UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF TEXAS

In Re: Helia Tec Resources, Inc.	§	
	§	**Cause No. 13-36251**
Debtor	§	
	§	**Chapter 11**

PARTY IN INTEREST HSC HOLDINGS CO., LTD.'S EVIDENTIARY ANALYSIS AND BRIEF IN SUPPORT OF ITS AMENDED MOTION TO CONVERT PURSUANT TO 11 U.S.C. §1112(B), AND ALTERNATIVE REQUEST FOR APPOINTMENT OF CHAPTER 11 TRUSTEE PURSUANT TO 11 U.S.C. § 1104(A)

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Party in Interest HSC Holdings Co., Ltd., formerly known as GE&F Co., Ltd. ("GE&F"), files this Evidentiary Analysis and Brief in Support of its Amended Motion to Convert Pursuant to 11 U.S.C. §1112(b) and Alternative Request for Appointment of Chapter 11 Trustee Pursuant to 11 U.S.C. § 1104(a) ("Motion to Convert or Appoint Trustee"), and respectfully shows the Court the following:

INTRODUCTION

1. Cause exists for converting this bankruptcy to Chapter 7, pursuant to 11 U.S.C. § 1112(b), and, alternatively, for appointing a Chapter 11 trustee, pursuant to 11 U.S.C. § 1104(a). Further in the alternative, it is appropriate that the Court appoint a Chapter 11 examiner, pursuant to 11 U.S.C. § 1104(c), to conduct a full investigation of Debtor, including investigation of fraud, dishonesty, misconduct, mismanagement, and irregularity in the management of the affairs of Debtor by current purported management "Management").

2. Evidence presented to this Court demonstrates that Management has engaged in self-dealing and has substantial conflicts of interest that would prevent Debtor from fulfilling its fiduciary duties of a debtor-in-possession. Evidence also demonstrates that Debtor's Management is guilty of gross mismanagement, before and after the commencement of this bankruptcy; Debtor and Management have engaged in acts of dishonesty and fraud; Debtor has continuing losses, with no reasonable likelihood of rehabilitation; and Debtor has failed to make accurate and full disclosures to this Court.

3. Because "cause" has been established pursuant to Sections 1112(b) and 1104(a) and (c), the Court has the decision to determine whether conversion or

appointing a Chapter 11 trustee or examiner would best serve the interests of creditors, equity shareholders, and other interests of the estate. Given Debtor's lack of ongoing business operations and continuing losses with no reasonable expectation of rehabilitation, and given the estate's inability to pay costs associated with Chapter 11 administration, conversion to Chapter 7 best serves all relevant interests.

4. Debtor's mere hope to recover the PNG Project Interest and the purported PIA Deposit are not sufficient to defeat conversion. In fact, Debtor has not, and cannot demonstrate how the interests of creditors and the estate would best be served by Debtor remaining in possession.

BACKGROUND AND CHRONOLOGY

5. This bankruptcy is the culmination of a concerted plan executed by Debtor's Management, Cary Hughes ("Hughes") and Timothy Gallagher ("Gallagher"), to exert ultimate control over Debtor Helia Tec Resources, Inc. ("HTR") in order to gain for their themselves, by significant windfall, a piece of an oil and gas project in Papua New Guinea ("PNG Project"). A chronology of events leading up to this bankruptcy is essential to understanding the plan and the mechanism that has ultimately led to this bankruptcy.

February 2005: InterOil Corporation ("IOC") entered into an Amended and Restated Indirect Participation Interest Agreement ("2005 IPI Agreement") with investors, including Clarion Finanz AG ("Clarion"). Pursuant to the IPI Agreement, Clarion (through its affiliate Pacific LNG Operating, Ltd. ("PLNG")) indirectly participated in IOC's oil and gas exploration drilling program in Papua New Guinea ("PNG Project").

December 2006: Hughes, a U.S. Citizen, lived in South Korea and worked for GE&F's predecessor, Helia Tec Co., Ltd. ("HTC"), serving on HTC's board of directors. The HTC Board appointed Hughes to act as its agent to establish a wholly-owned subsidiary and/or branch office in the United States for the purpose of engaging in the oil and gas business in the U.S. and internationally.

January 2007: Based on Hughes' instructions, Texas attorney Walter Walne formed HTR as a Texas corporation and wholly-owned subsidiary of HTC.[1] Based also on Hughes' instructions, Walne communicated with HTC in Korea, advising the Korean parent company that "[i]n fulfillment of the recent resolution of the Board of Directors of [HTC], please be advised that [HTR], a Texas corporation was formed effective January 4, 2007. . . . The new company is being organized as a wholly-owned subsidiary of [HTC], which is to be issued 2,600 shares of stock at a price of US$100.00 per share." Stock was issued to HTC at $100.00 per share, and Hughes elected himself as HTR's sole director and president.[2]

February 2007: HTR entered into a Project Investment Agreement ("2007 PIA Agreement"), as "Investor" with Clarion and PLNG as "Sponsor," through which HTR agreed to make an initial deposit of $15 million in order to indirectly participate in the PNG Project, through the 2005 IPI Agreement. Pursuant to the 2007 PIA Agreement and 2005 IPI Agreement, HTR was required to make full and timely payment of capital cash calls, which were necessary in order to maintain its investment in the PNG Project. HTR's $15 million investment in the PNG Project was funded entirely by HTC. In exchange for HTC's investment, Hughes issued additional HTR stock to HTC, also at $100.00 per share.

June 2007: PLNG sold and assigned to HTR a 1.2% interest the 2005 IPI Agreement, in exchange for $8 million paid pursuant to the February 2007 PIA Agreement. After the June 2007 assignment, HTR maintained a $7 million deposit with PLNG and Clarion for further investment in the PNG Project, which, by the terms of the PIA Agreement, was non-refundable and subject to contract term limitations.[3]

October 2007: Hughes presided over HTR's Annual Shareholder's Meeting and passed resolutions restricting the shareholder's rights to dilute Hughes' authority, replace Hughes as HTR's "sole" director and President, and take unilateral shareholder action without Hughes' cooperation.

November 2007: Hughes hired Gallagher as HTR's Director of Finance and engaged Robert Crow ("Crow") as an HTR consultant.

2007: In addition to its initial $15 million investment in the PNG Project, HTC funded over $1.5 million to cover HTR's capital cash calls on the PNG Project, for which HTC was issued additional HTR stock, at $100.00 per share. HTC also funded HTR's purchase of Texas oil and gas interests, including interests in DeWitt and Fort Bend Counties ("Texas Properties").

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[1] *See*, March 12, 2014 Hearing Transcript ("3/12 TR") (attached as Exhibit 2), 28:1 – 29:13.
[2] *See, Id. See also,* HSC DD.
[3] *See,* 3/12 TR, 198:12 – 14.

Early 2008: HTC underwent changes in ownership and management, changing the company name to GE&F. Thereafter, relations between Hughes and GE&F management began to deteriorate and Hughes unexpectedly left South Korean, never to return to his responsibilities as a GE&F director.

April – May 2008: Without GE&F's knowledge or consent, Hughes issued 20,000 shares of HTR to himself; 10,000 shares of HTR to Gallagher; and 10,000 shares of HTR to Crow; and executed assignments of overriding royalty interests in HTR's Texas Properties to himself, Gallagher, and Crow.

May - June 2008: Capital cash calls on the PNG Project continued, which Hughes expected and insisted were GE&F's sole responsibility. Finding these continued financial commitments difficult to maintain, GE&F requested that its Korean representatives replace Hughes in direct communications with PLNG and Clarion's principal, Carlo Civelli, to discuss HTR's and GE&F's further participation in the PNG Energy Project. Hughes communicated with Civelli, noting that it "made the best business and finance sense" for HTR to transfer the PNG Project interest to GE&F and for Civelli to communicate directly with GE&F's Korean representatives.[4]

August 15, 2008: Hughes, Gallagher, and Crow agreed with GE&F management that it was in the parties' best interest to work towards a final settlement agreement, whereby Hughes, Gallagher, and Crow would separate from HTR and GE&F would regain 100% share control of HTR. While negotiating a final agreement, the parties signed a Letter of Intent, through which they resolved some of their differences pending final settlement. Hughes agreed to resume limited control over HTR, and he and Gallagher agreed to work with Clarion, PLNG, and IOS to obtain their required consent to transfer the PNG Project to GE&F. GE&F appointed M.S. Yoon to closely consult with Hughes and Gallagher on HTR business matters.[5]

August 28, 2008: Hughes advised PLNG's Civelli that GE&F management was questioning what to do with the PNG Energy Project, noting that, because of the "[t]he financial burdens associated with further capital contributions, . . . [GE&F management] would like to exit the project and sell the PNG Energy Project assets." Further, Hughes noted that he had been "asked by GE&F to commence a discussion and negotiation with [Civelli]. . .with regard to the conversion of the nonrefundable, irrevocable deposit. . . [t]he goal then would be to transfer the PNG Project assets from HTR's balance sheet to GE&F's balance sheet . . . and probably work to sell the assets to a major energy player." Hughes attached a Delegation Letter, outlining the limitations of his authority, and a form Letter of Intent, noting that "GE&F has an absolute right to request and receive the assignment . . . of the Agreements in whole from HTR to GE&F; . . ." [6]

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[4] *See*, HSC B-4.
[5] *See*, HSC B-5.
[6] *See*, HSC B-6.

October 2008: Hughes noted to GE&F consultant Yoon that HTR bankruptcy was imminent and advised Yoon that it was imperative that GE&F assume ownership of the PNG Project interest "as soon as possible if not immediately."[7]

Late 2008: By the end of 2008, the world economy was facing its most dangerous crisis since the Great Depression of the 1930's. Casualties in the United States included the entire investment banking industry, the nation's largest insurance company, and two of the nation's largest commercial banks. Carnage was not limited to the financial sector. Any company that relied on commercial credit suffered heavily. By the year's end, the demand for oil had shrunk significantly, with oil prices falling from a July 2008 high of $147.00 per barrel to December 2008's low of $32.00 per barrel.[8]

Late 2008 – Early 2009: Hughes and Gallagher and GE&F and HTR continued efforts toward a final settlement concerning HTR assets, management, and ownership.

February 2, 2009: On behalf of HTR, Hughes entered into a $200,000.00 Loan Agreement and Revolving Credit Promissory Note ("Insider Loan") with Hughes, Gallagher, and Mastodon Operating, L.L.C. ("Mastodon Operating"), along with other instruments purporting to grant security interests in the Texas Properties and other HTR assets to the Insider Loan lenders.[9] Mastodon Operating and Mastodon Resources, L.L.C. ("Mastodon Resources") are controlled by Hughes and Gallagher and wholly-owned by Mastodon Energy Partners, L.L.C. ("Mastodon Energy"), which is owned and controlled by Hughes and Gallagher.[10]

February 18, 2009: HTR and GE&F as "Assignor" and PLNG as "Assignee" entered into an Assignment, through which the PNG Project assets were assigned to PLNG ("February 2009 Assignment").

February 27, 2009 (effective date): Hughes and Gallagher entered into a Consulting Service Agreement with Yoon, agreeing that Yoon would work directly with Hughes and Gallagher during the settlement process with GE&F, and Hughes and Gallagher agreed to pay Yoon a contingent fee with HTR funds received from the settlement.[11]

March 1, 2009: Hughes and Gallagher as "Employees" and GE&F and HTR as the "Company" entered into a Settlement, Release of Claims, and Indemnity Agreement ("March 2009 Settlement Agreement"),[12] agreeing that:

- Employees would relinquish their HTR employment agreements and declare them null and void, in exchange for mutual releases signed by all parties;

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[7] *See,* HSC B-7.
[8] *See,* Tuttle, "Oil Ministers See Demand Rising," Bloomberg, June 2010.
[9] *See,* HSC PP (Bates Nos. HG02439 – 471). *See also*, HSC E.
[10] *See,* 3/12 TR, 167:20 – 169:25.
[11] *See*, HSC KK.
[12] *See,* HTR 4.

