information from the Noteholders regarding the proposal, which it did not receive. Id.

32. The Noteholders filed the involuntary bankruptcy petition on November 25, 2008 (the "Petition Date"). Chan Aff., ¶ 13. The Debtor has not challenged the petition. Id.

33. Upon information and belief, the Noteholders have recently executed a letter of intent with the JV Partner on economic terms similar to the November 3rd Offer and the Prepackaged Plan Proposal. Nicholson Aff., ¶ 25.

Corporate Governance Issues

34. On October 17, 2008, the Board removed Mr. Po as the Debtor's Chief Executive Officer and as Chairman of the Board. Nicholson Aff., ¶ 26.

35. Thereafter, the Board learned that, on September 29, 2008, purportedly on the Debtor's behalf, Mr. Po agreed to pay Shandong Jiatai Petrochemical Co. Ltd. ("Shandong") $1,815,000 on account of expenses supposedly incurred by Shandong on account of the Debtor. Upon information and belief, Mr. Po has no affiliation with Shandong.[2] Nicholson Aff., ¶ 27.

[2] Mr. Po has vigorously denied any allegations of wrongdoing in connections with the LOIs, the Shangdong debt (which he believes was within his management authority), or otherwise. Nicholson Aff., ¶ 28.

36. The Debtor's Board of Directors currently consists of Don Nicholson, Don Burrell, and James Po. Nicholson Aff., ¶ 29. In addition, Felix Chung has indicated that he wishes to rejoin the Board. Id.

37. The Debtor is not required, contractually, under its bylaws, or pursuant to Nevada law, to maintain directors' and officers' liability insurance. Nicholson Aff., ¶ 30. It does not carry such insurance because of the costs involved (an estimated $400,000) and the lack of funds available. Id.

38. Since the Petition Date, the Board has functioned smoothly and has been able to make decisions-- there have been no fewer than seven Board meetings, including three Board meetings at which formal action has been taken. Nicholson Aff., ¶ 31.

Proposed Retention of CRO

39. As of the Petition Date, the Debtor did not have any officers or employees, but was managed by its Board, as is permitted under Nevada law. Nicholson Aff., ¶ 32.

40. Following the Petition Date, but *before* the Motion was filed, the Board began exploring the possibility of retaining a Chief Restructuring Officer. Nicholson Aff., ¶ 33.

41. On December 12, 2008, the Board resolved to retain Y.P. Chan as Chief Restructuring Officer, subject to Bankruptcy Court approval.[3] Nicholson Aff., ¶ 34.

42. In mid-September 2008, Mr. Chan was hired by the Debtor as a consultant to assist it in its efforts to refinance or restructure the Noteholders' debt. Chan Aff., ¶ 14. He is familiar with the Debtor and the China JVs' assets, has traveled to China on the Debtor's behalf,

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[3] Mr. Chan's proposed compensation would be $20,000 a month. If the Motion is denied, the Debtor will promptly file an application seeking his approval as CRO. Nicholson Aff., ¶ 29.

and has been involved in negotiations with the Noteholders. Id.

43. Moreover, Mr. Chan is a qualified restructuring consultant with valuable experience in corporate turnarounds of a public company, restructurings, capital raises, and the stainless steel industry. Chan Aff., ¶ 15. Mr. Chan obtained his MBA and MSEE from Columbia University and worked in China and Hong Kong from 1994 to 2003. Id. Biographical information about Mr. Chan is attached hereto as Exhibit C and is incorporated herein by reference.

44. It is anticipated that, as CRO, Mr. Chan's responsibilities would include the following, without limitation:

**A.** Making decisions with respect to all aspects of the management and operation of the Debtor's business;

**B.** Seeking to obtain debtor-in-possession financing;

**C.** With the assistance of the Debtor's SEC counsel, exploring the possibility of regaining SEC compliance and an OTC Bulletin Board listing;

**D.** Exploring the possibility of repatriating funds from China;

**E.** Performing a complete valuation of the Debtor's interests in the China JVs;

**F.** Taking responsibility for communicating with creditors, shareholders, and other stakeholders of the Debtor, for meetings with representatives of such constituencies in connection with the formulation, negotiation, and execution of a plan of reorganization, and for discussing the business operations, financial performance, and general condition of the Debtor and the China JVs; and

**G.** Assisting the Debtor and its counsel in the preparation of the Debtor's schedules of assets and liabilities and statements of financial affairs, the initial reporting package for the United States Trustee, and the Debtor's monthly operating reports.

