

UNITED STATES BANKRUPTCY COURT  
For the Southern District of Iowa

In the Matter of :  
FITNESS WORLD WEST, INC., : Case No. 90-3112-C H  
Debtor. : Chapter 11

ORDER--MOTION FOR APPOINTMENT OF INDEPENDENT TRUSTEE

The motion for appointment of an independent trustee by the United States of America on behalf of the Internal Revenue Service (herein "IRS") came on for hearing on March 8, 1991. IRS appeared by Kevin R. Query, Assistant U.S. Attorney; Paul From (herein "Landlord") appeared by James L. Spellman, Neiman, Neiman, Stone and Spellman, P.C.; Brenton National Bank of Des Moines and Metropolitan Federal Bank, F.S.B. (herein "Banks") appeared by Elizabeth E. Goodman, Davis, Hockenbergh, Wine, Brown, Koehn and Shors, P.C.; the U.S. Trustee appeared by Terry L. Gibson, Assistant U.S. Trustee; and, Debtor-in-Possession appeared by Richard M. LaJeunesse, Dreher, Wilson, Simpson, Jensen, Sellers, Harvey, Butters, Adams and Kaiser, P.C..

During the hearing, Landlord, Banks and U.S. Trustee joined said motion for appointment of Trustee.

At the conclusion of the hearing, the court took the matter under submission upon a briefing schedule.

Movants pray that a trustee be appointed pursuant to 11 U.S.C. § 1104(a).

Debtor-In-Possession resists said motion and prays that the motion be dismissed.

For the reasons set forth below, the motion for appointment of trustee will be granted.

### **JURISDICTION**

This court has jurisdiction pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

### **FINDINGS OF FACT**

1. Fitness World West, Inc. (herein either "Debtor" or "Fitness World") operates a fitness and athletic club at 3200 Westown Parkway, West Des Moines, Iowa.

2. Fitness World filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, on December 6, 1990. Debtor has remained in possession of its property and business and continues to do business under the direction of David C. Rosenberger, President.

3. The Rosenberger family holds 92 percent of the issued stock. The remaining 8 percent is held by Mary Enterline, who is an officer and director. The officers are as follows: David C. Rosenberger, husband and father, President; David K. Rosenberger, son, Vice President; Nancy E. Rosenberger, daughter, Vice President; Doris Rosenberger, wife

and mother, Secretary; and, Mary Enterline, Treasurer. All of the above plus Lance K. Rosenberger, son, are directors.

4. The Fitness World stock belonging to the Rosenbergers has been assigned to George Qualley prior to the time of filing. Mr. Qualley is an attorney who represents the Rosenbergers in other matters and a creditor of the Rosenbergers. This stock was assigned to Mr. Qualley to secure a pre-petition obligation and is held by him.

5. Fitness World has been in business since 1986. David C. Rosenberger managed the construction of the building and has run the affairs of Debtor since its inception.

6. There are approximately 4,000 members. Debtor's income is derived from dues collected from its members. There are several methods of payment of dues but some club members prepay for services, some up to 12 months in advance. The members have not formally been advised of this bankruptcy. Despite requests by the U.S. Trustee's office, the membership list has not been delivered to the U.S. Trustee.

7. Debtor paid rent to Landlord up to and including September 1990. Debtor has neither paid rent nor established an escrow account for rent since that date.

8. The monthly rent and proportioned taxes total approximately \$20,600.00. The amount of rent which is due and owing is approximately \$109,500.00. At the time of hearing approximately \$55,000.00 post-petition rent was owing.

9. Fitness World cannot operate without the present business premises.

10. The Iowa District Court, Polk County, held pre-petition that the lease had been terminated and Landlord was entitled to possession. This decision is on appeal.

11. There is hostility between Landlord and the Rosenbergers and Landlord does not wish to deal on any matter any further with David C. Rosenberger.

12. Debtor recently filed a mechanic's lien against the business premises in the amount of approximately \$595,000.00.

13. Landlord, if returned to possession, is considering keeping a fitness center at the location. However, there are other options available which Landlord is considering.

