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Office of the United States Trustee
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Elizabeth A. Ziegler,
for the United States Trustee

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

IN RE	§	
	§	CASE NO. 11-41880-DML-11
Halek Energy, LLC.,	§	
	§	
Debtor-in-Possession	§	Hearing: to be set

Emergency Motion By the United States Trustee's for the Appointment of Chapter 11 Trustee under 11 U.S.C. § 1104(a), or to convert case to Chapter 7 under 11 U.S.C. § 1112(b)

The United States Trustee has separately filed a motion for emergency hearing. The United States Trustee will mail notice of any hearing date and time, but you are encouraged to monitor the Court's docket for an order setting an emergency hearing.

TO THE HONORABLE D. MICHAEL LYNN,
UNITED STATES BANKRUPTCY JUDGE:

The United States Trustee for Region 6 moves for an order directing the appointment of a Chapter 11 Trustee in Halek Energy, LLC based on cause and the best interests of the creditors under 11 U.S.C. § 1104(a). The United States Trustee would show:

Overview

The United States Trustee seeks the appointment of a chapter 11 trustee. The Debtor's president, Jason Halek, breached his fiduciary responsibilities to the Debtor before the inception

of this case, and his actions since filing have caused the United States Trustee and creditors to lose confidence in his management of the estate.

First, “cause” exists for the appointment of a chapter 11 trustee. Here, cause includes incompetence, gross mismanagement of the bankruptcy estate, and inherent conflicts of interest. Second, appointing a trustee is in the best interest of creditors. In the alternative, cause exists to convert this case to chapter 7.

Jurisdiction

1. The Court has subject matter jurisdiction under 28 U.S.C. § 1334, 28 U.S.C. § 157(a)(1), and the standing order of reference. Appointing a trustee or examiner impacts the case administration and therefore is a core matter that the Court has the power to resolve. 28 U.S.C. § 157(b)(2)(A).
2. The United States trustee has standing to seek appointment of a trustee or examiner. 11 U.S.C. §§ 307, 1104.

Facts

Procedural History:

1. On April 1, 2011, Halek Energy, LLC filed a voluntary petition for relief under chapter 11.
2. The Debtor continues to operate as debtors-in-possession pursuant to §§ 1107(a) and 1108 of the bankruptcy court.
3. To date, no committee of unsecured creditors has been appointed.
4. The Debtor is engaged in the business of operating several oil and gas wells, as well as a salt water disposal well in Jack, Erath and Palo Pinto counties.
5. The Debtor’s chief executive officer and 80% owner/managing member is Jason Halek.

Pre-Petition Events:

6. On August 31, 2010, the Securities and Exchange Commission (“SEC”) commenced proceeding 3:10-CV-1719-K against Halek Energy, LLC, CBO Energy, Inc., Jason A. Halek, and Christopher Chad Wilbourn (“SEC Litigation”).

7. According to the Complaint, Mr. Halek and Halek Energy and CBO Energy conducted an unregistered securities offering of working interests in several oil and gas projects, and raised approximately \$22,000,000 from 300 investors. These materials allegedly contained materially false and misleading statements about the risks of the projects, the use of investor funds and potential returns on investments. (Complaint at ¶ 1)

8. On September 1, 2010, the Debtor and the SEC entered into an Interlocutory Judgment by which the Debtor agreed 1) to be enjoined from violating securities laws and 2) to pay disgorgement from ill-gotten gains to the SEC. [Exhibit 1] The Debtor also agreed it was precluded from arguing it did not violate federal securities laws in any trial on the amount of the disgorgement.

9. At the time of filing, the Judgment was not reduced to a monetary amount.

Post-Petition Events

10. On April 22, 2011, the Debtor filed its schedules and statement of financial affairs. [dockets no. 18, 19, 20]

11. The Schedules and SOFA are signed under the penalty of perjury by Jason Halek.

12. On April 29, 2011, the United States Trustee commenced the first meeting of creditors. Although Halek had signed the schedules and SOFA, Dan Mathis, a 20% owner/managing member who acquired his 20% interest within days of the bankruptcy filing, appeared on behalf of the Debtor.