Chan Aff., ¶ 16.

45. The Debtor believes that Mr. Chan is well-qualified to act as CRO and guide the Debtor through its bankruptcy case. Nicholson Aff., ¶ 35.

Bankruptcy Financing and Shareholder Opposition to the Motion

46. As of the date hereof, for the reasons described above, the Debtor has virtually no cash on hand. Nicholson Aff., ¶ 36.

47. Many of the Debtor's larger shareholders are aware of the involuntary bankruptcy filing and the Noteholders' request, among other things, for the appointment of a Chapter 11 trustee. Chan Aff., ¶ 17.

48. Indeed, shareholders holding a total of 6,011,532 shares and representing approximately 15% of the shareholder body (excluding Mr. Po, who has pledged his shares) have formed an ad hoc committee and have given the Debtor written commitments to provide $101,500 to fund the Debtor's bankruptcy case. Chan Aff., ¶ 18. The Debtor expects that other shareholders will follow suit. Id. These shareholders, however, have expressly stated that they oppose the appointment of a Chapter 11 trustee and the termination of exclusivity, and their commitments to provide bankruptcy financing are conditioned on the denial of that relief. Copies of the written commitments are attached hereto as Exhibit D and are incorporated herein by reference. Id.

## ARGUMENT

### A. The Debtor Has No Objection to the Proposed Gap Period Restrictions

49. Acknowledging that Bankruptcy Code section 303(f) allows the Debtor to operate and use, acquire, and dispose of property during the gap period, the Noteholders have requested that this Court prevent the Debtor from disposing of the Joint Venture interests without Court approval. See Motion, ¶ 32.

50. The Debtor has not taken any actions to dispose of the Joint Ventures during the gap period and has no objection to this restriction.

**B. A Chapter 11 Trustee Should Not Be Appointed Under Bankruptcy Code Section 1104(a)(1)**

51. Bankruptcy Code Section 1104(a)(1) provides that:

> At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, 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, either before or after commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a)(1).

52. The appointment of a chapter 11 trustee is an "extraordinary remedy." In re Euro-American Lodging Corp., 365 B.R. 421, 426 (Bankr. S.D.N.Y. 2007); In re Adelphia Comm'ns Corp., 336 B.R. 610, 656 (Bankr. S.D.N.Y. 2006), aff'd, 342 B.R. 122 (S.D.N.Y. 2006). There is a strong presumption that a debtor should remain in possession. In re The 1031 Tax Group LLC, 374 B.R. 78, 85 (Bankr. S.D.N.Y. 2007); Ionosphere Clubs, 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990); In re Marvel Entm't Group, Inc., 140 F .3d 463, 471 (3d Cir. 1998); see also In re Sharon Steel Corp., 871 F.2d 1217, 1225 (3d Cir.1989) ("It is settled that appointment of a trustee should be the exception, rather than the rule.").

53. The party seeking appointment of a trustee must prove the need for a trustee by "clear and convincing evidence." Euro-American Lodging, 365 B.R. at 426; In re Adelphia Commc'ns Corp., 336 at 656 (citing In re Marvel Entm't Group, 140 at 471); Ionosphere Clubs, 113 B.R. at 168; In re G-I Holdings, Inc., 385 F.3d 313, 317-19 (3d Cir. 2004).

54. Although Bankruptcy Code section 1104(a)(1) is broadly worded, courts typically find that "cause" exists when a debtor engages in fraudulent conduct designed to frustrate a creditor or engages in some blatant attempt to deceive creditors to the profit of the debtor and the detriment of creditors. See In re Mako, 102 B.R. 812, 812 (E.D. Ok. 1988).

55. Thus, courts have appointed trustees where (1) the debtor's principals siphoned money out of the debtor by means of a kickback scheme, see Fukutomi v. United States Trustee (In re Bibo, Inc.), 76 F.3d 256 (9th Cir. 1995), (2) assets were sold just prior to the bankruptcy filing with the knowledge that the transfer would be avoided, see In re Russell, 60 B.R. 42 (Bankr. W.D. Ark. 1985), and (3) a complete conversion of corporate assets occurred. See In re Colby Construction, Inc., 51 B.R. 113 (Bankr. S.D.N.Y. 1985).