- Employees would redeem their HTR stock for $3,0000.00;
- Company would assign the Texas Properties to Employees, in exchange for Employees' assumption of Texas Assets' "intrinsic" liabilities;
- HTR and GE&F would be responsible for certain HTR debts listed in Exhibit C to the agreement;
- HTR and GE&F would pay $200,000.00 of the debts listed on Exhibit C by March 5, 2009 ("$200,000.00 HTR Debt Payment");
- HTR and GE&F would pay remaining debts listed on Exhibit C on April 1, 2009 and May 1, 2009 ("Remaining HTR Debt Payments"); and
- Employees would resign their positions from HTR upon fulfillment of the Company's March 5th $200,000.00 HTR Debt Payment.

Both Employees and the Company signed a "Mutual Release and Indemnification," "Exhibit A" to the March 2009 Employee Settlement Agreement ("Release"), which specifically provided that "[t]he Employees hereby accept the assignment of the Texas Assets conveyed hereunder subject to (i) all of the terms and conditions hereof, and (ii) all of the terms and provisions of the Company regulations."[13]

March 3 and 9, 2009: "Subject to all of the terms and conditions" of the Release,[14] Hughes and Gallagher accepted assignment of the Texas Properties then immediately assigned the Texas Properties to Mastodon Resources, which remains the record owner of the Texas Assets assigned to Hughes and Gallagher pursuant to the March 2009 Settlement Agreement.[15]

March 27, 2009: Hughes met with IOC's Phil Mulacek and learned that GE&F had sold the PNG assets before March 2009 to PLNG.[16]

April 24, 2009: GE&F wired the $200,000.00 HTR Debt Payment to HTR's account, and Hughes made no effort to return to GE&F the $200,000 HTR Debt Payment.[17]

April 25, 2009: Gallagher wrote over $186,000.00 in checks on the HTR's account against the $200,000.00 HTR Debt Payment to himself, Hughes, and Mastodon Resources.[18]

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[13] *See, Id.*, attached "Exhibit A."
[14] *See, Id.*
[15] *See*, HSC F1a – F2b. *See also*, January 30, 2014 hearing transcript ("1/30 TR") (attached as Exhibit 1), 41:8 – 21; April 16, 2014 hearing transcript ("4/16 TR") (attached as Exhibit 3), 77:12 -18; 78:9 – 13.
[16] *See,* HTR 24. *See also,* 4/16 TR, 139:25 – 140:1.
[17] *See,* 1/30 TR, 49:8 – 10; 50:8 - 13; 52:16 - 17.
[18] *See*, HTR 8. *See also,* 1/30 TR, 49:8 – 11.

April 29, 2009: Hughes refused to resign from HTR or sign board resolutions effecting the change of HTR control.[19] Hughes and Gallagher did not return the $200,000 HTR Debt Payment to GE&F or the $186,000.00 in payments they received from the $200,000.00 HTR Debt Payment.[20] Hughes and Gallagher did not return the Texas Properties to HTR.[21]

May 9, 2009: Hughes hired Richard Battaglia ("Battaglia"), who filed a lawsuit suit against GE&F, PLNG, Clarion, and IOC, seeking to invalidate the February 2009 Assignment and claiming damages against GE&F and PLNG ("Federal District Court Action").[22]

June 3, 2009: Having accepted assignment of the Texas Properties "subject to" the Release attached to the March 2009 Employee Settlement Agreement and failing to return these properties to HTR,[23] Hughes and Gallagher breached the Release and March 2009 Employee Settlement Agreement by filing a federal court lawsuit, alleging that they sustained personal damages as a result of the February 2009 Assignment of the PNG Project Interest, and this action was later consolidated with the Federal District Court Action.[24]

June 15, 2009: Hughes authorized the issuance of HTR stock at $0.10 per share to himself and Gallagher, as alleged "reduction in deferred payroll account of the Company"; issuing 300,000 shares to himself and 150,000 shares to Gallagher.[25]

August 12, 2009: Through Battaglia, Hughes and Gallagher refused GE&F's tender of $3,000.00 for HTR stock and refused GE&F's request for HTR creditor information so that GE&F could make final payment of HTR's creditors pursuant to the March 2009 Settlement Agreement.[26]

August 19, 2009: Hughes presided over a purported HTR shareholder meeting, without participation of or written proxy from GE&F. Noting that "shareholders are aware of the perilous financial condition" of the Company, the minutes noted that participating shareholders voted, among other things, "re-elected" Hughes as Director and extended his "appointment" as President for two years; "elected" Gallagher Director and appointed him Vice President and Treasurer for two years; "authorized" Hughes and Gallagher to receive assignment and benefit of advances made on behalf of the Company by Directors and Officers; granted Hughes indemnification for all legal expense and authorized Company accounting for such expenses as accounts payable; increased common shares to 50 million; extended Gallagher's employment contract and increased his annual salary from $90,000 to $120,000; extended Hughes' employment contract and "reconfirmed"

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[19] *See,* HTR 27.
[20] *See*, 1 /30 TR, 50:8 – 13; 3/12 TR, 95:8 – 12.
[21] *See,* 1/30 TR, 52:18 – 21; 3/12 TR, 94:6 – 13.
[22] *See, e.g.*, 3/12 TR, 49:22 – 50:3.
[23] *See,* HTR 4, "Exhibit A"; 1/30 TR, 52:18 – 21; 3/12 TR, 94:6 – 13.
[24] *See*, HSC Q.
[25] *See,* 4/16 TR, 132:13 – 21.
[26] *See,* HSC Y (Jewell and Battaglia letters). *See also*, 3/12 TR, 90:3 – 7.

his $180,000 annual salary; and declared the February 2009 Assignment a "fraudulent conveyance."[27]

September 9, 2009: GE&F filed its Third Party Complaint in the Federal Court District Action against Hughes and Gallagher seeking a declaratory judgment that Hughes and Gallagher are no longer shareholders or officers or directors of HTR, based on the March 2009 Employee Settlement Agreement, and that all corporate actions taken by Hughes since April 24, 2009 are ultra vires and invalid.[28]

October 2, 2009: Hughes and Gallagher signed a "Mutual Settlement, Anti-Dilution, and Release Agreement" with Robert Crow, and Hughes issued 150,000 HTR shares to Crow, at $0.10 per share, for a $15,000 reduction of the $30,000 settlement to Crow.[29]

January 1, 2011: HTR, as "Borrower," and Hughes, Gallagher, and Mastodon Operating, as "Lender," entered into the First Amendment of the February 2, 2009 Insider Loan, extending the Insider Loan term for an additional two years and increasing the borrowing base amount from $200,000.00 to $2 million, "not to exceed" $2.2 million.[30]

September 20, 2011: Judge Melinda Harmon dismissed the Federal District Court Action in its entirety without prejudice, finding that disposition of the suit would necessarily result in a determination of ownership of the PNG Project Interest, an interest to which an absent party, PLNG, "currently holds title." *See, Helia Tec Resources Inc. v. GE&F Co., Ltd.*, No. H-09-1482, 2011 U.S. Dist. LEXIS 106453, *10 (S.D. Tex. Sept. 20, 2011).

October 27, 2011: HSC filed the shareholder derivative suit, asserting, among other claims, breach of fiduciary duty, statutory and common law fraud, and conspiracy against Hughes, Gallagher, Crow, Mastodon Operating, Mastodon Resources, and Mastodon Energy Partners, LLC (collectively, "Mastodon Entities") and Sendex Energy, LLC ("Sendex"), seeking on HTR's behalf monetary damages and a constructive trust over HTR shares issued by Hughes to himself, Gallagher, and Crow and over the Texas Properties and revenues from the oil and gas properties now owned by Mastodon Resources.[31]

December 2, 2011: Hughes engaged Battaglia to represent HTR, the putative derivative plaintiff, and defendants Mastodon Entities and defendant Sendex Energy, LLC ("Sendex") in the Shareholder Derivative Suit.[32]

January 12, 2012: Battaglia served an arbitration demand on GE&F, PLNG, Clarion, and IOC, all former defendants in the Federal Court Action, seeking to arbitrate the

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[27] *See,* HSC JJ.
[28] *See*, HSC J.
[29] *See,* HSC II.
[30] *See,* HSC PP (Bates Nos. HG02474 – 475).
[31] *See*, HSC H.
[32] *See*, HSC X.

validity of the February 2009 Assignment, an identical claim as that litigated and ultimately dismissed in the Federal District Court Action.[33]

March 1, 2012: Battaglia requested that the arbitration be placed on "temporary hold" pending resolution of procedural matters in the Shareholder Derivative Suit.[34]

September - October, 2012: Judge Melinda Harmon reinstated GE&F's Third Party Claims and Hughes' and Gallagher's Consolidated Claims against GE&F and issued a new Scheduling Order, setting the trial date for February 2014.

November and December 2012 and January and April 2013: Battaglia requested that the ICDR Case Manager continue to maintain a hold on the arbitration pending a ruling on abatement of the Shareholder Derivative Suit and the "individual claims of the officers and GE&F" in the Federal District Court Action, "which are back on the docket."[35] Except for Battaglia's initial demand, no action has been taken in the arbitration.[36]

January 1, 2013: HTR, as "Borrower," and Hughes, Gallagher, and Mastodon Operating, as "Lenders," entered into the Second Amendment of the February 2, 2009 Insider Loan, extending the loan term for an additional two years and adopting "[a]ll amounts currently outstanding and owed to Lender under the Agreement."[37]

February 7, 2013: The 135th Judicial District Court, DeWitt County, Texas, abated the Shareholder Derivative Suit, based on Judge Harmon's reinstatement of claims in the Federal Court Action.

September 20, 2013: GE&F filed motions to dismiss Hughes' and Gallagher's Consolidated Claims, based on lack of standing and necessary parties. These motions, along with the Federal District Court Action, are stayed as a result of this bankruptcy proceeding.

LEGAL STANDARD

6. The Bankruptcy Code authorizes the Court, based on "cause," to convert a Chapter 11 case to a Chapter 7 case or dismiss the case altogether, "whichever is in the best interest of creditors and the estate, for cause . . . ." *See,* 11 U.S.C. § 1112(b). Section 1112(b)(4) includes a list of non-exhaustive circumstances that would constitute "cause" authorizing conversion or dismissal, and "cause" may include any other reason

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[33] *See*, HSC I. *See also, Helia Tec Resources Inc. v. GE&F Co., Ltd.,* 2011 U.S. Dist. LEXIS 106453.
[34] *See*, HSC Z.
[35] *See*, HSC Z. *See also*, 3/12 TR, 126:18 – 127:8
[36] *See,* 3/12 TR, 125:1 – 3.
[37] *See*, HSC PP (Bates Nos. HG02472 -473).

that makes conversion to chapter 7 more beneficial to creditors than remaining in chapter 11. *See, In re Faith Empowered, LLC*, No. 09-30173-H3-11, 2011 Bankr. LEXIS 3530 (Bankr. S.D. Tex. Sept. 13, 2011). Courts are to consider the "totality of the circumstances" when determining whether there is cause pursuant to Section 1112(b). *Matter of Atlas Supply Corp.*, 857 F.2d 1061 (5th Cir. 1988). Section 1112(b) also provides that the court may, as an alternative, appoint a Chapter 11 trustee pursuant to 11 U.S. C. § 1104(a), if it is in the best interests of creditors and the estate to do so. *See,* 11 U.S. C. §§ 1112(b). Section 1112(b)(1) indicates that Chapter 11 cases can and should be converted before they move to confirmation if cause is established and there are no unusual circumstances or statutory exceptions established. *See, In re Keeley*, 460 B.R. 520, 547 (Bankr. D.S.D. 2011). Once cause exists for conversion, it is within the discretion of the Bankruptcy Court whether or not to convert based upon the best interests of the estate and creditors, and the court's decision will be overturned only for abuse of discretion. *In re Fraidin*, 188 B.R. 529 (Bankr. D. Md. 1995).

