

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF MARYLAND**  
(Baltimore Division)

IN RE

TMST, Inc., *f/k/a*,  
Thornburg Mortgage, Inc., *et. al.*,<sup>1</sup>

Debtor.

BANKRUPTCY CASE NO:

09-17787-DWK

Chapter 11 Cases  
(Jointly Administered)

**MOTION OF THE UNITED STATES TRUSTEE FOR  
AN ORDER DIRECTING THE APPOINTMENT  
OF A CHAPTER 11 TRUSTEE OR,  
IN THE ALTERNATIVE, AN EXAMINER**

The United States Trustee for the District of Maryland, Baltimore Division, in furtherance of the administrative responsibilities imposed pursuant to 28 U.S.C. § 586(a), respectfully requests that this Court enter an order directing the appointment of a chapter 11 trustee or, in the alternative, an examiner.

In support thereof, the U.S. Trustee represents as follows:

**I. PRELIMINARY STATEMENT**

Cause exists for the appointment of a chapter 11 trustee in these jointly administered cases. For a period of time prior to the commencement of these cases, TMST, Inc. (formerly known as Thornburg Mortgage, Inc., hereinafter "TMST") explored a strategy of acquiring a depository financial institution to strengthen its balance sheet and asset base. Within days after TMST and its related entities filed chapter 11 petitions in the Court, TMST's Chief

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<sup>1</sup> The Debtors in these Chapter 11 cases are (i) TMST, Inc. *f/k/a* Thornburg Mortgage, Inc. or TMA; (ii) Adfitech, Inc.; (iii) Thornburg Acquisition Subsidiary, Inc.; (iv) Thornburg Mortgage Home Loans, Inc.; and (v) Thornburg Mortgage Hedging Strategies, Inc.

Executive Officer, Larry A. Goldstone (“Goldstone”) and its Chief Financial Officer, Clarence G. Simmons, III (“Simmons”) formed a new entity, SAF Financial, Inc. (“SAF”), to continue to explore TMST's prior strategy of acquiring a depository financial institution from which to build an asset base for mortgage lending.<sup>2</sup>

Following the formation of SAF, Goldstone and Simmons continued to serve as TMST's CEO and CFO, respectively, and continued to be highly compensated at their prepetition salaries with the assets of TMST and its related debtor entities.<sup>3</sup> On May 11, 2009, Orrick, Herrington & Sutcliffe LLP (“Orrick”), Debtors' special corporate counsel<sup>4</sup>, was engaged by SAF to represent SAF in corporate matters.<sup>5</sup> Orrick's connection to and representation of SAF was not disclosed in this proceeding until August 28, 2009,<sup>6</sup> and only after allegations surfaced that Goldstone and Simmons were misappropriating estate assets in connection with SAF's start-up.

Through a preliminary investigation of this matter, the U.S. Trustee has learned that a number of Debtors' employees have been paid by the Debtors for time during which the

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<sup>2</sup> See Supplemental Declaration (Doc. 334) filed by TMST's special counsel indicating SAF was formed after May 4, 2009 by the current CEO and CFO. On May 11, 2009, TMST's special counsel was engaged by SAF to represent it with respect to general corporate matters.

<sup>3</sup> See Debtors' Statement Pursuant to Local Rule 2015-(b) (Doc. 254). According to this Statement, Goldstone is currently being compensated by the Debtors at a rate of \$85,493.34 per month and Simmons is being compensated at a rate of \$60,978.33 per month. This Statement also reflects that certain WARN Act payments allegedly due Goldstone and Simmons are being applied to their postpetition compensation.

<sup>4</sup> On May 4, 2009, Debtors filed an application to employ Orrick, Herrington & Sutcliffe, LLP as special counsel to the debtors for corporate matters (Doc. 33). By Order entered May 22, 2009, the Debtors' application to employ Orrick as special corporate counsel was granted (Doc. 112).

<sup>5</sup> See Orrick's Supplement Declaration (Doc. 334) filed on August 28, 2009.

<sup>6</sup> *Id.*

Debtors' employees performed services for SAF with no apparent benefit to the Debtors.

