Bankruptcy 2025: Views from the Bench

Litigation Update on Avoidance Actions

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2025

Views from the Bench

Litigation Update: Avoidance Actions

September 26, 2025

Panelists	Hon. Heather Cooper (D. Vt) Hon. Clifton Jessup (N.D. Ala.) Hon. Pamela McAfee (E.D.N.C.) Hon. Elizabeth Stong (E.D.N.Y.)
Moderators	Alexa Kranzley (Sullivan & Cromwell, NY) Lorenzo Marinuzzi (Morrison Foerster, NY)

Extension of Statute of Limitations:

In re Kwok, Case No. 22-50073 (JAM), 2024 WL 666646 (Bankr. D. Conn. Feb. 15, 2024)

- **Facts:**
  - In this individual voluntary chapter 11 case, the Trustee moved to extend the statute of limitations to bring avoidance actions under sections 108(a), 546(a), and 549(d).
  - Due to alleged lack of cooperation by the Debtor and incomplete or inaccurate schedules and statements, the Trustee had to resort to extensive third-party discovery, including 15 motions for Rule 2004 examinations, through which it then was working to piece together the Debtor's financial affairs.
- **Rule 9006. Computing and Extending Time; Motions.**
  - **(b)** Extending Time.
    - **(1)** *In General* . This paragraph (1) applies when these rules, a notice given under these rules, or a court order requires or allows an act to be performed at or within a specified period. Except as provided in (2) and (3), the court may—at any time and for cause—extend the time to act if:
      - **(A)** with or without a motion or notice, a request to extend is made before the period (or a previously extended period) expires; or
      - **(B)** on motion made after the specified period expires, the failure to act within that period resulted from excusable neglect.
    - **(2)** *Exceptions* . The court must not extend the time to act under Rules 1007(d), 2003(a) and (d), 7052, 9023, and 9024.
    - **(3)** *Extensions Governed by Other Rules* . The court may extend the time to:
      - **(A)** act under Rules 1006 (b)(2), 1017 (e), 3002 (c), 4003 (b), 4004 (a), 4007 (c), 4008 (a), 8002 , and 9033 — but only as permitted by those rules; and
      - **(B)** file the certificate required by Rule 1007(b)(7), and the schedules and statements in a small business case under §1116(3)—but only as permitted by Rule 1007(c).

Extension of Statute of Limitations:
In re Kwok, Case No. 22-50073 (JAM), 2024 WL 666646 (Bankr. D. Conn. Feb. 15, 2024)

- **Section 108: Extension of time.**
  - **(a)** If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor may commence an action, and such period has not expired before the date of the filing of the petition, the trustee may commence such action only before the later of—
    - **(1)** the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
    - **(2)** two years after the order for relief.
- **Section 546: Limitations on avoiding powers.**
  - **(a)** An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of—
    - **(1)** the later of—
      - **(A)** 2 years after the entry of the order for relief; or
      - **(B)** 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or
    - **(2)** the time the case is closed or dismissed.
- **Section 549: Postpetition transactions.**
  - **(d)** An action or proceeding under this section may not be commenced after the earlier of—
    - **(1)** two years after the date of the transfer sought to be avoided; or
    - **(2)** the time the case is closed or dismissed.

Extension of Statute of Limitations:
In re Kwok, Case No. 22-50073 (JAM), 2024 WL 666646 (Bankr. D. Conn. Feb. 15, 2024)

- **Rule 9006 may be utilized to extend the deadlines set forth in sections 108(a), 546(a), and 549(d).**
  - These statutes are not substantive, and instead present statutes of limitation subject to principles of equity.
  - The Court relied on the Eleventh Circuit decision *In re Int'l Admin. Servs.,* 408 F.3d 689 (11th Cir. 2005), finding that Rule 9006(b) can apply to section 546(a).
- **There was "cause" to extend the statute of limitations.**
  - The Court found that the Trustee had shown more than reasonable diligence in his efforts since his appointment.
- **Equitable tolling could not be applied prospectively.**
  - Relying further on *In re Int'l Admin. Servs.*, the Court found that equitable tolling is applicable only after the limitations period has expired.
  - Therefore, the request to extend the statute of limitations period was not ripe for consideration. The Trustee could seek equitable tolling if and when a defendant in an adversary proceeding asserts a defense that the Trustee's complaint is time-barred.