7. Once the movant shows cause for conversion, the court should convert the case, unless it finds and specifically identifies "unusual circumstances" establishing that conversion is not in the best interests of creditors and the estate ***and*** Debtor establishes that (a) there is a reasonable likelihood that a plan will be confirmed within a reasonable period of time; and (b) the grounds for converting include an act or omission, other than under Section 1112(b)(4)(A), (i) for which there is a reasonable justification for the act or omission and (ii) that will be cured within a reasonable period of time fixed by the Court. *See,* 11 U.S.C. § 1112(b)(2). *See also, In re Domiano*, 442 B.R. at 107; *In re Gateway Solutions, Inc.*, 374 B.R. at 566; *In re Keeley*, 536 – 37. Section 1112(b)(2) does not

define "unusual circumstances." *See*, 11 U.S.C. § 1112(b)(2). Courts have noted that the phrase "contemplates conditions that are not common in Chapter 11 cases." *In re Keeley*, 460 B.R. at 537, citing *In re Pittsfield Weaving Co.*, 393 B.R. 271, 274 (Bankr. D. N.H. 2008).

8. The Bankruptcy Code also provides two justifications for the appointment of a Chapter 11 Trustee. *See,* 11 U.S. C. § 1104(a). The first justification is for "cause," which includes fraud, dishonesty, incompetence, or gross mismanagement, either before or after commencement of the bankruptcy proceeding. *See, Id.,* § 1104(a)(1). The second justification is when the court determines that appointment of a trustee is in the best interest of creditors, equity security holders, and other interests of the estate. *See, Id.,* § 1104(a)(2). "Determinations to appoint a trustee pursuant to Section 1104 (a)(1) are fact intensive." *In re Sun Cruz Casinos, LLC*, 298 B.R. 821, 830 (Bankr. S.D. Fla. 2003), citing *In re Bellevue Place Assoc.,* 171 B.R. 615, 622 (Bankr. N.D. Ill 1994). "In addition to Section 1104(a)(1)'s enumerated examples of conduct constituting cause -- fraud, dishonesty, incompetence or gross mismanagement -- courts have found cause to appoint a trustee based on (1) materiality of the misconduct; (2) evenhandedness or lack of same in dealings with insiders or affiliated entities vis-à-vis other creditors or customers; (3) the existence of pre-petition voidable preferences or fraudulent transfers; (4) unwillingness or inability of management to pursue estate causes of action; (5) conflicts of interest on the part of management interfering with its ability to fulfill fiduciary duties to the debtor; (6) self-dealing by management or waste or squandering of corporate assets." *Id.*, citing *In re Matter of Intercat, Inc.,* 247 B.R911, 921 (Bankr. S.D. Ga. 2000). The court's appointment of a Chapter 11 trustee is reviewable only for abuse of

discretion. *In re Cajun Elec. Power Coop., Inc.*, 69 F.3d 746, (5th Cir. 2995), as amended, 74 F.3d 599 (5th Cir. 1996).

9. Section 1104 also authorizes the Court to appoint a Chapter 11 examiner, instead of a Chapter 11 trustee, 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 (1) such appointment is in the interests of creditors, any equity security holders, and other interests of the estate; or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5,0000." 11 U.S.C. § 1104(c).

ARGUMENT AND AUTHORITIES

I. "Cause" Exists For Converting this Case or Appointing a Chapter 11 Trustee.

10. GE&F has presented this Court with significant evidence that "cause" exists for converting this case to Chapter 7, pursuant to 11 U.S. C. § 1112(b), or, alternatively, appointing a Chapter 11 trustee pursuant to 11 U.S. C. § 1104(a).

A. Conflicts of Interest and Self-Dealing

11. Conflicts of interest and self-dealing provide "cause" for conversion pursuant to Section 1112(b). *See, e.g., In re Starmark Clinic*, No. 08-35865-H3-11, 2008 Bankr. LEXIS 2722 (Bankr. S.D. Tex. Oct. 20, 2008); *In re Natural Plants*, 68 B.R. 394 (Bankr. S.D.N.Y. 1986); *In re Graf*, 19 B.R. 269 (Bankr. D. Maine 1982). *See also*, *In re New Millenium Mgmt., LLC*, No. 13-35710-H3-11, 2014 Bankr. LEXIS 734, (Bank. S.D. Tex. Feb. 25, 2014) (self-dealing giving "cause" for conversion or appointment of Chapter 11 trustee, granting Section 1104 motion based on debtor's ongoing operations).

Conflicts of interest and self-dealing also provide "cause" for appointing a Chapter 11 trustee pursuant to Section 1104(a). *See, Id. See also, In re Cajun Electric Power Coop., Inc.*, 69 F.3d 746 (5th Cir. 1995), adopting dissenting opinion and affirming Ch. 11 appointment, 74 F.3d 599 (5th Cir. 1996); *In re New Towne Dev., LLC,* 404 B.R. 140 (Bankr. M.D. La. 2009); *In re Patman Drilling Internat'l*, 2008 Bankr. LEXIS 715. Conflicts "suffered by the estate" that interfere with its ability to carry out the fiduciary obligations of a debtor-in-possession have a significant bearing on the court's decision to appoint a Chapter 11 trustee. *See, Sun Cruz Casinos, LLC*, 298 B.R. 821, 830 (Bankr. S.D. Fla. 2003), citing *In re Matter of Intercat, Inc.*, 247 B.R. at 921.

12. Evidence of conflicts of interest and/or self-dealing that provide "cause" for converting to Chapter 7 or appointing a Chapter 11 trustee include:

- Debtor's failure to disclose lease arrangements with management's affiliates to the bankruptcy court. *See, e.g., In re New Millenium Mgmt., LLC*, 2014 Bankr. LEXIS 734 at *15 – 16 (appointing Chapter 11 trustee, but also finding "cause" for conversion).

- Management holding the majority of the purported debt. *See*, *In re Starmark Clinic,* 2008 Bankr. LEXIS 2722 at * 8 (converting to Chapter 7); *In re New Towne Dev., LLC,* 404 B.R. at 149 (appointing Chapter 11 trustee).

- Debtor paying management excessive management fees, while paying nothing to non-insider creditors. *See, In re Starmark Clinic.*

- Pending litigation against current management addressing issues of management control. *See, Id.*

- Questions raised concerning debtor's ability to act impartially concerning affiliate debts and transfers to affiliates and management. *See*, *In re Natural Plants,* 68 B.R. at 396 (conversion to Chapter 7); *In re Patman Drilling Internat'l*, 2008 Bankr. LEXIS 715 at *11 – 12 and 16 – 17 (noting that insider relationships have characteristics of self-dealing, appointing a Chapter 11 trustee); *In re Vaughan*, 429 B.R. 14, 28 (Bankr. D. N.M. 2010) ("[A] history of transactions with companies affiliated with the debtor company is sufficient cause for the appointment of a trustee where the best interests of the creditors require"); *In re Sharon Steel Corp.*, 86 B.R. 455 (appointing Chapter 11 trustee).

- Affairs of debtor closely intertwined with those of other entities involving the same principals, so that principals could not be disinterested in their management of debtor. *See, In re McCorhill Publ., Inc.*, 73 B.R. 1013 (Bankr. S.D.N.Y. 1987) (appointing Chapter 11 trustee).

13. There are conflicts of interest concerning Management that will interfere with Debtor's ability to carry out the fiduciary obligations of a debtor-in-possession. *See, Wolf v. Weinstein,* 372 U.S. 633, 649-652, 83 S. Ct. 969, 979-981, 10 L. Ed. 2d 33 (1963) ("[I]f a debtor remains in possession – that is, if a trustee is not appointed – the debtor's directors bear essentially the same fiduciary obligations to creditors and shareholders as would the trustee for a debtor out of possession"). *See also, Sun Cruz Casinos, LLC*, 298 B.R. at 830. These conflicts include:

- **Conflicted Management:** Hughes claims to be the President and "Sole Director" of HTR.[38] Gallagher maintains that he is Vice President and Treasurer of HTR.[39] Hughes and Gallagher own 100% of Mastodon Energy, which owns Mastodon Operating and Mastodon Resources.[40] Hughes and Gallagher control all three Mastodon Entities.[41] Mastodon Resources owns the Texas Properties, assigned by Hughes and Gallagher in an apparent attempt to circumvent the terms of the Release attached to the March 2009 Employee Settlement Agreement.[42] Hughes, Gallagher, and Mastodon Operating claim to be Debtor's largest secured creditors.[43] Mastodon Operating and Gallagher also claim to hold unsecured debt as well.[44]

- **Necessary Investigation and Potential Claims Against Management**: The estate must investigate and, potentially, pursue claims against Hughes, Gallagher, and the Mastodon Entities based on insider transactions and acts of self-dealing, including:

    - **The Insider Loan**: Through the February 2009 Insider Loan from Hughes, Gallagher, and Mastodon Operating, HTR has accrued five years' worth of purported secured debt for large executive salaries, personal litigation costs, and

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[38] *See,* Petition. *See also*, 1/30/14, 54:15.
[39] *See,* 3/12 TR, 160:22 – 25.
[40] *See,* 3/12 TR, 168:8 –169: 25.
[41] *See, Id.*
[42] *See,* HTR 4, "Exhibit A" (Hughes and Gallagher agreed to release GE&F and HTR from all claims "arising from . . . the Working Relationship or otherwise," and specifically agreed that they "hereby accept the assignment of the Texas Assets conveyed hereunder subject to . . . all of the terms and conditions hereof").
[43] *See*, Petition, Schedule D.
[44] *See, Id.,* Schedule F.

other administrative expenses as "involuntary advances" under the loan terms.[45] Through two extensions, as recently as January 2013, the Insider Loan term has been extended and the lending limit expanded from $200,000.00 to $2.2 million.[46] The Insider Loan is purportedly secured by Deeds of Trust and Assignments of Net Profits Interest on the Texas Properties and other security instruments.[47] Purported security agreements associated with the Insider Loan are the noted bases for insiders' alleged secured claims.[48]

- **Transfer of the Texas Properties**: In March 2009, HTR assigned all of its income-producing Texas oil and gas properties to Hughes and Gallagher, who promptly assigned these property interests to Mastodon Resources.[49] Although Hughes and Gallagher obtained the properties pursuant to the March 2009 Employee Agreement and pursuant to the Release,[50] they have renounced the settlement agreement and asserted claims against GE&F, but failed to return the properties to HTR.[51] Since the 2009 transfer of the Texas Properties, HTR has ceased to engage in domestic oil and gas business.[52] Any net profits received from the Texas Properties, as recently as December 2012, have been paid to Mastodon Resources, and no net profits have been credited against HTR's alleged accumulating debt on the Insider Loan.[53]

- **The April 2009 Cash Payments:** In April 2009, following GE&F's $200,000.00 HTR Debt Payment, Hughes and Gallagher accepted over $162,000.00 in payments from HTR's account, and Gallagher paid over $23,000.00 to Mastodon Resources.[54] These payments reflected purported HTR debts owed to Hughes, Gallagher, and Mastodon Resources pursuant to the March 2009 Employee Settlement Agreement.[55] Although Hughes maintains that the March 2009 Employee Settlement Agreement is not valid and that he and Gallagher have no obligation to abide by its terms, he has not returned any of the funds that he, Gallagher, and Mastodon Resources received in April 2009.[56]

- **The June 2009 Stock Issuances**: After renouncing the March 2009 Employee Settlement Agreement, refusing to resign from HTR, and filing lawsuits against

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[45] *See,* HSC PP (Bates Nos. HG02443 – 45). *See also*, 3/12 TR, 191:12–17; 249:2 – 14; 251:14 – 20; 252:12 -19; 4/16 TR, 53:10 – 54:6, 54:11 – 16; 59:18 – 21; 101:4 – 11; 105:21 – 106:1; 107:4 - 7.
[46] *See,* HSC PP (Bates Nos. HG02472 - 475).
[47] *See*, Exhibits E and PP.
[48] *See*, Petition, Schedule D.
[49] *See,* HSC F1a – F-2b.
[50] The Release associated with the March 2009 Employee Settlement Agreement expressly provided that "Employees hereby accept the assignment of the Texas Assets conveyed hereunder subject to . . all of the terms and conditions hereof. . . ." *See,* HTR 4, attached Exhibit A. *See also, Id.,* attached Exhibit B.
[51] *See,* HTR 4, "Exhibit A" and Exhibit B"; 1/30 TR, 41:12 – 21; 52:18 – 21; 3/12 TR, 94:6 – 13; 163:5 – 13.
[52] *See,* 3/12 TR, 206:2 – 5.
[53] *See*, 4/16 TR, 68:21 – 23; 72:17 – 20, 25 – 73:5, 16 – 74:4.
[54] *See,* HTR Exhibit 8. *See also*, 1/30 TR, 56:14 – 57:5.
[55] *See*, HTR Exhibit 4, attached Exhibit C.
[56] *See,* 1 /30 TR, 50:8 – 13; 3/12 TR, 95:8 – 12.