13. At the 341 meeting, the Debtor and the SEC announced they had reached a potential settlement agreement by which the Debtor would be required to disgorge approximately \$8,900,000 to the SEC. Of that amount, Jason Halek was jointly and severally liable for approximately \$550,000.

14. At the 341 meeting, Mr. Mathis testified the following items were not disclosed on the Schedules and SOFA;

a. Although Jason Halek's current salary is \$60,000, the Debtor failed to disclose in the year prior to filing his salary was \$400,000;

b. Transfers of the Debtor's working interest in several wells to third parties, including charities controlled by Jason Halek;

c. Total compensation paid to Jason Halek during the year prior to filing for bankruptcy, including royalty payments and payments to his charities;

d. Although listed on Schedule B, the gathering system is described as having a value of \$20,000, while the actual value of the system is \$200,000;

e. Although the attorney for the SEC is listed on Schedule F, the Debtor states he is receiving "notice only," and there is not corresponding entry for an unsecured debt owed to the SEC;

f. Statement of Financial Affairs question 1 indicates 2011 year to date gross income of \$69,000, while the Debtor's actual gross income is approximately \$1,250,000 per month – or over three million year to date -- from the operations of the wells;

g. The Debtor failed to disclose 2010 gross income in response to Statement of Financial Affairs question 1;

h. Annual salary for Jason Halek and Daniel Mathis is not disclosed;

15. Mr. Mathis testified he had not been part of the negotiations regarding filing the bankruptcy.

16. Mr. Mathis testified he knew of a Temporary Injunction Order in litigation pending in Jack County¹ (“Jack County Litigation”) requiring the Debtor to escrow proceeds from the operation of several of the wells, yet the Debtor had violated the terms of that order by failing to escrow the proceeds. [Exhibit 2]

17. On May 3, 2011, the case was dismissed for failure to file a cash flow statement, statement of operations for small business and a balance sheet. [docket no. 39]

18. On May 4, 2011, the Debtor filed these required documents, as well as a Motion to Vacate the Dismissal Order.

19. The Cash Flow statement indicates the following;

Month	Income	Expenses	Net
January 2011	\$1,541,846	\$1,443,439	\$98,407
February 2011	\$1,393,348	\$1,558,629	(\$165,281)
March 2011	\$1,064,738	\$1,549,818	(\$485,080)

20. The Order vacating dismissal order was entered on May 9, 2011. [docket no. 48]

21. On May 9, 2011, the Ad Hoc Committee of Investor Creditors filed a Motion to Appoint a Chapter 11 Trustee, citing the numerous non-disclosures in the Debtor’s schedules, as well as the Debtor’s pre-petition conduct as cause for the appointment of a trustee. [docket no.50]

Legal Analysis and Argument

¹ The Jack County Litigation is PFG Properties, LLC and Gaylene Haver v. Central Basin Oil, Inc., CBO Energy, Inc., Halek Energy LLC, Halek Energy Partners, LLC, Jason Halek, Jim Halek and Christopher Chad Wilbourn, Cause No. 10-12-140 in the 271st Judicial District, Jack County Texas.

Appointment of a trustee required where there is a finding of cause or where it is in the best interest of creditors

22. The United States Trustee is charged with monitoring the federal bankruptcy system. *See* 28 U.S.C. § 586(a)(3), *See also United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)* 33 F.3d 294, 295-96 (3d Cir. 1994).

23. Before confirmation, 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 the commencement of the case, or similar cause.” 11 U.S.C. §1104(a)(1).² Alternatively, the Court must appoint a trustee “if such appointment is in the interest of the creditors, any equity security holders, and other interests of the estate.” 11 U.S.C. § 1104(a)(2).

24. The duties of a trustee are defined in section 1106, and the Court has the ability to tailor some of them. 11 U.S.C. § 1106(a).

25. “If the court does not order the appointment of a trustee . . . , the court shall order the appointment of an examiner to conduct such investigation of the debtor as is appropriate . . . if such investigation is in the interest of creditors, any equity security holders, and other interests of the estate” 11 U.S.C. §1104(c)(1).