56. Under this strict standard, the Noteholders have not shown by clear and convincing evidence that there is cause to appoint a trustee in this case.

**i. The Alleged Past Misconduct of a Former Officer Does Not Warrant the Appointment of a Trustee**

57. The Noteholders allege that the Debtor's former Chairman and CEO, James Po, engaged in "self-dealing" and took actions that were not authorized by the Debtor's Board. See Motion, Prel. St., ¶¶ 23-25. The Noteholders offer no support for their allegation that Mr. Po's actions constituted "self-dealing."

58. Moreover, the Noteholders conveniently ignore the language of 11 U.S.C. § 1104(a)(1), which provides that the focus of the inquiry should be on "current management," and the case law, including in this jurisdiction, supporting that proposition. See In re The 1031 Tax Group LLC, 374 B.R. at 86 ("'[O]n a motion for the appointment of a trustee, the focus is on the debtor's current activity, not past misconduct.'") (citing In re Sletteland, 260 B.R. 657, 672 (Bankr. S.D.N.Y. 2001)); In re Microwave Prods. of Am., Inc., 102 B.R. 666, 671 (Bankr. W.D.

Tenn. 1989) ("[T]he fact that prior management of the debtor is guilty of fraud, dishonesty, incompetence, or gross mismanagement does not necessarily provide grounds for the appointment of a trustee under section 1104(a)(l), as long as the court is satisfied that current management is free from the taint of prior management.").[4]

59. Even if Mr. Po did engage in conduct that falls within the scope of Bankruptcy Code section 1104(a)(l), which he firmly denies, he is not current management, and any impropriety on his part cannot be attributed to the Board, which removed him from his CEO position two months ago.

60. Not only has Mr. Po been removed as CEO, but the Board has taken additional measures to remove any "taint" (real or perceived) associated with Mr. Po's alleged past misconduct, resolving to retain an independent CRO with broad management powers.

61. Similarly, in In re 1031 Tax Group LLC, 374 B.R. at 90, the debtor retained a CRO to remove the "taint" associated with prior management. The Court noted that "establishing fraud by a member of the Debtors' governing body that appoints new management is by itself insufficient to require the appointment of a trustee" and denied the U.S. Trustee's motion to appoint a trustee. Id.

62. The Noteholders' attempt to manufacture cause by holding the Debtor responsible for the *alleged* misconduct of its *former* CEO is not supported by the facts or the law.

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[4] The cases cited by the Noteholders, In re Rivermeadows Assocs., Ltd, 185 B.R. 615, 619 (Bankr. D. Wyo. 1995), and Ok. Refining Co. v. Blaik (In re Ok. Refining Co.), 838 F.2d 1133 (10th Cir. 1988), involved management that was in control both before and after the bankruptcy date and, as such, are distinguishable from this case.

**ii. The Intransigence of the Debtor's JV Partner Does Not Warrant the Appointment of a Trustee**

63. The Noteholders cite the Debtor's inability to repatriate profits, complete its audit and SEC filings, and keep plants in China operating at full capacity as grounds for the appointment of a trustee. See Motion, Prel. St., ¶¶ 20-23, 25-26, 39.

64. As described in great detail above, the JV Partner is the root of these problems. The Debtor recognizes the serious impact that the JV Partner's inaction has had, however, and has made efforts to correct the situation, contacting and meeting with the JV Partner on a number of occasions.

65. These efforts have been unsuccessful, and the Debtor believes that legal action against the JV Partner in China would not be effective. The Debtor anticipates that, as CRO, Mr. Chan will redouble efforts to make inroads with the JV Partner.

66. These facts simply do not establish clear and convincing evidence of "gross mismanagement" or other grounds required to appoint a trustee under 11 U.S.C. § 1104(a)(1).

**iii. The Debtor Is Managing Its Affairs and Has Been Proactive**

67. The Noteholders assert that the Debtor is not adequately managing its affairs and assets and suggest that the Debtor's Board is somehow handcuffed because (1) certain Board members and officers resigned pre-petition and (2) the Debtor has not purchased D&O insurance. See Motion, Prel. St., ¶¶ 26, 39.

68. To the contrary, over the past few months, representatives from the Debtor have made three separate trips to China to meet with the JV Partner, the Noteholders, and others. Good faith negotiations with the Noteholders continued up until the Petition Date.

