YOUNG CONAWAY STARGATT & TAYLOR, LLP

YCST BANKRUPTCY TREND WATCH

Young Conaway is pleased to announce the launch of YCST Bankruptcy Trend Watch, a new service from Young Conaway that is designed to identify emerging trends in restructuring and bankruptcy law that will impact your practice and the business of your clients. This edition will focus on recent Delaware bankruptcy court decisions affecting private equity funds and lenders. We hope that you will find the YCST Bankruptcy Trend Watch helpful and, as always, we are happy to field any comments or questions that you may have regarding the issues addressed in this YCST Bankruptcy Trend Watch or the restructuring practice generally.

***Official Committee of Unsecured Creditors v. CIT Group/Business Credit, Inc. (In re Jevic Holding Corp.)*, Case No. 08-11006 (BLS), Adv. No. 08-51903 (Bankr. D. Del. Sept. 15, 2011)**

The Committee asserted numerous claims against lender CIT, including fraudulent transfer, preferential transfer, aiding and abetting breach of fiduciary duty, and equitable subordination. CIT moved to dismiss, which motion was ultimately denied in part and granted in part. The Court refused to dismiss the Committee's fraudulent transfer claims under section 544(b) of the Bankruptcy Code because the Committee had pled a sufficient factual basis regarding the relevant transactions. For similar reasons, Court denied the motion as it pertained to the fraudulent transfer claims under section 548 and preference claims under 547. However, the Court granted the motion to dismiss as it pertained to the Committee's avoidance claim under section 544(b), aiding and abetting claim, and equitable subordination claim, which the Court found were not properly pled. As to the aiding and abetting claim, the Court applied the 4-part test articulated by the Delaware Court of Chancery in *Cargill, Inc. v. JWH Special Circumstance LLC*, and concluded that "threadbare recitals of the elements of [the] cause of action, supported by mere conclusory statements, do not suffice to support a claim under *Iqbal*."

***The Official Comm. of Unsecured Creditors of Moll Indus., Inc., et al. v. Highland Capital Mgmt. L.P., et al.*, Case No. 10-11371 (MFW), Adv. No. 10-53291 (MFW) (Bankr. D. Del. Aug. 3, 2011)**

Unsecured Creditors' Committee asserted claims against the debtor's secured lenders seeking to (i) recharacterize or equitably subordinate lenders' secured claims, and (ii) pierce the corporate veil against a lender as an alleged alter ego of the debtor. The secured lenders moved to dismiss. The Bankruptcy Court rejected the attempted recharacterization, finding that the Creditors' Committee had failed to meet its burden under *Exide*, and, further, that many of the factors "actually support characterization of the [security instruments] as debt . . . ." Similarly, the Bankruptcy Court rejected the request for equitable subordination, ruling that the Creditors' Committee had failed to sufficiently allege that the secured lenders controlled, or were insiders of, the debtor. Finally, the Bankruptcy Court granted the motion to dismiss with respect to the Creditors' Committee's alter ego claim on the basis that the Creditors' Committee had failed to make its case under *Broadstripe*.

***SB Liquidation Trust v. Preferred Bank (In re Syntax-Brillion Corp.)*, Case No. 08-11407 (BLS), Adv. No. 10-51389 (BLS) (Bankr. D. Del. July 25, 2011)**

Trustee asserted claims against bank for aiding and abetting breach of fiduciary duties, fraud, and fraudulent transfers. The Bankruptcy Court dismissed all claims, finding that a California statute absolved the bank from the fiduciary duty claims and that the facts did not support a finding that "the Bank actually or constructively knew or should have known of the allegedly fraudulent nature of" its depositor's scheme.

***Friedman's Liquidating Trust v. Goldman Sachs Credit Partners, L.P. (In re Friedman's Inc.)*, Case No. 08-10161 (CSS), Adv. No. 09-51010 (CSS) (Bankr. D. Del. July 12, 2011)**

Plaintiff/trustee commenced an action objecting to the claims of certain lenders and seeking recharacterization of such claims. Defendants moved to dismiss the complaint because "it was the intent of the parties for the monies at issue to be debt, rather than equity." Looking to the factors utilized by the Third Circuit in its *Submicron* decision, the Court denied the motion and found that the "[p]laintiff has made facially plausible allegations regarding the recharacterization of the claim." Specifically, the plaintiff had alleged that as there was a pro rata contribution by the shareholders, interest payments were deferred, the interest rate was below market, interest was not paid when monies were available, and the contribution was made on a subordinated, unsecured basis.

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About Young Conaway Stargatt & Taylor, LLP

Young Conaway Stargatt & Taylor, LLP, with offices in New York and Delaware, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Nearing its sixth decade, Young Conaway also guides regional businesses and individuals through a myriad of employment, real estate, tax, estate planning, environmental, and banking issues from the firm's offices in downtown Wilmington, DE.