26. The Court also can tailor some of an examiner’s defined statutory duties. 11 U.S.C. § 1106(b).

27. The “cause” to appoint an examiner or a trustee may be a reason other than the enumerated factors. *Oklahoma Ref. Co. v. Blaik (In re Oklahoma Ref. Co.)*, 838 F.2d 1133, 1136

² Section 1104(e) of the Bankruptcy Code provides that the United States trustee “shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor’s chief executive officer, or members of the governing body who selected the debtor’s chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor’s public financial reporting.” 11 U.S.C. § 1104(e).

(10th Cir. 1988); cf. *Little Creek Dev. Corp. v. Commonwealth Mortg. Corp. (In re Little Creek Dev. Corp.)*, 779 F.2d 1068, 1072 (5th Cir. 1986) (defining “cause” in context of dismissal statute).

28. Courts have appointed trustees or examiners when the debtor’s insiders have conflicts of interest arising from the sale of the Debtor’s assets. In *Cajun Electric*, the Fifth Circuit affirmed the appointment of a trustee, in part, because the co-operative members were interested in purchasing part or all of Cajun Electric’s assets. *Cajun Elec. Power Cooperative, Inc. v. Central Louisiana Elec. Co., Inc. (In re Cajun Elec. Power Cooperative, Inc.)*, 69 F.3d 746, 751 (5th Cir. 1995) (Garza, J., dissenting), *adopted as majority opinion on reh’g*, 74 F.3d 599 (5th Cir. 1996). The Fifth Circuit held that “a trustee may be the only effective way to pursue reorganization” when the management has cross-purposes. *Cajun Elec.*, 69 F.2d at 751.

29. Two circuits have held that “cause” exists when appointing a chapter 11 trustee “is the only effective way to pursue reorganization.” *Cajun Elec. Power Coop., Inc. v. Central La. Elec. Coop., Inc. (In re Cajun Elec. Power Coop., Inc.)*, 74 F.3d 599, 600 (5th Cir.) (adopting on rehearing the opinion of dissent in 69 F.3d 746, 751), cert. denied, 519 U.S. 808 (1996); *see also In re Marvel Entertainment Group, Inc.*, 140 F.3d 463 (3^d Cir. 1998) (adopting reasoning of *Cajun Electric*. and affirming appointment of trustee when acrimony between debtor’s management and creditors undermined any ability to prosecute bankruptcy case). While *Cajun Electric* and *Marvel* have factual distinctions, both *Cajun Electric* and *Marvel* focused on the underlying problem that exists in this case: this case can proceed properly through the chapter 11 process only if a chapter 11 trustee is appointed.

Cause exists to appoint a chapter 11 trustee:

30. Cumulatively, the facts of this case establish incompetence, gross mismanagement, and

conflicts of interest of the Debtor by Jason Halek such that cause exists to appoint a trustee. Appointing a chapter 11 trustee would provide the Debtor with a true fiduciary to the bankruptcy estate.

31. Reviewing the facts of this case establishes that Jason Halek has grossly mismanaged pre-petition by breaching his pre-petition duties of care and loyalty and by failing to maintain corporate structure and investment agreement, and the gross mismanagement and incompetence continued post-petition by failing to provide accurate financial information on the Debtor's Schedules and SOFA. Based on the testimony at the 341 meeting, the Debtor failed to disclose numerous transfers of its working interest in the wells in the year prior to filing for bankruptcy, including transfers of property to entities controlled by Jason Halek. Under the facts, the Debtor may have significant causes of action to recover valuable assets from insiders potential defendant to fraudulent transfer and breach of fiduciary duty claims should not be allowed to select the party who will litigate those claims, and the failure to disclose the transfers exacerbates the conflict of interest. A neutral trustee is proper.

32. Halek, as the 80% owner and chief executive officer, owes a fiduciary duty to the estate. *CFTC v. Weintraub*, 471 U.S. 343, 355, 105 S. Ct. 1986, 85 L. Ed. 2d 372 (1985); *Wolf v. Weinstein*, 372 U.S. 633, 649-50, 83 S. Ct. 969, 10 L. Ed. 2d 33 (1963). This fiduciary duty consists of the duty of care and the duty of loyalty; the duty of care requires the fiduciary to make good faith decisions, and the duty of loyalty requires the fiduciary to "refrain from self-dealing, to avoid conflicts of interests and the appearance of impropriety, to treat all parties to the case fairly and to maximize the value of the estate." *Lange v. Schropp (In re Brook Valley VII)*, 496 F.3d 892, 900-01 (8th Cir. 2007).