GE&F and others to invalidate the February 2009 Assignment and against GE&F to recover personal damages, Hughes issued 300,000 HTR shares to himself and 150,000 shares to Gallagher, at par value of $0.10 per share, based on total consideration (alleged unpaid salary) totaling $45,000.00.[57] Based on those stock issuances, Hughes and Gallagher now claim that they own approximately 60% of HTR.[58]

- **The Informal Office Lease Arrangement**: Pursuant to an informal, unwritten agreement not previously disclosed to the Court, Debtor is subletting portions of its office suite to Mastodon Entities, Richard Battaglia, and Mr. Kim.[59] Based on the Insider Loan "involuntary advance" provisions, Mastodon Operating pays the rent to the landlord, then credits HTR on the loan agreement for Mastodon Operating's portion.[60] As of March 12, 2014, Debtor has been in default under the terms of the Lease for failing to obtain landlord's consent to subtenants, having failed to pay all rent required under the Lease, and having filed for bankruptcy.[61] Pursuant to the Office Lease terms, only Debtor is liable to landlord for any breach of the lease.[62] This arrangement places on Debtor full and exclusive liability for what is, essentially, Mastodon's office suite.[63] While HTR "occupies" a conference room with a table and chairs, all other parts of the office space are occupied by parties other than Debtor.[64]

- **Litigation Conflicts**. There are pending litigation issues that significantly impact Debtor, its Management, and its shareholders:

  - **Debtor's Claim to Recover the PNG Project Interest and PIA Deposit.** Management maintains that it has "sustained" HTR for the past 5 years for the purpose of "clearing the title to its assets," purportedly the PNG Project Interest and the purported PIA Deposit, which Debtor claims as its only significant assets.[65] HTR's Federal District Court claims against GE&F, PLNG, Clarion, and IOC to invalidate the February 2009 Assignment of the PNG Project Interest were first filed in May 2009 and were dismissed without prejudice in September 2011.[66] Hughes and Gallagher authorized Battaglia to assert the same claims via arbitration in January 2012.[67] Nothing has prevented Debtor from pursuing its arbitration claims, however meritless they may be, since 2012.[68] However, the

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[57] *See*, 4/16 TR, 133:10 – 19.
[58] *See*, Petition, SOFA, No. 21.
[59] *See*, 3/12 TR, 180, 1 – 6; 182:1 – 6; 183:2 – 5, 11 – 25; 273:14 – 19.
[60] *See, Id.,* 191:12 - 23.
[61] *See,* Exhibit BBB; and 3/12 TR, 189:1 – 191:7.
[62] *See, Id. See also*, 3/12 TR, 183:18 – 25.
[63] 3/12, 54:24 – 55:1; 188:1 – 13.
[64] *See, Id.*, 180:12 – 16; 193:23 – 195:3.
[65] *See*, Petition, Schedule B. *See also*, 3/12 TR, 204:14 – 15; 4/16 TR, 102:25 – 104:8.
[66] *See,* 3/12 TR, 49:20 – 50:5.
[67] *See*, HSC Exhibits I and Z.
[68] Initially, the state district court presiding over the Shareholder Derivative Suite issued a temporary restraining order precluding HTR from proceeding with the arbitration. However, the TRO expired by its own terms, with no injunction precluding HTR from moving forward with the arbitration.

arbitration has been effectively stalled for over two years, as a result of Battaglia's numerous requests to stay the action pending resolution of other litigation matters, including Hughes' and Gallagher's personal claims against GE&F.[69]

- **Management's Pursuit of its Personal Claims.** In a parallel federal court action, eventually consolidated with the Federal District Court Action, Hughes and Gallagher have sought personal gain based on the February 2009 Assignment.[70] Among other claims asserted in their personal suit against GE&F, Hughes and Gallagher seek a constructive trust over payments by PLNG for the 2009 Assignment of the PNG Project Interest, as well as monetary damages.[71]

- **Hughes and Gallagher Place Their Interests Before Debtor's.** On two occasions, Hughes and Gallagher have sought, through separate counsel representing HTR and Hughes and Gallagher, to broker a global settlement, through which they would benefit personally and Debtor's claims against GE&F, PLNG, Clarion, and IOC would be dismissed with prejudice.[72]

- **Management Seeks to Hire Conflicted Counsel.** Debtor previously retained and, in this proceeding, Debtor has requested that the Court approve Richard Battaglia as "special counsel" to represent Debtor in its pursuit of claims asserted in the arbitration.[73] This request has been withdrawn, based on Battaglia's failure to disclose his many affiliations with Management and its affiliated companies. Management's retention of Battaglia to simultaneously represent the Mastodon Entities as Defendants and Debtor as putative derivative Plaintiff demonstrates Management's placing their own interests before those of Debtor.[74]

- **Hughes is Conflicted From Representing Debtor's Interests in Any Proceeding Seeking to Invalidate the 2009 Assignment.** Hughes played a significant role in initiating, brokering, and encouraging the assignment and PLNG's purchase of the PNG Project Interest.[75] Hughes will be a likely fact witness in any proceeding on behalf of Debtor to invalidate the assignment and, in all likelihood, will be involved in that proceeding as a responsible third party.

- **The Shareholder Derivative Suit.** Inherent conflicts of interest would prevent Management from fulfilling its fiduciary duties to pursue the Shareholder Derivative Suit in the best interests of the estate, its creditors, and its equity holders: [76]

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[69] *See*, Exhibit Z.
[70] *See*, Exhibit Q. *See also*, 3/12 TR, 8:18 – 9:2.
[71] *See,* Exhibit Q.
[72] *See,* Exhibits O and P.
[73] *See,* Docket No. 31.
[74] *See, Id. See also*, HSC Exhibit X.
[75] *See*, HSC Exhibits B-4, B-5, B-6, and B-7.
[76] *See, Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233, 251 (5th Cir. 1988) (debtor-in-possession has the duty and obligation to pursue choses in action for the benefit of all creditors and shareholders). Although a shareholder derivative suit may be pursued by debtor's creditors' committee, in

- **Management and Their Chosen Counsel are Conflicted.** Hughes, Gallagher, and the Mastodon Entities are named defendants in the Shareholder Derivative Suit pending in DeWitt County District Court.[77] Battaglia represents Debtor, the beneficiary of shareholder derivative claims, and the Mastodon Entities and Sendex Energy, defendants in the Shareholder Derivative Suit and alleged creditors in this bankruptcy proceeding.[78]

- **Management Has Signified its Intent Not to Pursue the Shareholder Derivative Suit.** Debtor failed to list the Shareholder Derivative Suit as an asset of Debtor.[79] Further, Battaglia, who seeks to be "special counsel" to represent Debtor in litigation to "help" Debtor "deal with the Korean issues," has already formulated an opinion concerning the validity of the Shareholder Derivative Suit claims, stating "we didn't believe in the validity of your client's position to even – standing to assert a claim."[80]

- **Issues of Debtor Control Remain.** Significant issues concerning Management's legitimate control and ownership of Debtor remain unresolved. These issues are not only raised in the Shareholder Derivative Suit, but are also raised in GE&F's claims asserted in the Federal Court Action.[81] The presence of these unresolved claims concerning this Debtor strongly favors conversion of this case to Chapter 7 or the appointment of a Chapter 11 trustee or examiner. *See, e.g., In re Starmark Clinic*, 2008 Bankr. LEXIS 2722 at *8, *et seq*. (converting case to Chapter 7, based in part on remaining issues concerning who controls debtor, which issues were the subject of pending state court); *In re Concord Coal Corp.*, 11 B.R. 552, (Bankr. S.D. W.V. 1981) (appointing Chapter 11 trustee, based in part on ongoing disputes concerning Debtor's management, noting that "the diversion of attention to [the litigation concerning management's dealings with other shareholders], does not enhance the ability of [management] to manage this troubled Debtor"); *In re Gillman Servs., Inc.*, 46 B.R. at 328 (appointing a Chapter 11 examiner, based in part on management's election not to pursue potential causes of action management's self-dealing and relating to management's sale of the debtor's principal assets to affiliates).

B. Gross Mismanagement

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the event of conflicted management, creditor-driven litigation is not appropriate in this bankruptcy proceeding. There is no creditors' committee. Even if there was a group of non-insider creditors available or willing to pursue the derivative suit, there is no compelling reason to keep management in charge of Debtor, with no business operations, no income-generating assets, and no intent to rehabilitate this corporate shell of a debtor, while the shareholder derivative suit is pursued against management. *See, e.g., In re PRS Ins. Group, Inc.*, 274 B.R. 381, 388 (Bankr. D. Del. 2001), citing *In re Fiesta Homes*, 125 B.R. 321, 326 (Bankr. S.D. Ga. 1990).

[77] *See*, Exhibit H.

[78] *See*, HSC H and X. *See also,* Petition, Schedules D and F.

[79] *See*, Petition, Exhibit B.

[80] *See,* 3/12 TR, 119:11 – 13.

[81] *See,* HSC J and Q.

14. "Gross mismanagement" by current management of debtor, post-petition, is an enumerated cause for conversion pursuant to Section 1112(b). *See*, 11 U.S.C. § 1112(a)(4)(B). *See also, In re ARS Analytical, LLC*, 433 B.R. 848, 864 (Bankr. D. N.M 2010). "Gross mismanagement," before and after filing bankruptcy, gives "cause" for appointing a Chapter 11 trustee pursuant to Section 1104. *See*, 11 U.S.C. § 1104(a)(1). *See also, in re William A. Smith Constr. Co.*, 77 B.R. 124, 126 (Bankr. N.D. Ohio 1987).

15. The following actions taken by management are acts of "gross management" giving "cause" for conversion and/or appointment of a Chapter 11 trustee:

- Failure to pay taxes, especially when the failure leads to liability for interest and penalties. *See, In re Moore Construction, Inc.* 206 B.R. 436, 437 (Bankr. N.D. Tex. 1997) (failure to pay taxes, pre- and post-petition, ordering conversion); *In re Euro-American Lodging Corp.*, 365 B.R. 421, 426 (Bankr. S.D.N.Y. 2007) (debtor's failure to pay any corporate income, franchise, real estate, or sales taxes for seven years, appointing Chapter 11 trustee), citing *In re Evans*, 48 B.R. 46, 48 (Bankr. W.D. Tex. 1985) (appointing Chapter 11 trustee); *In re Great Northeastern Lumber & Millwork Corp.*, 20 B.R. 610, 611 (Bankr. E.D. Pa. 1982) (appointing Chapter 11 trustee).

- Continuing losses post-petition, causing further harm to creditors and other parties in interest and revealing that management cannot achieve the goal of reorganization. *See, In re Sharon Steel Corp.,* 86 BR 455, 465 - 66 (Bankr. W.D. Pa. 1988) (appointing Chapter 11 trustee).

- Management's failure to seek bankruptcy earlier, so that "judicial supervision" could have been used to assure the company's continued existence. *See, Id.,* at 461.

- Management's failure to maintain complete and accurate financial records and failure to substantiate undocumented transactions. *See, In re Domiano*, 442 B.R. 97, 105 - 06 (Bankr. M.D. Pa. 2010) (converting to Chapter 7).

- Executing transactions without bankruptcy court approval. *See, Id.*

- Post-petition "informal borrowing" not approved by the bankruptcy court. See, *In re Gateway Access Solutions, Inc.*, 374 B.R. 556, 567 (Bankr. M.D. Pa. 2007) (converting to Chapter 7).