## **II. JURISDICTION AND VENUE**

1. On May 1, 2009 (the “Petition Date”), TMST and several affiliated entities<sup>7</sup> (hereinafter collectively the “Debtors”) filed voluntarily petitions in this Honorable Court for relief under chapter 11 of the United States Bankruptcy Code. The Debtors continue to operate their businesses and manage their properties as debtors-in-possession pursuant to 11 U.S.C. §§ 1107 and 1108.

2. The Debtors' chapter 11 cases are being jointly administered. A trustee has not been appointed in these cases. A plan of reorganization has not been confirmed.

3. This Court has jurisdiction to consider this Motion pursuant to 28 U.S.C. §§ 157 and 1334.

4. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper in this Court pursuant to 28 U.S.C. § 1408 and 1409.

5. The U.S. Trustee has standing to bring this motion pursuant to 28 U.S.C. § 586 and 11 U.S.C. § 307. Under 28 U.S.C. §586, the U.S. Trustee is charged with monitoring the federal bankruptcy system. *See United States Trustee v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 295-96 (3<sup>rd</sup> Cir. 1994)(noting that the U.S. Trustee has “public interest standing” under 11 U.S.C. § 307 which goes beyond mere pecuniary interest). In situations where there is “cause” to remove the debtor's management, the U.S.

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<sup>7</sup> See Footnote #1.

Trustee may seek the appointment of a chapter 11 trustee. *See, e.g., In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 473 (3<sup>rd</sup> Cir. 1998).<sup>8</sup>

### **III. BACKGROUND**

6. On May 1, 2009, the Debtors filed voluntary petitions under chapter 11 in this Court, initiating the above-captioned cases. By Order entered May 6, 2009 (Doc. 54), this Court directed that the Debtors' cases be jointly administered under case number 09-17787.

7. TMST (f/k/a Thornburg Mortgage, Inc. or "TMA") is a Maryland corporation that conducts its operations as a real estate investment trust (a "REIT") for federal income tax purposes. It is headquartered in Santa Fe, New Mexico. Until it was delisted in December of 2008, the common stock of TMST was traded on the New York Stock Exchange. The remaining Debtors are wholly-owned direct or indirect subsidiaries of TMST.

8. The Debtors report that their operations consist of three businesses: (a) TMST (f/k/a TMA), which engaged in the business of acquiring, securitizing, and managing investments in mortgage securities and mortgage loans; (b) Thornburg Mortgage Home Loans, Inc. ("TMHL"), a subsidiary of TMST, which originated, acquired, and securitized mortgage loans; and (c) ADFITECH, Inc. ("Adfitech"), an independently-operated wholly-owned subsidiary of TMHL, headquartered in Edmond, Oklahoma, that provides mortgage-

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<sup>8</sup> 11 U.S.C. § 1104(e) 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 office, 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." (Emphasis added.)

related auditing and quality control consulting services to financial institutions. *See* Declaration of Clarence G. Simmons, III in Support of First Day Motions, dated May 1, 2009 (Doc. 26) at ¶ 6. According to the Debtors, the remaining two debtor entities do not have any ongoing operations. *Id.*

9. Goldstone and Simmons are the Debtors' top two officers.

10. Goldstone is a director and the CEO and President of TMST, Inc., Chairman of the Board of TMST Home Loans, Inc.; the Chairman of the Board and CEO of TMST Hedging Strategies, Inc.; the President, CEO and a director of TMST Acquisition Subsidiary, Inc.; and a director of ADFITECH, Inc. *See* Orrick's Supplemental Declaration at ¶ 4.

11. Simmons is the Senior Executive Vice President and CFO of TMST, Inc.; the Senior Executive Vice President, CFO and a director of TMST Home Loans, Inc., the CFO and a director of TMST Hedging Strategies, Inc.; Senior Executive Vice President, CFO and a director of TMST Acquisition Subsidiary, Inc.; and a director of ADFITECH, Inc. *See* Orrick's Supplemental Declaration at ¶ 4.