14. This court entered an order granting Paul From's motion for relief from stay on March 4, 1991. This court concurred with the Iowa District Court and concluded that the lease had been terminated under Iowa law. This termination of lease was prior to the filing of Fitness World's bankruptcy petition. This court permitted Paul From to proceed with further action in the state court proceeding for forcible entry and detainer.

15. Fitness World filed its notice of appeal from the order granting relief from stay, and this order is presently on appeal.

16. The United States Trustee notified both the Debtor and Debtor's counsel of the reporting requirements imposed upon Debtor as Debtor-in-Possession. Pursuant to 11 U.S.C. §§ 1106(a)(1) and 704(8) and Bankruptcy Rule 2015(3), Debtor is required to file monthly operating reports which are to include a statement of receipts and disbursements and such other information as required by the United States Trustee and the court. Debtor has been advised of these requirements on more than one occasion.

17. Debtor, as Debtor-in-Possession, has filed late reports. The filed monthly operating reports are incomplete and are inadequate to advise the court and interested parties as to the status of Debtor's post-petition operations.

18. Debtor has failed to properly serve the monthly reports on the U.S. Trustee even though the officers, employees and counsel of Debtor know that this is a requirement.

19. Debtor has hired John Foust as an employee. Mr. Foust is a CPA and has a law degree. He maintains an independent accounting office and clientele. Mr. Foust testified that his business is advising companies that are struggling financially and attempting to reorganize their debt.

20. Mr. Foust is personally familiar with the monthly report requirements of the Bankruptcy Code and Rules and has

worked with these reports on prior occasions. Mr. Foust was specifically hired to assist in the preparation of the monthly reports and was placed on Debtor's payroll as an employee for the stated purpose of avoiding the necessity of seeking this court's approval in employing a professional person and avoid the court's review of compensation paid to a professional person.

21. David and Doris Rosenberger are being paid \$1,000.00 and \$500.00 per week, respectively. They were not paid wages pre-petition and this payment of wages commenced upon the filing of the bankruptcy petition.

22. In mid-1990, David Rosenberger caused the incorporation of a corporation by the name of West World, Inc. A creditor of Fitness World was garnishing Fitness World's bank account, and West World was incorporated for the sole purpose of creating another bank account wherein Fitness World's funds could be deposited without being subject to garnishment. West World has no assets or employees and David Rosenberger is the sole shareholder. All of Fitness World's receipts were deposited in this account until the bankruptcy petition was filed. This information was not revealed publicly until after Debtor filed its petition.

23. There is a dispute as to whether Fitness World is current on its insurance coverage. The total annual premium of \$9,172.00 was due and payable in four installments of

\$2,293.00: July 1, 1990, September 1, 1990, December 1, 1990, and March 1, 1991. Fitness World has made only two of the payments.

24. Fitness World used the Brenton Bank as a pre-petition depository of credit card vouchers and statements. Brenton Bank caused this credit card agreement to be terminated. Fitness World continues to accept credit card payments and it has not established another agreement with a lending institution for deposit of these credit card transactions. Fitness World is holding these payments without depositing them for collection. This has been Fitness World's procedure since the filing of the petition.

25. Fitness World has been in possession of the premises since the order for relief on December 6, 1990, and has not filed an assumption of the lease pursuant to 11 U.S.C. § 365(d)(4). Subject real estate is non-residential and the court has not granted additional time for the filing of an assumption of the lease.

26. As of the date of hearing, the U.S. Trustee has not received any of the quarterly fees.

27. The schedules filed herein show total liabilities of \$513,744.00, of which \$103,311.00 are taxes owing to the IRS and \$25,570.00 are taxes owing to the State of Iowa. Fitness World lists assets of \$1,151,638.00, of which \$1,000,000.00 is listed as a contingent and unliquidated claim against 7 Flags

Fitness and Racquet Club and LeMar Koethe in Iowa District Court, Polk County.

28. Secured Creditors include Metropolitan Federal Bank and First Security Leasing. Metropolitan Federal Bank has filed a claim of \$221,617.88 secured by accounts receivable, inventory, equipment, documents, instruments, and intangibles.

First Security Leasing is listed as a secured creditor under three leases of fitness and exercise equipment. No payments have been made to either Metropolitan Federal Bank or First Security Leasing during the progress of this case.