69. Since the Petition Date, the Debtor has had at least seven Board meetings and has resolved to retain a CRO. In addition, Felix Chung has expressed an interest in rejoining the Board.

70. With Mr. Chan at the helm, the Debtor is committed to prosecuting its bankruptcy case and formulating a plan of reorganization that maximizes the value of its assets for all parties-in-interest. A trustee should not be appointed.

## C. A Chapter 11 Trustee Should Not Be Appointed Under Bankruptcy Code Section 1104(a)(2)

71. Bankruptcy Code Section 1104(a)(2) provides that:

> At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

11 U.S.C. § 1104(a)(2).

72. Under this section, a court must find that the appointment of a Chapter 11 trustee is in the best interests of each of the three statutorily identified constituencies-- creditors, equity security holders, *and* other parties-in-interest. 11 U.S.C. § 1104(a)(2) (emphasis added); 7 Collier on Bankruptcy 1104.02[3][d][i] (15th ed. 2007).

73. Courts should weigh the costs and benefits of appointing a trustee in making their determination, see Collier on Bankruptcy 1104.02[3][d][ii], and "engage[ ] in a fact-driven analysis, principally balancing the advantages and disadvantages of taking such a step, mindful of the many cases . . . that have held that appointment of a trustee is an extraordinary remedy, and should be the exception, rather than the rule." In re Adelphia Comm'ns Corp., 336 B.R. at 658 (citation omitted).

74. It is difficult to identify any benefits that the appointment of a trustee would afford the Noteholders, the Debtor's other unsecured creditors, or the Debtor's shareholders.

75. First, the Debtor's Board is competent and has already engaged a CRO knowledgeable about its affairs and history with the Noteholders. See 7 Collier on Bankruptcy 1104.02[3][d][ii] ("When current management is competent and able to adjust to its new obligations under chapter 11, and when the creditors' committee is functioning properly, there may in fact be little or no benefit to the appointment of a trustee. . . .").

76. Second, the Noteholders would undoubtedly have a hand in selecting any trustee, allowing them to advance their own agenda, including terminating exclusivity and filing the plan of reorganization that they currently have in the works.[5] Allowing the Noteholders to take control of this case, before a creditors committee has even been formed, does not benefit the Debtor's other creditors.

77. Finally, the Debtor's shareholders have formed an ad hoc committee (on virtually no notice) that opposes the appointment of a trustee. This, in and of itself, is reason to deny the Noteholders' request under 11 U.S.C. § 1104(a)(2). ("[W]hen equity security holders or other ownership interests properly and in good faith support the debtor's current management, it will be difficult to obtain an order for the appointment of a trustee under the 'interest' standard."). 7 Collier on Bankruptcy 1104.02[3][d][i].

78. While there are no noticeable benefits to appointing a trustee, there are significant and obvious costs to doing so, including the time it will take the trustee and his or her

[5] The Debtor cannot help but question whether the Noteholders have sought the appointment of a trustee in a back-door attempt to terminate the Debtor's exclusivity periods under Bankruptcy Code section 1121(c)(1).

professionals to acquaint themselves with the Debtor and the case and the deprivation of the Debtor's fundamental bankruptcy right to operate as a debtor-in-possession. Id. ("The costs involved in a trustee's appointment are readily apparent. First, there is the cost of the trustee itself. The trustee is also likely to retain counsel. . . . There are also the intangible costs of delay and 'education' of the trustee, who must learn about the business and the various constituencies in a case before the trustee can address adequately the underlying issues. In addition, there is the even more intangible cost divesting the debtor's owners and managers of control and influence in the chapter 11 process.").

79. Moreover, with the shareholders' commitment to fund the Debtor's bankruptcy case contingent on the debtor continuing as a debtor-in-possession, the appointment of a trustee could undermine the Debtor's ability to obtain bankruptcy financing. See In re Adelphia Comm'ns Corp., 336 B.R. at 659 (refusing to appoint trustee under 11 U.S.C. § 1104(a)(2), among other reasons, because of the negative impact on the debtors' ability to maintain financing).