12. Simmons signed the petitions on behalf of the Thornburg Debtors and he signed the Declaration in Support of the Debtors' myriad first day motions (Doc. 26).

13. On May 4, 2009, the Debtors filed an application to employ Orrick as Special Counsel to the Debtors to “perform the legal services that will be necessary during the Debtors' chapter 11 cases in connection with general corporate governance and securities matters, along with other matters related to [TMST's] obligations as a publicly traded company . . . .” (Doc. 33 at ¶ 5) (the “Application to Employ”). By Order entered May 22,

2009, the Debtors' Application to Employ Orrick as special corporate counsel was granted (Doc. 112).

14. Upon information and belief, on or very shortly after the petition date, Goldstone and Simmons formed SAF to continue to explore TMST's prior strategy of acquiring a depository financial institution from which to build an asset base for mortgage lending.

15. Goldstone and Simmons own a majority of the outstanding stock of SAF. *See* Orrick's Supplemental Declaration at ¶ 5.

16. On May 11, 2009, Orrick was engaged by SAF to represent SAF with respect to general corporate matters. *Id* at ¶ 6. Orrick failed to timely disclose this new engagement to this Court.

17. On or about August 25, 2009, the Committee of Unsecured Creditors (the "Committee") received an anonymous letter asserting that Goldstone and Simmons are misappropriating a portion of the Debtors' payroll to help fund work on a new start-up company (the "Whistle-Blower Letter").

18. On Friday, August 28, 2009, at 9:51 a.m., counsel for the Committee forwarded a copy of the Whistle-Blower Letter to Debtors' general bankruptcy counsel and Orrick.

19. On Friday, August 28, 2009, at 5:17 p.m., Orrick filed its Supplemental Declaration (Doc. 334), disclosing for the first time in the Debtors' bankruptcy cases its ongoing representation of SAF.

20. The Committee shared the Whistle-Blower Letter with the U.S. Trustee and

the U.S. Trustee, thereafter, engaged the Debtor, through its general bankruptcy counsel, in discussions regarding this matter.

21. Through these discussions, the U.S. Trustee has learned, among other things, that, post-petition, employees of Debtors did, in fact, perform services on behalf of SAF and that such employees were compensated by the Debtors for the services they performed on behalf of SAF.

#### **IV. ARGUMENT**

##### **A. Appointment of a Trustee is Required Upon Finding of Cause**

22. Section 1104(a) of the Bankruptcy Code provides:

“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 . . . . ; or

(2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate . . . .”

23. Cause exists both pursuant to Section 1104(a)(1) and (a)(2) for the appointment of a trustee in these cases. It is a basic tenet of bankruptcy law that a chapter 11 debtor-in-possession “administers the assets of the estate and any business conducted therein, as a fiduciary for both equity interests and creditors.” *Commodity Futures Trading Comm’n v. Weintraub*, 471 U.S. 343, 355 (1985); *see also United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983).

24. Through section 1104(a)(1) of the Bankruptcy Code, Congress has mandated that a chapter 11 debtor-in-possession, who acts as a fiduciary of the bankrupt estate, be an honest broker. See *Wolf v. Weinstein*, 372 U.S. 633, 651 (1963)(willingness of courts to leave debtors in possession “is premised upon an assurance that the officers and managing employees can be depended upon to carry out the fiduciary responsibilities of the trustee”); *In re V. Savino Oil and Heating Co.*, 99 B.R. 518, 526 (Bankr. E.D.N.Y. 1989)(“The willingness of Congress to leave a debtor-in-possession is premised on an expectation that current management can be depended upon to carry out the fiduciary responsibilities of a trustee. And if the debtor-in-possession defaults in this respect, [s]ection 1104 (a)(1) [of the Bankruptcy Code] commands that stewardship of reorganization effort must be turned over to an independent trustee”) (cited with approval in *In re Marvel Entm’t Group, Inc.*, 140 F.3d 463, 474 (3<sup>rd</sup> Cir. 1998)).