Sufficiency of Complaints:

Official Committee of Unsecured Creditors of Pack Liquidating, LLC v. Kepler Group, LLC, Case No. 22-10797 (CTG), Adv. Proc. No. 23-50536, 2024 WL 4427676 (Bankr. D. Del. Oct. 4, 2024)

- **Facts**:
  - The Committee filed an adversary proceeding to recover over $400,000 in payments made in the 90 days prior to the bankruptcy filing.
  - Kepler, one of the defendants, was an e-marketing service provider that installed Amazon advertising platforms for customers.
  - The Committee alleged that Kepler purchased advertising campaigns from Amazon as an agent for the Debtors.
  - Amazon billed Kepler for the advertising services, and then Kepler billed the Debtors for the same amount plus a fee for its installation services. Kepler then paid Amazon after receiving payment from the Debtors.
  - Kepler moved to dismissed the complaint, raising the "mere conduit" defense.
- **Mere Conduit:**
  - A party is a mere conduit if it receives a transfer solely for another and not for its own benefit.

Sufficiency of Complaints:

Official Committee of Unsecured Creditors of Pack Liquidating, LLC v. Kepler Group, LLC, Case No. 22-10797 (CTG), Adv. Proc. No. 23-50536, 2024 WL 4427676 (Bankr. D. Del. Oct. 4, 2024)

- **Applicable tests:**
  - The defendant must establish that (i) it lacked control over the transfer before the payment simply passed through its hands, and (ii) it lacked power to redirect the funds for its own use.
  - Factors to determine if the defendant had control over the transferred funds include: (i) if the defendant's bank account was maintained solely in its name, (ii) if funds from other sources were deposited into the account, and (iii) whether the defendant had an obligation to segregate the funds.
- **The complaint on its face did not plead facts that establish the affirmative defense of a mere conduit.**
  - Kepler was not under a contractual obligation to use the Debtors' payments for the benefit of Amazon. It had the freedom to do what it pleased with the funds, even if it did end up using them to pay Amazon.
  - Kepler commingled the funds from the Debtors with non-Debtor receipts.
- **The complaint adequately alleged a fraudulent conveyance under section 548.**
  - The complaint, incorporating the first day declaration, generally alleged insolvency and insufficient liquidity to fund the Debtors' operations.
  - Even though the transaction likely cannot give rise to both claims for preference and constructive fraudulent conveyance, the Court determined that the Committee could bring both claims to preserve them.

Litigation Funding:

Trustee of the Fresh Acquisitions Liquidating Trust v. Jones, et al., Case No. 21-30721 (SGJ), Adv. Proc. No. 22-3087 (Bankr. N.D. Tex. Aug. 4, 2025)

- **Facts**:
  - The Liquidating Trustee entered into a litigation funding agreement without prior notice to the court or the creditors/trust beneficiaries.
  - Several defendants brought suit against the Liquidating Trustee, alleging that this agreement was hurting the prospect of settlement in several post-confirmation adversary proceedings.
- **The Liquidating Trustee improperly entered into the litigation funding agreement post-confirmation.**
  - The disclosure statement did not disclose litigation funding as a possible means to fund post-confirmation litigation.
  - The Liquidating Trustee did not exercise reasonable business judgment or act as a prudent fiduciary.
  - Entering the litigation funding agreement was an abuse of discretion that was harmful to creditors/trust beneficiaries.

Sale of Avoidance Actions:

Matter of South Coast Supply Co., 91 F.4th 376 (5th Cir. 2024)

- **Facts:**
  - Debtor South Coast sought to recover $300,000 in allegedly preferential transfers made to its former CFO, Robert Remmert.
  - South Coast proposed to sell certain assets under its chapter 11 plan, and Briar Capital (creditor) held a security interest entitling it to $700,000 of such sale proceeds.
  - Under the Debtor's confirmed plan, Briar Capital agreed to waive its administrative expense claims and relinquish its $700,000 security interest in the sale proceeds in exchange for the Debtor's interest in the pending preference action against Remmert.
  - In the litigation proceeding, Remmert moved to dismiss the complaint, arguing that Briar Capital lacked standing under section 1123(b)(3)(B) to pursue the estate claim.
  - The District Court for Southern District of Texas dismissed the complaint for lack of subject matter jurisdiction, ruling that (i) sales of preference claims are impermissible and (ii) Briar Capital lacked standing to pursue the preference claim.