***Andrew D'Amico, et al. v. Tweeter Opco, LLC, and Schultze Asset Mgmt., LLC (In re Tweeter Opco, LLC, et al.)*, Case No. 08-12646 (MFW), Adv. No. 08-51800 (MFW) (Bankr. D. Del. July 8, 2011)**

Plaintiffs representing former employees of the debtors asserted claims under the WARN Act against the debtors' parent which held indirect ownership interests in, and was a lender to, the debtors. Both parties moved for summary judgment. As in *Manning* (decided by the same judge), the primary question presented was whether the parent and the debtors constituted a "single employer" for purposes of WARN liability. The Bankruptcy Court focused its inquiry on whether the parent or lender had specifically directed the allegedly illegal employment practice that formed the basis for the litigation. Finding that the record demonstrated numerous instances of "specific direction" by the parent regarding the various operational and employment practices of the debtors, including the termination at issue, the Bankruptcy Court granted summary judgment in favor of plaintiffs and against the parent.

***NHB Assignments LLC v. General Atlantic LLC (In re PMTS Liquidating Corp.)*, Case No. 08-11551 (BLS), Adv. No. 10-56167 (BLS) (Bankr. D. Del. July 1, 2011)**

Liquidating trustee asserted breach of fiduciary duty and fraud claims against PE fund/parent company and its managing member (who was also on the board of the portfolio company). The Bankruptcy Court: (i) dismissed the complaint against the PE fund/parent because the complaint failed to sufficiently allege that the PE fund/parent exercised "actual control" over the portfolio company; (ii) dismissed the fraud claim against the PE fund/parent due to a lack of "special relationship of trust or confidence"; (iii) denied the motion to dismiss against the member of the PE fund/parent for breach of fiduciary duties/good faith; and (iv) dismissed the fraud claim against the PE fund/parent member due to insufficiency of allegations regarding knowingly false statements.

***Wachovia Bank, Nat'l Assoc. v. WL Homes, LLC, et al. (In re WL Homes, LLC, et al.)*, Case No. 09-10571 (BLS), Adv. No. 09-50514 (Bankr. D. Del. May 25, 2011)**

The Court characterized the proceeding as "about the ability of a parent company to grant a security interest in an asset of its subsidiary and the extent to which a third party may enforce such security interest." Prior to the petition date, Wachovia entered into an LOC with WL Homes and obtained a security interest in the bank account of a subsidiary of WL Homes. WL Homes filed Chapter 11 proceedings that were subsequently converted to Chapter 7. The subsidiary did not file bankruptcy. Wachovia moved for summary judgment to assert its rights as to the subsidiary account, and the Chapter 7 trustee cross-moved for summary judgment. In his cross-motion the Chapter 7 trustee sought a finding that the subsidiary bank account was not properly pledged as collateral since the subsidiary non-debtor did not authorize or ratify the pledge of its bank account. The Bankruptcy Court held that "the fact that an agent may represent more than one principal does not alter the well-established doctrine that an agent with authority is capable of binding its principal." As a result, the Bankruptcy Court found that the security interest was valid and binding so long as it was otherwise in accord with the UCC.

***Burtch v. Conn. Cmty. Bank, N.A. (In re J. Silver Clothing, Inc.)*, Case No. 05-10522, Adv. No. 07-50814 (KG) (Bankr. D. Del. Apr. 29, 2011)**

Chapter 7 trustee commenced an action seeking: (i) avoidance of alleged fraudulent and preferential transfers to the debtor's secured lender and the debtor's chairman and majority shareholder; (ii) damages for claims sounding in breaches of fiduciary duty by the chairman/majority shareholder; and (iii) disallowance of the defendants' claims pursuant to section 502(d) of the Bankruptcy Code. Upon competing motions for summary judgment, the Bankruptcy Court granted the defendants' judgment on all counts.

***John Manning, et al. v. DHP Holdings II Corp. a/k/a DESA (Cayman) Holding, LLC, et al.*, Case No. 08-13422 (MFW), Adv. No. 09-50023 (MFW) (Bankr. D. Del. April 26, 2011)**

Plaintiffs representing former employees of the debtors asserted claims under the WARN Act against the debtors' parent. Plaintiffs claimed that the parent and the debtors constituted a "single employer" because they "had common ownership, directors, and officers . . . " Upon the parent's motion for summary judgment, the Bankruptcy Court ruled that "[a]lthough [the parent] and the Debtors had common ownership, directors, and officers, the Court finds that the Debtors and [the parent] were not a 'single employer' because [the parent] did not exercise *de facto* control over the Debtors' termination of employees and did not share personnel policies or operations with the Debtors."

***George L. Miller, Chapter 7 Trustee v. Sun Capital Partners, Inc., et al. (In re IH 1, Inc., et al.)*, Case No. 09-10982 (PJW), Adv. No. 10-52279 (PJW) (Bankr. D. Del. Jan. 25, 2011)**

Chapter 7 trustee moved to disqualify counsel for certain defendants on the basis that, prior to the petition date, the firm represented both the PE fund/parent and portfolio company/debtor on matters substantially related to the subject matter of the litigation.

The Bankruptcy Court ruled that counsel could represent the defendants only if the debtor or trustee consented to the concurrent representation. Since the engagement letter waiver only permitted counsel to represent the PE fund "and its affiliated investment funds and management companies" in the event of a conflict, the Court disqualified the firm as to representation of defendants as outside of the scope of the waiver.

If you have any questions or would like to discuss the decision further, please contact any of the Bankruptcy and Corporate Restructuring partners at Young Conaway. The Firm is also available for complimentary Delaware Update CLE programs to address any aspects of Delaware law that are of interest to our friends and colleagues around the country.

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