**B. Cause Exists for the Appointment of  
a Trustee in these Cases - § 1104(a)(1)**

25. Bankruptcy Code sections 1106 and 1107 impose upon debtors-in-possession the basic duties of trustees. The diversion of estate resources for the benefit of insiders constitutes a breach of the fiduciary duties of loyalty and honesty, and constitutes an actual conflict of interest inconsistent with the basic fiduciary obligations of a debtor-in-possession. Section 1104(a)(1) mandates that such conduct result in the appointment of a trustee.

26. Included in the trustee duties assumed by debtors-in-possession is the duty to be accountable for estate property. 11 U.S.C. §§ 704 and 1106. In permitting estate

resources to be surreptitiously used for the sole benefit of insiders, the Debtors have failed to meet their fiduciary obligation to be accountable for estate property.

27. A debtor-in-possession's duty of accountability includes with it a minimum level of candor to the Court and parties-in-interest. *See, Savino Oil*, 99 B.R. 518.

One of the most fundamental and crucial duties of a debtor-in-possession upon the filing of a Chapter 11 petition is to keep the Court and creditors informed about the nature, status and condition of the business undergoing reorganization. . . . Open, honest and straightforward disclosure to the Court and creditors is intrinsic to the entire reorganization process and begins on day one, with the filing of the Chapter 11 petition.

*Savino Oil*, 99 B.R. at 526.

When a debtor, as in this case, “fails to disclose material and relevant information to the Court and creditors, a Chapter 11 trustee is required.” *Id.* (citing *In re Deena Packaging Industries, Inc.*, 29 B.R. 705 (Bankr. S.D.N.Y. 1983).

28. Not only is candor to the Court and parties-in-interest lacking in this case, but the Debtors violated chapter 11's basic prohibition on the use of estate assets other than in the ordinary course of business absent notice, a hearing, and court authorization. 11 U.S.C. § 363(b). No notice was provided nor was court approval sought to use estate assets to help fund the start-up of SAF.

29. Furthermore, the use of the Debtors' employees by its most senior officers to staff start-up aspects of a new and undisclosed company is, at its very best, strong evidence of incompetence and/or gross mismanagement. Compounding the Debtors' gross mismanagement and lack of candor to this Court is Orrick's undisclosed representation of the

insiders' new company.

30. Even more troubling than Debtors' gross mismanagement and their lack of accountability and candor is their failure to prevent the misappropriation of estate assets for the benefit of insiders. The Debtors' inability to protect estate assets from such misuse - as is expected and required of a fiduciary - is inexcusable and constitutes clear cause for the appointment of a trustee in these cases. *Savino Oil*, 99 B.R. 518.

31. In addition to the use of the Debtors' employees to staff SAF start-up matters, the Debtors' ongoing compensation of highly-paid officers and directors who are engaged in setting up a new and separate business entity improperly diverts estate resources without benefitting those to whom the officers and directors owe their best efforts and constitutes independent grounds for the appointment of a trustee. *See, In re North American Comm., Inc. (Chesapeake R&D Ltd. Partnership v. North American Comm.)* 138 B.R. 175 (Bankr. W.D. Pa. 1992) (holding that excessive compensation of insiders constituted gross mismanagement and, thus, warranted appointment of trustee).

32. Employees who are being paid to maximize the assets of the Debtors are likely to instead prioritize their work in favor of an emerging entity, owned by insider management, that may offer them future employment. The creation of this active and actual conflict-of-interest is the doing of current management, which cannot now be entrusted to perform their fiduciary obligations.

33. The Debtors have defaulted on their fiduciary obligations in these cases to act at all times in the best interests of its creditors. The Debtors can no longer reasonably be

expected or depended upon to carry out the fiduciary responsibilities of a trustee. Accordingly, the stewardship of Debtors' reorganization efforts must be turned over to an independent trustee. *Savino Oil*, 99 B.R. at 526.

**C. The Appointment of a Chapter 11 Trustee is in the Interests of Creditors - § 1104(a)(2)**

34. The Appointment of a Trustee in these cases is also in the interests of the creditors and other interests of this estate. 11 U.S.C. § 1104(a)(2).