- Pre-petition mismanagement of financial affairs. See, *In re McCorhill Publishing, Inc.*, 73 B.R. 1013, 1017 (Bankr. S.D.N.Y. 1987) (appointing Chapter 11 trustee).

- Management's pre-petition transfer of assets to insiders and non-debtor affiliates. *See, In re Main Line Motors, Inc.*, 9 B.R. 782 (Bankr. E.D. Pa. 1981) (appointing Chapter 11 trustee).

- Pre-petition withdrawal of sums from debtor's operations and placing funds in control of two non-debtor affiliates. *See, Id.*

- Controlling officer's pre-petition withdrawals from debtor at time of financial crisis. *In re Sharon Steel Corp.*, 86 BR at 461 (appointing Chapter 11 trustee).

- Debtor's sale of assets to management's affiliate before commencement of the bankruptcy. *In re Gillman*, 46 B.R. 322 (Bankr. D. Mass. 1985) (noting "poor business decision" and "possible fraudulent transfer" that should be investigated by a Chapter 11 examiner or trustee).

- Management's diversion of assets to pay for personal expenses. *See, In re PRS Ins. Group, Inc.*, 274 B.R. 381, (Bankr. D. Del. 2001) (appointing Chapter 11 trustee).

16. Evidence demonstrates that Management committed numerous acts of mismanagement, that considered separately and/or in the aggregate, constitute "gross mismanagement" warranting conversion pursuant to Section 1112(b) or appointment of a Chapter 11 Trustee. *See, In re Sharon Steel*, 86 B.R. at 461 (while one act of mismanagement was not, standing alone, proof of "gross mismanagement" or incompetence, the mismanagement "problems," considered together, was a basis for appointing a trustee pursuant to Section 1104(a)(2)).

- **"Illiquidity" For Over Five Years.** According to Gallagher, Debtor has been "illiquid" since 2008.[82] As early as October 2008, Hughes noted the "very real possibility of involuntary bankruptcy and forced liquidation," given HTR's "Texas Business Situation" with "an extended period of over due payables, debts owed to vendors which have provided products and/or services to the Texas Properties."[83] And yet, Hughes failed to seek protection of the bankruptcy court in order to preserve Debtor's business assets and operations or protect creditors' rights. *See, e.g., In re Sharon Steel Corp.*, 86 BR at 461 (finding that more than two years of delay in filing bankruptcy, causing further loss to the estate, constituted "gross mismanagement").

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[82] *See*, 4/16 TR, 136:1 - 8.
[83] *See*, HSC B-7.

- **Pursuing Self Interests at Debtor's and Creditor's Expense.** Rather than taking necessary action to preserve HTR assets and business operations, Management took affirmative steps to protect their personal interests over those of the company and non-insider creditors:

  - **The Insider Loan.** Through the Insider Loan "involuntary advance" provision, Management documented HTR's alleged continuing obligation to pay insiders' executive salaries.[84]

  - **Assignment of All Income-Producing Assets**. HTR assigned all its income-producing assets to Hughes and Gallagher, pursuant to the March 2009 Employee Settlement Agreement and the accompanying Release.[85] Immediately after accepting assignment of the Texas Properties, Hughes and Gallagher assigned these assets to their affiliate, Mastodon Resources.[86] Thereafter, Hughes and Gallagher refused to honor their settlement commitments but never returned the Texas Properties to HTR.[87]

  - **Paying Insiders Before Non-Insider Creditors**. Management paid themselves and their affiliate Mastodon Resources over $186,000.00 from GE&F's April 24, 2009 $200,000.00 HTR Debt Payment, while over $307,000.00 in non-insider creditor claims remained unpaid.[88]

  - **Further Refusal to Pay Non-Insider Creditors**. In August 2009, Richard Battaglia, Debtor's trial counsel, (while pursuing the Federal District Court Action on a contingent fee basis), refused to provide creditor information to enable GE&F's counsel to use available funds to pay the $307,000.00 due to non-insider creditors pursuant to the March 2009 Employee Settlement Agreement.[89]

  - **Approving High Executive Salaries While the Company Suffers "Perilous Financial Condition."** Also in August 2009, while HTR had no assets or business operations,[90] Hughes signed the minutes of a purported "Shareholder Meeting," attended by Hughes, Gallagher, and Crow (and not GE&F), recognizing HTR's "perilous financial condition" and approving a 30% raise for Gallagher (increasing his annual salary from $90,000 to $120,000) and "reconfirming" Hughes' annual salary of $180,000.[91]

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[84] *See,* HSC PP; 4/16 TR, 99:5 – 23; 101:2 – 17; 104:24 – 105:12, 24 – 106:12.
[85] *See,* HTR 4 (attached Exhibit A), through which Hughes and Gallagher expressly agreed to "accept the assignment of the Texas assets . . . subject to . . all conditions herein."
[86] *See*, HSC F1a - F2b. *See also*, 3/12 TR, 163:8 – 13; 4/16 TR, 76:21 - 24.
[87] *See,* HTR 27. *See also,* 1/30 TR, 52:18 – 21; 3/12 TR, 94:6 – 13.
[88] *See*, HTR 4 (Exhibit C) and 8. *See also*, 1/30 TR, 43:16 – 22; 44:4 – 46:3; 3/12 TR, 260:17 – 261:1.
[89] *See,* HSC Y.
[90] *See,* 3/12 TR, 205:10 – 11; 206:2 – 5; 4/16 TR, 134:11 – 12.
[91] *See,* HSC KK.

- **Further Acts of Gross Mismanagement.** Gallagher maintains he and Hughes have aimed "to keep Helia Tec alive as an entity" long enough for Helia Tec "to remove the cloud on the title to its assets."[92] For over five years, Management has employed "sustaining actions" – acts of gross mismanagement, pre- and post-petition -- that have increased insider debt and brought this Debtor no closer to "removing the cloud."[93]

  - **Continuing to Charge Debtor For Lucrative Executive Salaries.** During the five-year "period of illiquidity" leading up to this bankruptcy, with no business operations,[94] Hughes and Gallagher have claimed $25,000.00 monthly salaries, based on purported employment agreements that have not been disclosed or approved by the Court.[95] Debtor's Monthly Operating Reports have continued to show these accruing obligations to Management.[96]

  - **Working to "Sustain" the Litigation, Not Debtor.** Over the past year, Gallagher, who is not a lawyer, has spent over half his HTR work time (for which he claims $10,000.00 in "guaranteed" monthly salary)[97] acting in "largely a research role," to respond to GE&F's motions in the Federal District Court Action, which involves no claims asserted by or against Debtor.[98] Over several years, Gallagher's work associated with Debtor's business operations has been virtually non-existent.[99]

  - **Extending and Enlarging the Insider Loan.** As recently as ten months before the bankruptcy filing, the Insider Loan was extended and the borrowing limit was enlarged from the original $200,000.00 to $2.2 million.[100]

  - **Expanding Debts to Insiders.** As a result of the "involuntary advances" made pursuant to the Insider Loan during Debtor's prolonged "period of illiquidity," HTR's purported insider debts morphed from $200,000.00 to, according to Debtor's Petition, over $1.5 million, increasing 1,000% since 2009. Over 90% of the purported debt in this bankruptcy is allegedly held by insiders and "secured" by the Insider Loan and accompanying security agreements.[101]

  - **Utilizing the Mastodon Entities to Take Over Debtor's Properties and Operations.** Now that Mastodon Resources owns the Texas Properties and HTR "has no money," all new business opportunities go to Mastodon, rather than

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[92] *See, e.g.*, 4/16 TR, 103::6 - 9
[93] *See*, 4/16 TR, 136:1 – 8.
[94] *See, Id.*, 200:4 – 14. *See also*, 4/16 TR, 136:1 – 8.
[95] *See*, 3/12 TR, 165:8 – 10. *See also*, Petition, Schedule G.
[96] *See, Id.*, 200:4 – 14.
[97] *See*, 3/12, 165:8 – 10.
[98] *See*, 3/12 TR, 164:11 – 165:4; 11 – 166:18. *See also*, HSC J and Q.
[99] 3/12 TR, 166:15 – 18 ("it has been slow").
[100] *See*, HSC PP (Bates No. HG02472 - 475).
[101] *See*, HTR 4, Exhibit C; Petition, Schedules D and F.

HTR.[102] Any net profits received from the Texas Properties, including net profits as late as December 31, 2012, have been received by Mastodon Resources. Even though the purported assignment of net profits was never released, Management has never credited the Insider Loan balance for net profits received by Mastodon Resources.[103]

- **Utilizing Debtor to Subsidize Mastodon Salaries.** Although the Mastodon Entities own the properties, run all the business operations, collect any net profits, and seize any new business opportunities, Debtor is charged, pursuant to the Insider Loan, $10,000.00 per month for Gallagher's salary, which is nearly three times Gallagher's $3,800.00 monthly salary paid by Mastodon Resources.[104]

- **Utilizing Debtor for Office Lease Liability.** Debtor is wholly liable under its Office Lease.[105] Debtor informally sublets its office suite to the Mastodon Entities, Richard Battaglia, and Steve Kim.[106] Based on the Insider Loan "involuntary advance" provisions, Mastodon Operating pays the rent to the landlord, then credits HTR on the loan agreement for Mastodon Operating's portion.[107] Mastodon Operating credits Debtor $600 a month that Battaglia pays and $800 per month that Mr. Kim pays.[108] This arrangement places on Debtor full and exclusive liability for what is, essentially, Mastodon's office suite.[109] While HTR "occupies" a conference room with a table and chairs, all other parts of the office space are occupied by parties other than Debtor.[110] As of March 12, 2014, Debtor was in default under the terms of the Lease for failing to obtain landlord's consent to subtenants, having failed to pay all rent required under the Lease, and having filed for bankruptcy.[111]

- **Paying No Employment Taxes.**[112] Despite paying executive compensation through "credits" to lenders on the Insider Loan for over five years, with insider debt based on salaries purportedly exceeding $1 million, Management has paid no HTR employment taxes since 2009, and FICA taxes continue to accrue interest and penalties post-petition.[113]

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[102] *See,* 3/12 TR, 206:2 – 5.
[103] *See*, HSC E (26 – 34 of 49). *See also*, 4/16 TR, 68:21 – 23; 72:17 – 20, 25 – 73:5, 16 – 74:4.
[104] *See, 3*/12 TR, 159:19 – 160:1.
[105] *See*, Exhibit BBB; 3/12 TR, 183:18 – 25.
[106] *See*, 3/12 TR, 180, 1 – 6; 182:1 – 6; 183:2 – 5, 11 – 25; 273:14 – 19.
[107] *See, Id.,* 191:10 – 23.
[108] *See, Id.*
[109] *See,* 3/12 TR, 54:24 – 55:1; 188:1 – 13.
[110] *See, Id.*, 180:12 – 16; 193:23 – 195:3.
[111] *See,* HSC BBB (Bates Nos. SJLP00001 – 27 (pars. 5.1(a), 7.1(b) and (g)); and 3/12 TR, 189:1 – 191:7.
[112] Debtor's "involuntary advances" of management salaries pursuant to the Insider Loan should be recharacterized as equity. However, to the extent such involuntary advances represent true wage liabilities, Debtor has failed to pay FICA taxes as required under federal law. *See,* HSC's Brief Concerning Payment of Employment Taxes, filed May 5, 2014.
[113] *See, Id. See also*, 4/16 TR, 16:10 – 22.