33. Halek has violated his fiduciary responsibilities to the estate by breaching his duty of care

and loyalty. Pre-petition, while the Debtor was becoming insolvent, rather than curb his excessive withdrawals from the corporation, he took a salary of approximately \$400,000, and transferred working interests in the wells to other entities under his control. He further breached his fiduciary duties by causing the Debtor to ignore a state court order which required the Debtor to escrow proceeds from one of its operating oil wells. Moreover, Mr. Halek has created a conflict of interest between himself and the Debtor post-petition by entering the Judgment with the SEC, in which he is personally jointly and severally liable with the Debtor in the amount of \$550,000 on a \$8,900,000 judgment for violating federal securities laws. His personal interest in avoiding paying a portion of the Judgment are directly opposed to the Debtor's interest in seeking to collect that money to assist in the repayment of the judgment. Under these facts, allowing Halek to remain in control fosters neither unsecured creditor nor public confidence in the bankruptcy system. A trustee should be appointed.

It is in the best interests of creditors to appoint a chapter 11 trustee.

34. Appointment of chapter 11 trustee is also in the interests of creditors, equity security holders, and other interests of the estate. The Court should direct the appointment of a chapter 11 trustee to serve the "interests of creditors, any equity security holders, and other interests of the estate." 11 U.S.C. §1104(a)(2).

35. As Jason Halek appears to have used the corporation to promote his own self interest and caused the Debtor to violate federal securities laws, he is incapable of conducting an independent and unbiased evaluation of the finances of the Debtor. He is a potential target of preferential or fraudulent transfer actions by allowing the Debtor to transfer its working interests in the wells to his charities, yet he would have an inherent conflict of interest as to whether to pursue those actions. Moreover, the financial information provided in the cash flow statement indicates that

while Mr. Halek was in control of the Debtor pre-petition, the Debtor's income decreased each month, while its expenses significantly increased. Given the financial history, an independent trustee should be appointed to evaluate the on-going operations of the Debtor and evaluate the hemorrhaging of cash.

36. It is in the best interest of creditors to have an independent trustee to assume control over the estate, to evaluate any preferential or fraudulent transfer actions, to pursue those actions, and to potentially provide a return to the unsecured creditors. Therefore, it is in the best interests of creditors to appoint a chapter 11 trustee.

Alternatively, cause exists for conversion to chapter 7.

37. In the alternative, cause exists to convert this case to one under chapter 7 as there has been gross mismanagement of the estate. *See* 11 U.S.C. § 1112(b)(4)(B). Mr. Halek caused the Debtor to transfer a portion of its working interests in several wells pre-petition, and then failed to disclose those transfers to the court. In addition, instead of reducing his salary while facing increased litigation expenses, and declining profits, Mr. Halek maintained his \$400,000 yearly salary and only reduced it when bankruptcy was imminent. Moreover, since filing for bankruptcy, the Debtor has failed to disclose significant financial data to the court and creditors on its schedules and SOFA. These facts demonstrate the Debtor is effectively without proper management. Therefore, grounds exist to convert this case to one under Chapter 7 as there has been gross mismanagement of the Debtor's estate.

For these reasons, the United States Trustee requests the Court to order the appointment of a Chapter 11 Trustee, or to convert this case to chapter 7. The United States Trustee requests any other relief to which he is entitled.

DATED: May 11, 2011

Respectfully submitted,

WILLIAM T. NEARY
UNITED STATES TRUSTEE

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Certificate of Conference

I certify that on May 10, 2011, I conferred with Marilyn Garner, counsel for the Debtor.

The Debtor is opposed to the relief requested.

/s/ Elizabeth A. Ziegler
Elizabeth A. Ziegler

Certificate of Service

I certify that I sent copies of the foregoing document on May 11, 2010 to the following parties via U.S. Mail, postage prepaid, or via ECF to the parties listed below and on the attached mailing matrix.

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