35. The interests of creditors and of this estate require that an independent fiduciary take control of these related chapter 11 cases. Given the diversion of estate assets to an undisclosed entity owned by Debtors' top officers, creditors cannot rationally be satisfied with management that acts contrary to creditors' best interests. *See In re Sharon Steel Corp.*, 871 F.2d 1217 (3<sup>rd</sup> Cir. 1989); *In re Products International Co.*, 395 B.R. 101 (Bankr. D. Ariz. 2008).

**D. In the Alternative, an Examiner Must be Appointed to Investigate the Misappropriation of Debtors' Assets**

36. In the event the Court concludes that sufficient grounds do not exist for the appointment of a trustee under either 11 U.S.C. § 1104(a)(1) or (a)(2), this Court must direct the appointment of an examiner to conduct a broad investigation into the affairs of the Debtors.

37. Pursuant to 11 U.S.C. § 1104(c)(2), if the court does not order the appointment of a trustee under 11 U.S.C. § 1104(a), the court is required to order the appointment of an examiner:

to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if –

...

(2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed \$5,000,000.

11 U.S.C. § 1104(c)(2).

38. TMST is liable on, among other unsecured debts, a senior note for \$304,611,571 to Deutsche Bank National Trust Company; a senior subordinated note for \$1,334,176,370 to Wilmington Trust Company; and a junior note for \$23,796,641 to Wells Fargo Delaware Trust Company. Because these debts clearly exceed the \$5 million threshold of § 1104(c)(2), the appointment of an examiner under that section to investigate the affairs of the TSMT and its related debtor entities is mandatory. *See Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*(6<sup>th</sup> Cir.1990); *In re Loral Space & Communications, Ltd.*, 2004

WL 2979785 (S.D.N.Y. Dec. 23, 2004) (reversing 313 B.R. 577 (Bankr. S.D.N.Y. 2004)); *In re UAL Corp.*, 307 B.R. 80 (Bankr. N.D. Ill. 2004); *In re Mechem Fin. of Ohio, Inc.*, 92 B.R. 760 (Bankr. N.D. Ohio 1988); *In re The Bible Speaks*, 74 B.R. 511 (Bankr. D. Mass. 1987); *In re 1243 20th Street, Inc.*, 6 B.R. 683 (Bankr. D.C. 1980); *In re Lenihan*, 4 B.R. 209 (Bankr. D.R.I. 1980).

39. Pursuant to Local Bankruptcy Rule 9013-2, the United States Trustee states that he is not filing a memorandum of law in support of this motion.

**WHEREFORE**, the U.S. Trustee respectfully requests that this Court enter an order directing the U.S. Trustee to appoint a chapter 11 trustee or, in the alternative, directing the U.S. Trustee to appoint an examiner and granting such other and further relief as is just and proper.

Respectfully submitted,

W. Clarkson McDow, Jr.  
United States Trustee, Region Four

Date: September 16, 2009

By: /s/ Mark A. Neal  
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Counsel for the United States Trustee

**CERTIFICATE OF SERVICE**

**I HEREBY CERTIFY** that on September 16, 2009, a copy of the foregoing Motion of the United States Trustee for An Order Directing the Appointment Of a Chapter 11 Trustee Or, In the Alternative, an Examiner was sent via first class mail, postage prepaid to:

Those parties listed on the amended consolidated list of the 20 largest unsecured creditors (dkt. no. 58.)

According to the Court's ECF records, electronic notice of this motion should be provided to the at least the following persons:

John P. Amato  
Hugh M. Bernstein  
Todd Michael Brooks  
Frederick W. H. Carter  
Maria Ellena Chavez-Ruark  
Gregory Cross  
Deborah H. Devan  
Stephen K. Gallagher  
Edmund A. Goldberg  
Charles R. Goldstein  
Alan M. Grochal  
Joyce A. Kuhns  
Joseph Orbach  
William P. Pearce  
David E. Rice  
Susan Jaffe Roberts  
Alison M.C. Schrag  
Jeffrey L. Schwartz  
Dennis J. Shaffer  
Sumeet Sharma  
Bradley J. Swallow  
Richard Wasserman

/s/ Katherine A. Levin  
Katherine A. Levin