- **Financing Hughes' and Gallagher's Personal War.** Along with "accrued salaries," these "involuntary advances" under the Insider Loan have also financed Hughes' and Gallagher's five-year campaign against GE&F and others, to solidify their alleged secured claim to the PNG Project Interest and to profit personally from HTR's claims relating to the PNG Project Interest.[114] As late as December 2012, Hughes and Gallagher attempted to dismiss with prejudice HTR's arbitration claim in exchange for GE&F's payment directly to Hughes and Gallagher.[115]

C. Management's Fraud and Dishonesty

17. Evidence of Management's pre- or post-petition fraud or dishonest conduct provides "cause" for the appointment of a Chapter 11 trustee. *See,* 11 U.S.C. § 1104(a). Evidence of "dishonesty" and/or "fraud" that provide "cause" for appointing a Chapter 11 trustee include:

- Diversion of corporate assets for the benefit of insiders. *See, William A. Smith Constr. Co.,* 77 B.R. at 127 – 28; *In re Wings Digital Corp.*, No. 05-12117, 2005 Bankr. LEXIS 3476, *4 (Bankr. S.D.N.Y. May 16, 2005) (noting that management's 7-year history of interfamilial transactions intended to create security interests superior to those of non-insider creditors constituted fraud, noting that "investigation of the financial affairs of this Debtor would be one of a trustee's most important tasks"); *In re Sharon Steel,* at 459 ("[t]he transfer is prima facie at least an insider voidable preference . . . voidable as a fraudulent conveyance. . . there is no way . . . management can or will seek to recover [debtor] the transferred stock"); *In re Intercat, Inc.* 247 B.R. at 923 (constituting "mismanagement at best and fraud or dishonesty at worst"); *In re Grasso*, 490 B.R. 500, 505 (Bankr. E.D. Pa. 2013); *In re PRS Ins. Group, Inc.*, 274 B.R. at 385.

- Possible fraud against creditors by debtor's cessation of business, allowing a related entity to take over its operations. *See, In Re Great Northeastern Lumber & Millwork Corp.*, 20 B.R. at 611.

- Failure to include relevant financial data on bankruptcy schedules, including omission of rental income, raises questions of "dishonest conduct." *In re Deena Packing Indus., Inc.*, 29 B.R. 705, 707 (Bankr. S.D.N.Y. 1983).

- Failure to account for or disclose significant intercompany obligations. *See, In re New Orleans Paddlewheels, Inc.*, 350 B.R. 667 (Bankr. E.D. La. 2006) (constituting management "malfeasance").

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[114] *See*, 4/16 TR, 57:22 – 58:5; 59:18 – 21.
[115] *See*, HSC P. *See also*, 3/12 TR, 12:7 –15:11.

- "Padding the creditor list to defeat the involuntary petition." *In re Euro-American Lodging Corp.*, 365 B.R. at 426.

- "Embarking on a campaign to freeze out shareholder." *See, Id.*

- Debtor's dishonest testimony. *In re Grasso*, 490 B.R. at 505.

- "Some combination of dishonesty, incompetence, or gross mismanagement of the affairs of the Debtor." *In re Patman Drilling Internat'l, Inc.*, No. 07-34622-SGJ, 2008 Bankr. LEXIS 715, *16 (Bankr. N.D. Tex. Mar. 14, 2008).

18. There is evidence of "dishonesty" and "fraud" warranting the appointment of a Chapter 11 trustee. *See,* 11 U.S.C. § 1104(a). Management has engaged in acts of dishonesty and fraud through its sustained campaign to enrich insiders at the expense of Debtor and its non-insider creditors. These acts include:

- **Diverting Corporate Assets:**

  - Transferring all of Debtor's income-producing Texas oil and gas properties to Hughes and Gallagher, who promptly assigned these property interests to Mastodon Resources.[116] This act alone shows fraud and dishonest intent to avoid their obligations under the Release attached to the March 2009 Employee Settlement Agreement, which specifically obligated Hughes and Gallagher to "accept the assignment of the Texas Assets. . . subject to all of the terms and conditions hereof."[117]

  - Paying themselves over $162,000.00 and Mastodon Resources over $23,000.00 against the $200,000.00 HTR Debt Payment, while non-insider creditors remain unpaid.[118]

  Thereafter, Hughes and Gallagher renounced the March 2009 Settlement Agreement through which they obtained the properties and the April 2009 cash payments and failed to return the properties or the cash to HTR.[119]

- **Manufacturing Alleged Secured Debt:** Hughes and Gallagher set up the Insider Loan as a mechanism for impairing HTR with insider "secured" debt through

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[116] *See,* HSC F1a – F-2b.
[117] See, HTR 4, "Exhibit A."
[118] *See,* HTR 8. *See also*, 1/30 TR, 56:14 – 57:5.
[119] *See,* HTR 27 and 30. *See also*, 1/30 TR, 41:12 – 21; 3/12 TR, 94:6 – 13; 163:5 – 13.

"involuntary advances" for salary, litigation expenses, rent payments, and other administrative expenses.[120]

- **Use of Delay to Increase Purported Insider Secured Claims**

  - Knowing that Debtor was "illiquid" and had no ongoing business operations, Management maintains that it utilized the Insider Loan to "sustain" HTR while Management sought to "remove the cloud on the title to its assets."[121] All along, Management knew that the company was "illiquid" and bankruptcy was a potentiality.[122] Delaying this bankruptcy allowed Management to manufacture and build insider secured creditor claims.[123] *See, e.g., In re Wings Digital Corp.*, 2005 Bankr. LEXIS 3476 at *4 (management's 7-year history of intra-familial transactions intended to create security interests superior to those of non-insider creditors constituted fraud). Since 2009, HTR's borrowing limit has increased from $200,000.00 to $2.2 million.[124] Since 2009, insider debt pursuant to the Insider Loan has increased by nearly 1,000%.[125] Insiders' purported secured claims account for over 90% of all creditors' claims.[126]

  - Debtor demanded arbitration against GE&F, PLNG, Clarion, and IOC over two years ago.[127] Debtor has stayed the arbitration,[128] while Hughes and Gallagher pursued their personal claims against GE&F (successfully reinstating the claims before Judge Harmon).[129] Hughes and Gallagher have also sought to benefit personally from settlement of HTR's dormant arbitration claim.[130] Despite the fact that the arbitration has been filed and dormant for over two years, Debtor maintains that it has "placed the arbitration on hold pending this bankruptcy filing."[131]

- **Utilizing Affiliates to Carry on Business Activities With HTR's Diverted Assets:** Since the 2009 transfer of the Texas Properties, HTR has ceased to engage in domestic oil and gas business.[132] Any net profits received from the Texas Properties, as recently as December 2012, have been paid to Mastodon Resources, and no net profits have been credited against HTR's alleged accumulating debt on the Insider

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[120] *See*, Petition. *See also*, HSC PP; 3/12 TR, 191:12–17; 249:2 – 14; 251:14 – 20; 252:12 -19; 4/16 TR, 53:10 – 54:6, 54:11 – 16; 59:18 – 21; 101:4 – 11; 105:21 – 106:1; 107:4 - 7.
[121] *See,* 3/12 TR, 204:14 – 15; 4/16 TR, 53:10 – 54:6; 101:25 – 102:2; 103:5 - 8.
[122] *See*, 4/16 TR, 136:1 – 8; HSC B-7; HSC Y (1st of last 3 pages).
[123] *See, e.g.,* HSC B-7; HSC Y (first of last three pages).
[124] *See*, HSC PP (Bates Nos. HG02472 – 475).
[125] *See,* HSC PP and Petition, Schedule D.
[126] *See*, Petition, Schedules D and F.
[127] *See,* HSC I.
[128] *See*, HSC I and Z. *See also*, 3/12 TR, 125:1 – 3; 126:18 – 127:8
[129] *See,* HSC Q.
[130] *See,* HSC P.
[131] *See,* Debtor's Disclosure Statement, 15 – 16.
[132] *See,* 3/12 TR, 206:2 – 5.

Loan.[133] Any new business opportunities are given to Mastodon, rather than HTR.[134] Although HTR has had no business operations since 2009, Debtor is wholly-liable on the office suite shared with the Mastodon Entities, and Gallagher's monthly salary for HTR is over twice that for Mastodon Resources.[135]

- **Engaging in a Campaign to Freeze out Parent Company**. In 2007, HTC charged Hughes, as its "U.S.A. Agent," with responsibility for establishing HTR as its "wholly-owned subsidiary."[136]
    - Based on nearly $20 million funded by HTC and GE&F for HTR assets and PNG Project cash calls, Hughes issued less than 200,000 shares of HTR stock to the parent company at $100.00 per share.[137]
    - Hughes and Gallagher entered into the March 2009 Employee Settlement, then refused to relinquish control or ownership of HTR, despite having received and retained benefits from the March 2009 Employee Settlement Agreement.[138]
    - After he refused to resign, Hughes issued 600,00 shares of HTR stock to himself, Gallagher, and Crow, at $0.10 per share, seeking to dilute parent company's control and ownership of purported HTR assets.[139]
    - In August 2009, Hughes and Gallagher took shareholder action, in the absence of GE&F representatives, noting HTR's "perilous financial condition," but affirming their own employment agreements and approving their high executive salaries.[140]

19. Management's failure to include relevant information in its bankruptcy filings also raises questions of "dishonest conduct." *See, e.g., In re Deena Packing Indus., Inc.*, 29 B.R. at 707 (failure to include relevant financial data on bankruptcy schedules, including omission of rental income, raises questions of "dishonest conduct"). These nondisclosures include Debtor's failure to identify:

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[133] *See*, 4/16 TR, 68:21 – 23; 72:17 – 20, 25 – 73:5, 16 – 74:4.
[134] *See*, 3/12 TR, 205:2 – 24.
[135] *See*, 3/12 TR, 159:5 – 160:1.
[136] *See*, HSC DD.
[137] *See, e.g., Id.*
[138] *See*, 1/30 TR, 50:8 – 13; 3/12 TR, 95:8 – 12. *See also*, 1/30 TR, 52:18 – 21; 3/12 TR, 94:6 – 13.
[139] *See*, 4/16 TR, 132:13 – 21.
[140] *See*, HSC JJ.

- **The Shareholder Derivative Suit**, a chose in action and an asset of the estate, which asserts derivative claims against Hughes, Gallagher, the Mastodon Entities, and others.[141]

- **Hughes' and Gallagher's Federal District Court Claims,** through which, according to Gallagher, Hughes and Gallagher seek to recover funds paid pursuant to the February 2009 assignment on Debtor's behalf.[142]

- **The Unwritten Sublease Agreements**, through which Mastodon Operating pays the rent to landlord; Battaglia and Kim pay Mastodon their portion of the rent; and Mastodon "credits" Debtor for HTR's portion of the lease payment and makes an "involuntary advance" on the Insider Loan for Mastodon's portion of the lease payment.[143] This arrangement is places on Debtor full and exclusive liability for what is, essentially, Mastodon's office suite.[144]

- **Hughes' and Gallagher's Purported Employment Agreements**, through which Hughes and Gallagher claim large executive salaries and have encumbered HTR with excessive insider debt.[145]

D. Debtor's Continuing Losses, With No Reasonable Likelihood of Rehabilitation.

20. Section 1112(b)(4) provides that "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" is "cause" for converting to a case to Chapter 7. *See*, 11 U.S.C. § 1112(b)(4)(A). In determining whether there is a continuing loss or diminution of the estate pursuant to Section 1112, "courts must look beyond a debtor's financial statements and a full evaluation of the present condition of the estate." *In re Moore Construction, Inc.*, 206 B.R. at 437 – 38, citing *In re Economy Cab & Tool Co.*, 44 B.R. 721 (Bankr. D. Minn. 1984). "Rehabilitation," in the context of Section 1112(b)(4)(A), refers to "the debtor's ability to restore the viability of its business." *In re Loop*, 379 F.3d 511, 516 (8th Cir. 2004), *cert. denied*, 543 U.S. 1055, 125 S. Ct. 915, 160 L. Ed 2d 778 (2005). *See also*, *In*

[141] *See*, Petition, Schedule B. *See also*, HSC H.
[142] *See*, Petition. *See also*, 4/16 TR, 121:14 – 19; 122:4 – 15; HSC Q.
[143] *See*, 3/12 TR, 191:10 – 23.
[144] *See*, 3/12 TR, 54:24 – 55:1; 188:1 – 13; 180:12 – 16; 193:23 – 195:3.
[145] *See*, Petition, Schedule E.

re Wright Air Lines, Inc., 51 B.R. 96, 100 (Bankr. N.D. Ohio 1985) ("Rehabilitation" means "to put back in good condition; re-establish on a firm, sound basis").