29. No request to use cash collateral has ever been filed by Debtor and neither Metropolitan Federal Bank nor IRS have given their consent to use cash collateral.

30. Metropolitan Federal Bank, Brenton National Bank of Des Moines, the IRS, and Landlord have stated their unwillingness to work with current management but are willing to work with an independent trustee.

#### **ISSUE**

Whether a trustee should be appointed pursuant to 11 U.S.C. § 1104(a).

#### **DISCUSSION**

11 U.S.C. § 1104(a) provides as follows:

(a) 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--

- (1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
- (2) if 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.

The appointment of a trustee is an extraordinary remedy, and it is generally presumed that a debtor will remain in possession following the commencement of a Chapter 11 proceeding. In re Colorado-Ute Electric Association, Inc., 120 B.R. 167, 173 (Bankr. D. Colo. 1990); In re Cardinal Industries, Inc., 109 B.R. 755, 765 (Bankr. S.D. Ohio 1990); In re Ford, 36 B.R. 501, 504 (Bankr. W.D. Ky. 1983). However, once cause is found for the appointment of a trustee the court has no discretion and must appoint a trustee. In re Oklahoma Refining Co., 838 F.2d 1133, 1136 (10th Cir. 1988).

The party moving for the appointment of a trustee has the

burden of proof of showing that the appointment of a trustee is warranted by clear and convincing evidence. In re Sharon Steel Corp., 871 F.2d 1217, 1226 (3rd Cir. 1989). A debtor-in-possession is the rule and not the exception in a Chapter 11 case. Matter of Marin Motor Oil, Inc., 689 F.2d 445, 446 (3rd Cir. 1982), cert den., 459 U.S. 1207 (1983). There is a strong presumption that a reorganization debtor should be permitted to continue management of the estate. Colorado-Ute, supra, 120 B.R. at 173; Ford, supra, 36 B.R. at 504. Nevertheless, the appointment of an independent trustee "represents a potentially important protection that the court should not lightly disregard or incumber with overly protective attitudes towards debtors-in-possession." Colorado-Ute, supra, 120 B.R. at 173-174, quoting In re V. Savino Oil & Heating Co., Inc., 99 B.R. 518, 525 (Bankr. E.D.N.Y. 1989).

"Cause," as used in § 1104(a)(1) is not limited to the elements stated in the subsection. 11 U.S.C. § 102(3); Oklahoma Refining, supra, 838 F.2d at 1136; Savino Oil & Heating, supra, 99 B.R. at 525.

Section 1104(a)(1) specifically provides that a trustee may be appointed if Fitness World's management engaged in fraud or dishonesty either before or after the filing of the petition.

David Rosenberger admitted that he created a second

corporation prior to the filing of the petition for the sole purpose of concealing the identity of funds on deposit and misrepresenting the ownership of those funds. This constitutes an unmistakable act to deceive a creditor to the profit of Fitness World. Mr. Rosenberger is capable of using deceit in order to evade the claims of legitimate creditors. Savino Oil & Heating, supra, 99 B.R. at 526. Fraud and dishonesty are clearly shown.

Fitness World employed an accountant post-petition without notice and approval of employment for the sole purpose of evading the court's approval of the employment and review of the compensation paid to a professional person. This constitutes a violation of 11 U.S.C. § 327 and Fed.R.Bankr.P. 2014(a); In re Nautilus of New Mexico, Inc., 83 B.R. 784 (Bankr. D.N.M. 1988).

Fitness World, as debtor-in-possession, has the same fiduciary obligation under the Bankruptcy Code to creditors as a trustee for a debtor removed out of possession. Savino Oil & Heating, supra, 99 B.R. at 525. Fitness World has a duty to provide accurate financial reports in order to disclose all transactions involving estate assets.

The monthly reports are incomplete, inaccurate, delinquent, and misleading. This constitutes a continuing attempt by the management of Fitness World to conceal business transactions from the scrutiny of creditors. The failure to

maintain adequate records and submit prompt and complete reports is cause warranting the appointment of a trustee pursuant to § 1104. Oklahoma Refining, supra, 838 F.2d at 1136; Cardinal Industries, supra, 109 B.R. at 762.