Sale of Avoidance Actions:
Matter of South Coast Supply Co., 91 F.4th 376 (5th Cir. 2024)

- **Section 541: Property of the estate**
  - **(a)** The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
    - **(1)** Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
    - **(7)** Any interest in property that the estate acquires after the commencement of the case.
- **Section 363: Use, sale, or lease of property**
  - **(b)(1)** The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless--
    - **(A)** such sale or such lease is consistent with such policy; or
    - **(B)** after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease--
      - **(i)** giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and
      - **(ii)** finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.
- **Section 1123: Contents of plan**
  - **(b)** Subject to subsection (a) of this section, a plan may—
    - **(3)** provide for—
      - **(B)** the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

Sale of Avoidance Actions:
Matter of South Coast Supply Co., 91 F.4th 376 (5th Cir. 2024)

- **Preference actions are property of the estate under section 541 and therefore may be sold pursuant to section 363(b)(1).**
  - Section 541(a)(1)
    - The Court relied on *United States v. Whiting Pools* to highlight congressional intent that a broad range of property be included in the estate.
    - Preference actions are meant to bring value back to the estate and therefore should be included as property of the estate.
    - Preference claims arise with the filing of the bankruptcy petition which make them property that the debtor has an interest in as of the commencement of the case.
  - Section 541(a)(7)
    - The Code makes transferred assets available to the estate postpetition via preference actions. Therefore, the preference actions themselves qualify as property of the estate under this subsection.
  - The Court joined the 8th and 9th Circuits in affirming that avoidance actions, including preferences, are property of the estate under section 541 that can be sold.

Sale of Avoidance Actions:

Matter of South Coast Supply Co., 91 F.4th 376 (5th Cir. 2024)

- **Principles of value maximization and equity are satisfied by the sale of preference claims.**
  - Approving the sale in this case did not undermine equitable distribution because Briar Capital's waiver of its administrative claims constituted real value for the estate.
  - Sales in this context may benefit the estate where it lacks resources to litigate and the outcome from the sale is more equitable overall.
- **Standing to pursue the preference claim does not require being a "representative of the estate."**
  - The Court rejected Remmert's argument that under section 1123(b)(3)(B) Briar Capital was not a representative of the estate.
  - The Court relied on section 363(b)(1), another mechanism for liquidating assets, which has no "representative of the estate" requirement, to find that purchasers of preference claims have standing to pursue them even if they are not representatives of the estate.

Lien Attachment to Avoidance Actions:

In re BDC Group, Inc., Case No. 23-00484 (TJC), 2024 WL 4137984 (Bankr. N.D. Iowa Sept. 10, 2024)
Keystone Savings Bank v. Hanrahan, Case No. C24-104-LTS-MAR, 2025 WL 2014326 (N.D. Iowa Jul. 17, 2025)

- **Facts:**
  - Secured creditor Keystone filed a motion to recognize its lien on the Debtor's avoidance actions and proceeds, relying on its prepetition security agreements that pledged all property.
  - The Committee argued that because Chapter 5 avoidance actions only arise upon a bankruptcy filing, Keystone's security interest could not reach these claims.
- **Section 552: Postpetition effect of security interest**
  - **(a)** Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.
  - **(b)(1)** Except as provided in sections 363, 506(c), 522, 544, 545, 547, and 548 of this title, if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, products, offspring, or profits of such property, then such security interest extends to such proceeds, products, offspring, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.