21. The following circumstances satisfy the elements of Section 1112(b)(4)(A) and provide "cause" for conversion:

- "In the context of a debtor who has ceased business operations and liquidated virtually all of its assets, any negative cash flow – including that resulting only from administrative expenses – effectively comes straight from the pockets of the creditors." *In re Loop Corp.*, 379 F.3d at 516.

- Continuing operating losses and accumulating debt to insiders and affiliates gives "cause" for conversion pursuant to Section 1112(b) and for appointing a Chapter 11 trustee pursuant to 11 U.S.C. § 1104. *See, In re Patman*, No. 2008 Bankr. LEXIS 715 at *14.

- Mounting administrative expenses that "erode the position of the estate's creditors and diminish the value of the estate." *In re Loop Corp.*, 379 F.3d at 516, citing *In re Citi-Toledo Partners*, 170 B.R. 602, 606 (Bankr. N.D. Ohio 1994).

- Unpaid post-petition employment taxes, leading to a large, continuously accumulating debt. *In re Moore Constr.,* 206 B.R. at 437 – 38, citing *In re Telemark Management*, 41 B.R. 501 (Bankr. W.D. Wis. 1984).

22. The evidence presented in this case supports conversion pursuant to Section 1112(b)(4)(A):

- **Negative Cash Flow**. Debtor's operating reports reflect a negative cash flow, with no current assets.[146]

- **No Revenues**. In the years and months preceding this bankruptcy, Debtor has generated no revenues. Debtor has no money with which to initiate business operations or with which to pursue new business opportunities.[147]

- **No Income-Generating Assets**. HTR assigned its only income-producing domestic oil and gas properties to Hughes and Gallagher in March 2009.[148] These assets are now owned by Hughes' and Gallagher's affiliate, Mastodon Resources.[149] Now, any net profits from the income-producing properties, including income generated less than twelve months before the commencement of this bankruptcy, have gone to

[146] *See, e.g.*, HSC WW and EEE.
[147] *See, Id. See also*, 3/12 TR, 205:2 – 7.
[148] *See*, HSC F1a and F2a. *See also*, 3/12 TR, 163:8 – 13; 4/16 TR, 76:21 - 24.
[149] *See*, HSC F1b and F2b. See also, 4/16 TR, 78:24 – 79:5.

Management's affiliate, Mastodon Resources, rather than HTR.[150] Despite owning none of the Texas Properties, HTR remains liable, according to bankruptcy filings and Mastodon management, for plugging and abandonment liabilities associated with some of the Texas Properties.[151]

- **Accumulated Debt to Insiders**. Debtor has accumulated purported debt to insiders at a phenomenal rate through the Insider Loan "involuntary advance" provision, which "finances" insiders' salaries, legal expenses, and office rent.[152] Administrative expenses, purportedly financed through the Insider Loan, continue to accumulate.[153] Management has manifested its intention to accumulate additional debt for executive salaries, if approved by the Court.[154]

- **Mounting FICA Tax Liabilities**. Debtor has paid no employment taxes since 2009, and interest and penalties continue to accumulate.[155] [156]

- **No Intent to Rehabilitate.** Debtor has manifested a clear intent not to rehabilitate its business operations, acknowledging that HTR ceased all business operations and has not been in the domestic oil and gas business since 2009.[157] Management directs any new oil and gas opportunity to Hughes' and Gallagher's Mastodon Entities, rather than HTR.[158]

E. Failure to Make Accurate Disclosures

23. "Absolute transparency is required" of a Chapter 11 debtor-in-possession. *In re Vaughan*, 429 B.R. 14, 30 (Bankr. D. N. M. 2010). A failure to provide accurate schedules to the bankruptcy court has been deemed sufficient "cause" under Section 1112(b) to convert to Chapter 7 or under 1104(a)(1) to appoint a trustee. *See, Id.* (converting to Chapter 7, based in part on debtor's failures to provide accurate disclosures on its schedules); and *In re Plaza de Retiro, Inc.*, 417 B.R. 632, 641 (Bankr. D. N.M. 2009) (appointing a Chapter 11 trustee based on debtor's failure to provide

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[150] *See,* 4/16 TR, 71:16 – 72:1; 72:12 – 20, 73:16 – 74:9.
[151] *See,* 4/16 TR, 85:19 – 86:19. *See also*, Petition, Schedules D and F.
[152] *See,* 3/12 TR, 191:12–17; 249:2 – 14; 251:14 – 20; 252:12 -19; 4/16 TR, 53:10 – 54:6, 54:11 – 16; 59:18 – 21; 101:4 – 11; 105:21 – 106:1; 107:4 - 7. *See also*, HSC PP (Bates Nos. HG02443 – 45).
[153] *See,* HSC WW and EEE; 3/12 TR, 197:1 – 21; 198:5 - 13; 205:15 – 21; HSC PP; Petition, Schedule D.
[154] *See*, 3/12 TR, 165:5 – 10, 166:11 -12; 201:2 – 13.
[155] *See*, 3/12 TR, 259:12 – 260:2; 4/16 TR, 16:10 - 22
[156] *See*, Note 67, above.
[157] *See,* 3/12 TR, 205:10 – 11; 206:2 – 5.
[158] *See,* 3/12 TR, 205:2 – 11.

accurate disclosures on its schedules). Debtors are under a continuing duty to disclose all pending and potential claims. *See*, 11 U.S.C. Section 521(1).

24. Debtor's failure or refusal to make full and accurate disclosures to this Court supports converting this case to Chapter 7 or appointing a Chapter 11 trustee. Since the filing of its Petition in October 2013, Debtor has attempted to deceive this Court concerning the nature of Debtor's purported "assets," the existence of claims, and the existence and character of insider transactions and debts:

- **Shareholder Derivative Suit**. Debtor failed to list on its Schedule B the Shareholder Derivative Suit against Hughes, Gallagher, the Mastodon Entities and others.[159]

- **Federal District Court Action Claims**. Debtor failed to list on its Schedule B the Federal District Court Action claims asserted by Hughes and Gallagher (including Hughes' and Gallagher's claim for a constructive trust over the funds paid for the assignment of the PNG Project Interest), which, according to Gallagher, Hughes and Gallagher assert personally against GE&F on Debtor's behalf.[160]

- **Office Lease "Arrangements."** Debtor failed to disclose income received from subtenants to Debtor's 1,600 square feet office suite.[161] Debtor is wholly responsible under its Office Lease, and Debtor has subleased the Suite without landlord's consent (in violation of the lease terms) to the Mastodon Entities, Richard Battaglia, and to Steve Kim.[162] This arrangement places on Debtor full and exclusive liability for the Office Lease (the assumption of which Debtor seeks the Court's approval), which is essentially, Mastodon's office suite.[163] While HTR "occupies" a conference room with a table and chairs, all other parts of the office space are occupied by parties other than Debtor.[164]

- **Purported Employment Agreements**. Debtor failed to seek the Court's approval of the purported employment agreements with Hughes and Gallagher, through which HTR allegedly agreed to pay Hughes $15,000.00 monthly and Gallagher $10,000.00 monthly.[165]

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[159] *See, Id. See also*, HSC H.
[160] *See*, 4/16 TR, 121:14 – 19. *See also, Id.*, 122:4 – 15. *See also*, HSC Q.
[161] *See, e.g.*, HSC WW and EEE.
[162] *See*, 3/12 TR, 180, 1 – 6; 182:1 – 6; 183:2 – 5, 11 – 25; 273:14 – 19. *See also*, HSC BBB (Bates Nos. SJLP0011, par. 5.1(a)).
[163] *See*, Petition, Schedule G. *See also,* HSC BBB; 3/12 TR, 54:24 – 55:1; 188:1 – 13.
[164] *See, Id.*, 180:12 – 16; 193:23 – 195:3.
[165] *See*, Petition, Schedule G. *See also*, 3/12 TR, 165:5 – 10; 200:4 – 14.

- **Inaccurate Statement of Financial Affairs**. Debtor failed to make accurate disclosures in its Statement of Financial Affairs ("SOFA"), including:

  - Failure to disclose amounts "credited" to Debtor as a result of the Mastodon entities' and Battaglia's undisclosed and unauthorized tenancy under the Office Lease.[166]

  - Failure to disclose "credits" or "setoffs" made within 90 days immediately preceding the bankruptcy, in favor of Debtor on the Insider loan for the Mastodon entities' undisclosed and unauthorized tenancy under the Office Lease through December 31, 2012.[167]

  - Failure to disclose payments made for the benefit of insider creditors within the past year, including net profits generated from the Texas Properties through December 31, 2012, which remain subject to an unreleased Assignment of Net Profits Interest and which, according to Gallagher, were received by Mastodon Resources.[168]

  - Failure to disclose "compensation in any form," to insiders for the year immediately preceding the commencement of this case, including its credit on the Insider Loan in favor of Hughes and Gallagher for $25,000.00 every month for purported salaries owed to Hughes and Gallagher.[169]

II. Conversion is in the Creditors' and Estate's Best Interests.

25. Section 1112(b)(1) requires that the Court convert the case to Chapter 7 or dismiss the case, whichever is in the best interests of creditors and the estate, once "cause" is established "unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate. *See,* 11 U.S.C. § 1112(b)(1). Evidence establishes that there is "cause" pursuant to Section 1112(b) for converting this case to Chapter 7, and there is "cause" pursuant to Section 1104(a) for appointing a Chapter 11 trustee. *See,* Section I, above. Given the particular circumstances of this Debtor, the best interests of creditors and the estate would be better served if the Court converts this case to Chapter 7.

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[166] *See*, Petition, SOFA, no. 2. *See also*, 3/12 TR, 191:10 – 23.
[167] *See, Id. See also*, SOFA, nos. 3.b. and 13.
[168] *See, Id.*, no. 3.c. *See also*, 4/16 TR, 72:12 – 24; HSC E (26 – 34 of 49).
[169] *See,* SOFA, no. 23. *See also*, 3/12 TR, 242:21 – 243:3.

26. The purpose of a Chapter 7 is for the "prompt closure and distribution of the debtor's estate," and "to efficiently administer the liquidation of the estate for the benefit of creditors." *In re Watson*, No. 04-46189, 2007 Bankr. LEXIS 4290, *14 (Bankr. S.D. Tex. Dec. 14, 2007), citing *Pioneer Inv. v. Servs. Co.,* 507 U.S. 380, 389, 113 S. Ct. 1489, 123 L. Ed. 2d 74 (1993); *In re Reed*, 405 F.3d 338, 341 (5th Cir. 2005).

27. A Chapter 11 bankruptcy embraces the "two recognized policies of preserving going concerns and maximizing property available to satisfy creditors." *Bank of America Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle Street P'ship*, 526 U.S. 434, 435, 119 S. Ct. 1411, 143 L. Ed. 2d 607 (1999). "Chapter 11 is not a panacea for every debtor in distress. Many troubled businesses are simply not viable." 7 Collier on Bankruptcy Section 1112.04[5][a] at 1112-24-1112-25. Additionally, "the costs of the reorganization process may outweigh the likely benefits in any particular case." *Id.*

28. "The preservation of the business enterprise must not be at the expense of creditors." *Case v. Los Angeles Lumber Prods. Co., Ltd.,* 308 U.S. 106, 119 n. 14, 60 S. Ct. 1, 84 L. Ed. 110 (1939). *See also, In re Timbers of Inwood Forest Assocs., Ltd.,* 808 F.2d 363, 373 (5th Cir. 1987)(en banc), *aff'd,* 484 U.S. 365, 108 S. Ct. 626, 98 L. Ed. 2d 740 (1988)):

> [W]hen there is no reasonable likelihood that the statutory objective of reorganization can be realized or when the debtor unreasonably delays, then the automatic stay and other statutory provisions designed to accomplish the reorganization objective become destructive of the legitimate rights and interests of creditors, the intended beneficiaries. In that situation it is incumbent upon the bankruptcy judge to effectuate the provisions of the Bankruptcy Code for the protection of creditors lest the judge keep the Code's word of promise to the ear of creditors and break it to their hope. The bankruptcy judge must meet head-on his obligation to decide, fairly and impartially, the hard questions.