Incompetence or gross mismanagement of debtor's affairs is cause for the appointment of a trustee. Debtor stopped paying the rent in October 1990. Mr. Rosenberger concedes that the business cannot operate without the present business premises. The lease has been terminated and this constitutes gross mismanagement of the corporation. In re JP Enterprises, Inc., 22 B.R. 661 (Bankr. E.D. Pa. 1982).

The failure to make lease payments; the use of cash receipts without disclosing the same to secured creditors and obtaining their consent; the failure to keep insurance payments current; the use of professionals without approval; the payment of salaries to David and Doris Rosenberger upon the filing of the petition; all combine to constitute gross mismanagement and cause concern about the ability of present management to manage the affairs of Debtor-in-Possession.

A trustee may be appointed pursuant to 11 U.S.C. § 1104(a)(2) if the appointment of a trustee is in the interest of creditors, equity owners, and other interests in the estate. The court cannot consider whether Debtor's securities are publicly held, or the amount of Debtor's assets or liabilities.

Factors which are considered under § 1104(a)(2) are as follows:

- (1) the trustworthiness of the debtor;
- (2) the debtor-in-possession's past and present performance and prospects for the debtor's rehabilitation;
- (3) the confidence--or lack thereof--of the business community and of creditors in present management; and
- (4) the benefits derived by the appointment of a trustee, balanced against the cost of the appointment.

In re Ionosphere Clubs, Inc., 113 B.R. 164, 168 (Bankr. S.D.N.Y. 1090).

The appointment of a trustee is justified where there is substantial doubt as to whether debtor's current management may be considered loyal to the debtor's rehabilitation and whether current management can gain and maintain the confidence of secured and unsecured lenders in sufficient measure to support rehabilitation. In re Concord Coal Corp., 11 B.R. 552 (Bankr. S.D. W. Va. 1981); Cardinal Industries, supra, 109 B.R. at 765-66.

The court believes that the interests of all parties will be served by the presence of an independent trustee. The landlord and secured creditors are united in their desire to have a trustee appointed and all expressed a complete lack of confidence in present management. The landlord is completely

unwilling to work with present management and has expressed an intention that he could work with an independent trustee.

The trustworthiness of present management of Fitness World is subject to doubt. Management has shown a willingness to engage in subterfuge in evading financial responsibility and candid disclosure of financial situation. This activity is continuing and hinders Debtor's ability to deal with the Landlord and creditors.

The court has arrived at this conclusion notwithstanding the fact that David Rosenberger testified that the business would collapse if he left. The business will definitely collapse if the business is evicted from the premises, and there is some hope that an independent trustee may salvage the business. Further, the good relationship of present management with the membership might waver if present management was dealing in a forthright manner with them. Even if the business must be liquidated, this is better done under an independent trustee than present management.

There are current and ongoing disputes between Debtor, Landlord and creditors, and the creditors have lost all confidence in the present management of Debtor. The reorganization process is doomed to failure if these disputes are not resolved. The present management of Debtor is either unable or unwilling to enter into meaningful negotiations to resolve these disputes. The need for a neutral party to

mediate disputes between Debtor and its creditors is ground for a trustee's appointment. In re the Bible Speaks, 74 B.R. 511, 513 (Bankr. D. Mass. 1987) citing In re Bonded Mailings, Inc., 20 B.R. 781 (E.D.N.Y. 1982).

The interest of equity security holders must be considered with the interests of creditors and other interests of the estate. Generally, if the current management of a corporation is also equity security holders, this interest would normally be opposed to the appointment of a trustee. However, the Rosenbergers have assigned their stock to a creditor and their interests as equity security holders converge with those interests of the creditor. Accordingly, this factor is of lesser significance under the facts of this case.

#### **CONCLUSION**

The court concludes that it has been clearly shown that a trustee must be brought in under the provisions of both 11 U.S.C. § 1104(a)(1) and (2).

IT IS ACCORDINGLY ORDERED, as follows:

(1) the joint motion for appointment of independent trustee is sustained; and

(2) the United States Trustee shall proceed to appoint a trustee pursuant to 11 U.S.C. § 1104(c).

Dated this 26th day of April, 1991.

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RUSSELL J. HILL  
U.S. BANKRUPTCY JUDGE