80. Because the costs far outweigh the benefits, a trustee should not be appointed under 11 U.S.C. § 1104(a)(2).

## D. A Chapter 11 Trustee Should Not Be Appointed Under Bankruptcy Code Section 1104(a)(3)

81. Bankruptcy Code Section 1104(a)(3) provides that:

> At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee if grounds exist to convert or dismiss the case under section 1112, but the court determines the appointment of a trustee or an examiner is in the best interests of the creditors and the estate.

11 U.S.C. § 1104(a)(3).

82. As an initial matter, there is an inconsistency between the Noteholders' commencement of this involuntary Chapter 11 case and their implicit position that there are grounds to convert or dismiss the case. Because the Noteholders do not present any argument for conversion or dismissal under 11 U.S.C. § 1112, however, a trustee cannot be appointed under 11 U.S.C. § 1104(a)(3).

83. In any event, "[t]he 'best interests of creditors and the estate' standard here does not appear to differ materially from the 'interests of creditors, any equity security holders, and other interests of the estates' of section 1104(a)(2). . . ." 7 Collier on Bankruptcy 1104.02[4] (15th ed. 2007).

84. The appointment of a trustee is not in the best interests of the creditors and the Debtor's estate for the reasons set forth above and, accordingly, the Court should not appoint a trustee under 11 U.S.C. § 1104(a)(3).

**E. The Debtor's Exclusivity Periods Should Not Be Terminated**

85. Bankruptcy Code section 1121(b) provides that only the debtor may file a plan of reorganization during the initial 120 days after the order for relief. Bankruptcy Code section 1121(c)(3) provides that if such a plan is filed, then the debtor has the exclusive right to solicit acceptances thereon for 180 days after the order for relief. Finally, Bankruptcy Code section 1121(d) enables a bankruptcy court to extend or reduce such periods for cause.

86. Congress intended that at the outset of a Chapter 11 case, a debtor should be given the unqualified opportunity to negotiate a settlement and propose a plan of reorganization without interference from creditors and other interests. See In re Texaco, 81 B.R. 806, 809 (Bankr. S.D.N.Y. 1988).

87. As a result, a request to reduce the exclusivity periods is a serious matter and the party making that request bears the burden of proving cause. In re McLean Industries, Inc., 87 B.R. 830, 834 (Bankr. S.D.N.Y. 1987). A motion to reduce or terminate the debtor's exclusivity periods should be granted "neither routinely nor cavalierly." Id.

88. The Noteholders assert that "courts have often found that acrimonious relations between a debtor and its creditors provide sufficient cause to terminate exclusivity" and cite certain cases that supposedly support this proposition. See Motion, ¶48.

89. The cases cited do *not* stand for that proposition or, at the very least, are easily distinguishable from the Debtor's case. In In re Situation Mgmt. Sys., 252 B.R. 859 (Bankr. D. Mass 2000), the court terminated exclusivity where, after five previous extensions, the debtor proposed a "new value" plan of reorganization. In Texas Extrusion Corp. v. Palmer, Palmer & Coffee (In re Texas Extrusion Corp.), 68 B.R. 712, 725 (N.D. Tex. 1986), the court affirmed the decision to reduce the exclusivity periods in light of allegations that the individual debtor deliberatively attempted to delay confirmation of the corporate debtor's plan by filing her own bankruptcy case. Finally, in In re Crescent Beach Inn, Inc., 22 B.R. 155, 160 (Bankr. D. Me. 1982), the court reduced the debtor's 180-day exclusivity period to confirm a plan to 120 days to ensure that it would be on the path to a reorganization by Labor Day, the end of its prime business season.

90. None of these cases hold that acrimony between the debtor and its creditors constitutes cause for terminating exclusivity, and certainty not at the very beginning of the case. If this were true, many debtors could immediately be stripped of their exclusivity rights, as some conflict between creditors and debtors is inherent to the bankruptcy/restructuring process.

91. Moreover, while the Debtor's and Noteholders' relationship may, at this juncture, be strained (or even "severely" strained), they were in discussions up until the Petition Date and, less than a week ago, both parties indicated a willingness to continue those discussions.

92. The Noteholders have not demonstrated cause for the immediate termination of the Debtor's exclusivity periods, before the Debtor has even had an opportunity to begin to formulate a plan of reorganization.

## CONCLUSION

For the foregoing reasons, the Debtor respectfully submits that the Court should deny the Noteholders' request for a Chapter 11 trustee and termination of the Debtor's exclusivity periods, and grant such other and further relief as is just and proper under the circumstances.

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