29. In this case, there is nothing to reorganize through a Chapter 11 proceeding. Debtor has not engaged in the oil and gas business since 2009. Since that time, Debtor has been bereft of assets and revenues. Chapter 11 conversion is the more appropriate vehicle for liquidating this estate. *See, In re Vaughan*, 429 B.R. at 48 (converting to Chapter 7 rather than appointing a Chapter 11 trustee, noting that debtor has no ongoing business and there are no funds to support a reorganization plan; "debtor's only choice is to liquidate. This is more easily accomplished in Chapter 7 by a professional panel trustee"). *See also, In re Millenium Mngmt, LLC,* 2014 Bankr. LEXIS 734, at *16 (finding "cause" to convert or appoint a Chapter 11 trustee; electing to appoint a Chapter 11 trustee "in consideration of the fact that Debtor has an operating business").

30. Although the Bankruptcy Code permits liquidation through Chapter 11, liquidation under a Chapter 11 trustee is not practical here, since Debtor has negative cash flow and no funds to pay the high Chapter 11 administrative costs. *See, In re Domiano*, 442 B.R. at 109 (noting factors favoring conversion over a Chapter 11 receiver, including incomplete financial reporting, inability to evaluate a contingent litigation claim, and mounting administrative costs associated with Chapter 11).

31. Further, it would not best serve the interests of creditors or the estate to permit Debtor with conflicted Management to remain in possession while a Chapter 11 examiner undertakes a necessarily lengthy investigation of Debtor and Management, given costs and conflict concerns. *See, In re Graf*, 19 B.R. at 270 (noting factors favoring conversion over appointing Chapter 11 examiner and liquidating with debtor-in-possession, including apparent conflicts of interest with management evaluating insider

claims and increased costs of a Chapter 11 liquidation in tandem with examiner fees); *In re Moore Construction, Inc.*, 206 B.R. at 438 – 39 (favoring conversion over a Chapter 11 examiner, noting "[a]ppointing an examiner may be appropriate in some cases, here, further examination will not remedy the problem but will only serve to exacerbate it. The Debtor is currently over $1,400,000.00 in debt, with hundreds of thousands of dollars of employment tax debt; and, therefore, the Court finds no reason to allow this debt to increase and further harm the creditors while the Debtor continues its exercise in tire kicking").

III. Debtor's Mere Hope to "Remove the Cloud" on the PNG Project Interest is Not Sufficient to Defeat Conversion.

32. As set forth above, GE&F has demonstrated that "cause" exists to convert this case to Chapter 7 or appoint a Chapter 11 trustee, and it better serves the interests of creditors and the estate to convert this case. *See*, Sections I and II, above. *See also*, 11 U.S.C. §§1112(b)(1) and 1104(a) and (c). Even if the Court could "specifically identify unusual circumstances" against conversion or appointment of a trustee, Debtor must, and cannot, satisfy its burden to prove that (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established by the Code or, if not applicable, within a reasonable period of time; and (B) the grounds for converting this case (other than "cause" pursuant to Section 1112(b)(4)(A)) (i) include an act or omission for which there exists reasonable justification (ii) that will be cured within a reasonable period of time fixed by the court. *See,* 11 U.S.C. §1112(b)(2).

33. Debtor cannot discharge its burden pursuant to Section 1112(b)(2), even if the Court could "specifically identify unusual circumstances" cautioning against conversion. *See,* 11 U.S.C. §1112(b)(2). Debtor's "mere hope of prevailing" on the

contingent litigation plan it unfolds in its proposed plan and disclosure statement does not demonstrate "unusual circumstances" and is not a sufficient basis to defeat a showing of cause to convert. *See, In re Domiano,* 442 B.R. at 108, citing *In re BH S&B Holdings, LLC,* 439 B.R. 342, 350 (Bankr. S.D.N.Y. 2010); *In re FRGR Managing Member, LLC,* 419 B.R. 576, 583 (Bankr. S.D.N.Y. 2009).

IV. Debtor's Proposed Plan and Disclosure Statement Do Not Demonstrate How it Best Serves the Creditors and the Estate for Debtor to Remain in Possession.

34. Debtor's proposed plan and disclosure statement, filed at long last, just before the May 5, 2014 hearing, do not provide an adequate response to the Court's fundamental inquiry for Debtor: How does it serve the best interests of the estate and creditors for Debtor to remain in possession?[170] Further, the proposed plan and disclosure statement do not adequately address the Court's questions concerning proposed procedures for addressing conflicts of interest facing this Management.[171] In fact, the proposed plan and disclosure statement raise even more questions concerning conflicts of interest, since Debtor proposes that Hughes would act as the Trust Agent for the proposed liquidating trust.[172] Debtor seems to suggest that the interests of the estate and creditors would best be served by a conflicted fiduciary having exclusive rights to make litigation decisions, including whether to pursue the Shareholder Derivative claims against himself, Gallagher and their Mastodon companies; and that creditors and the estate would best be served with a conflicted Plan Agent with sole discretion about which claims to pay, including his own.[173]

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[170] *See,* 4/16 TR, 161:25 – 162:3.
[171] *See, Id.,* 162:6 – 14. See also, 4/16 TR, 130:8 – 21.
[172] *See,* Docket No. 89, at 6, n. 1.
[173] While Debtor's plan subordinates Hughes' and Gallagher's insider claims, it ultimately pays them in full.

35. Stripped of its elegant prose and sales pitch, Debtor's proposed plan is, at its core, an unrealistically optimistic, multi-step, multi-contingent international litigation plan; a contingent litigation plan in a party dress. Debtor offers no particulars or proof, and none exists, of its alleged current ownership of the PNG asset or of its alleged right to convert the IPI interest to IOC common stock. Debtor insinuates that its proposed trust has the simple task of converting its alleged IPI interest to IOC common stock and demanding a refund of its non-refundable PIA deposit. Of course, if these legally impossible tasks were as simple as Debtor suggests, why would it need to pay legal fees of $5,530,000.00?[174]

36. The centerpiece of Debtor's proposed litigation trust is a claim that Debtor has unsuccessfully pursued for five years, in tandem with personal claims pursued by Hughes and Gallagher.[175] HTR's action to invalidate the February 2009 Assignment and all other Federal District Court Action claims were dismissed by Judge Harmon in September 2011, after years of discovery and after HTR sought and was denied summary judgment. *See, Helia Tec Resources Inc. v. GE&F Co. Ltd.*, 2011 U.S. Dist. LEXIS 106453. GE&F then filed the Shareholder Derivative Suit, and -- only then -- Debtor made an arbitration demand on GE&F, PLNG, Clarion, and IOC.[176] HTR maintains that arbitration is mandatory, based on an arbitration clause in the 2005 IPI Agreement, notwithstanding its choice to ignore the purported mandatory arbitration provision while it unsuccessfully pursued its claims in the Federal Court Action for nearly three years. Having made the arbitration demand over two years ago, HTR's counsel has done

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[174] *See,* Docket no. 89, at 10.
[175] Only recently, Gallagher denied that he and Hughes were seeking to profit personally from claims based on alleged injury to HTR arising out of the February 2009 Assignment. See, 4/16 TR, 122:4 – 15.
[176] *See,* HSC J.

nothing but instruct the arbitration administrator to abate the arbitration.[177] There is no evidence that Debtor has joined or served all necessary parties or that all parties have entered appearances.

37. The arbitration claim faces insurmountable legal and factual hurdles. Parties responding to Debtor's arbitration will most likely allege that Debtor waived its arbitration rights by litigating in federal court for over three years (basis alone for waiver of mandatory arbitration) and by making an arbitration demand then sitting on the arbitration for over two years without just cause (another basis for waiver of arbitration).[178] There are viable defenses that will be vigorously asserted before the arbitration panel, should the arbitration be permitted to proceed. Further, it is likely that Hughes, as a responsible third party, will be joined in the arbitration, directly conflicted with Debtor's claims.[179] Indeed, Debtor's proposed plan and disclosure statement make no provision for a contingent agent and set out no procedure for addressing such conflicts that would arise with Hughes' participation in the arbitration.

38. Debtor offers no method of funding a complex, multi party, international arbitration and Battaglia's engagement agreement provides that Debtor, not Battaglia, must pay all litigation expenses. Battaglia is to receive a forty percent contingent fee without even risking any litigation expenses capital. What's more, Battaglia and his proposed co-counsel are highly conflicted, representing alleged creditors, both secured and unsecured, ***and*** representing parties on both sides of the DeWitt County shareholder

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[177] *See,* HSC Z

[178] Now, incredibly, Debtor suggests in its Disclosure Statement that the arbitration has been abated only "pending this bankruptcy filing." *See*, Docket No. 89, at 15 – 16.

[179] *See, e.g.,* HSC B-4 – B-7.

derivative litigation.[180] These conflicts are not addressed in the proposed plan and disclosure statement.

39. Debtor admits in its Disclosure Statement that IOC has refused to recognize Debtor as having any right under the IPI Agreement and has refused to convert the Debtor's alleged interest to IOS common stock.[181] Therefore, even if Debtor could overcome procedural, legal, and factual hurdles in its arbitration quest to establish ownership in the PNG Project, which is highly unlikely, Debtor still would face, in all likelihood, further costly arbitration proceedings against IOC to enforce its alleged right to convert its interest to IOC stock.

40. This proposed plan offers no explanation of why creditors and the estate would be best served by placing Hughes back in control of the arbitration/litigation campaign that he has not successfully resolved in five years. How are creditors best served by giving it back to Hughes and Battaglia, the very people who likely waived Debtor's arbitration rights and, at a minimum, delayed Debtor's claim so that Hughes and Gallagher could pursue their individual claims in federal district court for personal damages?

41. Regardless of how Debtor characterizes it, Debtor's proposed plan is a pipe dream, subject to exclusive control by a Plan Agent who is guilty of gross mismanagement, fraud and dishonesty, and who is conflicted at multiple levels.

CONCLUSION

42. It is abundantly clear: this Debtor should not remain in possession. There is "cause" for converting this case to Chapter 7, and conversion is in the best interests of

[180] *See,* HSC X.
[181] *See*, Disclosure Statement, 8 - 9.

non-insider creditors, equity shareholders, and other interests of the estate. *See,* 11 U.S.C. § 1112(b). Alternatively, there is "cause" for appointing a Chapter 11 trustee, and this appointment is in the best interests of non-insider creditors, equity shareholders, and other interests of the estate. *See,* 11 U.S.C. § 1104(a)(1) and (2). As a further alternative, it is appropriate that the Court appoint a Chapter 11 examiner to conduct a full investigation of Debtor, including investigation of the affairs of Debtor and its current Management, because such appointment is in the interests of non-insider creditors, equity security holders, and other interests of the estate. *See,* 11 U.S.C. § 1104(c). Debtor has not, and cannot, demonstrate that it is in the best interests of creditors and the estate for Debtor to remain in possession.

WHEREFORE, Party in Interest HSC Holdings Co., Ltd, f/k/a GE&F Co., Ltd., requests that the Court convert this bankruptcy to Chapter 7 for the liquidation of Debtor or, alternatively, appoint a Chapter 11 trustee; and grant GE&F such other relief to which it shows itself justly entitled.

Respectfully submitted,

THE LAW OFFICES OF DAVID B. HARBERG

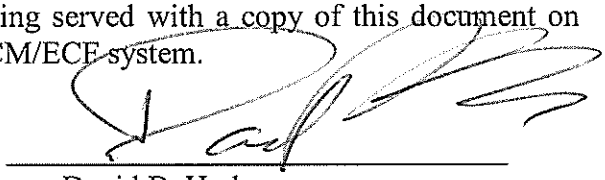
By:_____

David B. Harberg
State Bar No. 08942450
S.D. Tex. No. 15262
1010 Lamar, Suite 450
Houston, Texas 77002
Telephone: (713) 752-2200
Facsimile: (832) 553-7888

Attorneys for Party in Interest HSC Holdings Co., Ltd., f/k/a GE&F Co., Ltd.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that all counsel of record who are deemed to have consented to electronic service are being served with a copy of this document on this 14th day of May, 2014, via the Court's CM/ECF system.



David B. Harberg