Lien Attachment to Avoidance Actions:

In re BDC Group, Inc., Case No. 23-00484 (TJC), 2024 WL 4137984 (Bankr. N.D. Iowa Sept. 10, 2024)
Keystone Savings Bank v. Hanrahan, Case No. C24-104-LTS-MAR, 2025 WL 2014326 (N.D. Iowa Jul. 17, 2025)

- **Bankruptcy Court: Keystone's prepetition lien rights did not extend to chapter 5 avoidance actions.**
  - Prepetition liens cannot attach to rights/actions by the trustee that do not exist prior to the bankruptcy filing.
  - The related recoveries are "after-acquired property" within section 552(a) rather than "proceeds" of prepetition collateral under section 552(b)(1).
  - The Court declined to rely on 8th Circuit case *Simply Essentials*, which stated "that the debtor has an inchoate interest in avoidance actions prior to the commencement of the bankruptcy proceeding."
    - The inchoate right does not extend into a debtor's recovery on the proceeds for which creditor's lien could attach.
    - If this was permitted, the trustee could not sell avoidance actions for the benefit of the estate because a prepetition creditor could recover all of the proceeds for its sole benefit. This conflicts with congressional intent of creating a fiduciary duty in the debtor/trustee to maximize value for the estate.

Lien Attachment to Avoidance Actions:

In re BDC Group, Inc., Case No. 23-00484 (TJC), 2024 WL 4137984 (Bankr. N.D. Iowa Sept. 10, 2024)
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- **District Court: On appeal, the District Court affirmed the Bankruptcy Court's decision to deny the motion to recognize the lien.**
  - *Simply Essentials* did not overturn prior caselaw holding that avoidance actions are after-acquired property that cannot be encumbered by prepetition liens.
    - The language quoted by Keystone applied to a narrow issue on appeal in that case, which was whether avoidance actions can be sold as property of the estate.
  - Avoidance actions require estate resources to succeed and produce a recovery, and therefore cannot be "proceeds" themselves.

MCAs & Avoidance Actions

- **Merchant Cash Advance ("MCA"):**
  - This is a type of financing that is considered an advance or purchase of future earnings.
  - A business receives cash from an MCA entity in exchange for a future portion of its future sales or revenue.
  - The MCA entity is repaid via a percentage of daily sales, and accordingly, such repayments may fluctuate.

- Courts have encountered a line of cases involving MCAs, particularly in small business cases, and have been asked to determine whether a debtor/trustee can avoid repayments made in the 90 days prior to a bankruptcy filing.

MCAs & Avoidance Actions

Gecker v. LG Funding (In re Hill and Network Salon Services), 589 B.R. 614 (Bankr. N.D. Ill. 2018)

- **Facts:**
  - Hill owned Network Salon, which entered into a number of MCA agreements with LG Funding that were personally guaranteed by Hill.
  - Hill and the Salon filed for chapter 7.
  - The Chapter 7 Trustee filed a complaint to recover funds transferred by the Salon to LG Funding pursuant to the MCA agreements.
- **The transfers made to LG Funding were on account of an antecedent debt.**
  - Even though the agreements were not loans, but rather a sale, the Salon still owed a debt to LG Funding.
  - The Court cited to NY caselaw that described money owed to a merchant in an MCA transaction as a debt.
- **The transfers between the parties were made in the ordinary course of business defense.**
  - LG Funding was in the business of providing merchant cash advances to small businesses.
  - The Salon also entered into MCA agreements with 14 different MCA companies.
  - The relevant MCA agreements were performed according to their terms consistently for several months.

MCAs & Avoidance Actions

In re JPR Mechanical Inc., Case No. 19-23480 (DSJ), Adv. Proc. Nos. 21-07079 & 21-07082, 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025)

- **Facts:**
  - The Debtor entered into several MCA agreements with Radium.
  - The Trustee sought to recover certain payments made in May and June of 2019 as preferential transfers.
- **The transfers were not made in the ordinary course of business according to ordinary business terms.**
  - Transfers in April were approximately $13,000 per day, and transfers in June were approximately $107,000 per day.
  - Therefore, certain transfers made in May in the amount of approximately $1.4 million and in July in the amount of approximately $750,000 far exceeded these amounts and the specified percentage of daily receipts to be paid to Radium under the MCA agreement.
  - There was no factual support that Radium's receipt of these transfers was consistent with industry standards.

MCAs & Avoidance Actions

In re Williams Land Clearing Grading and Timber Logger, Case No. 22-02094-5 (PWM), Adv. Proc. No. 23-00024-5, 2025 WL 1426503 (Bankr. E.D.N.C. May 16, 2025)

- **Facts**:
  - The Debtor and Apex entered into an MCA agreement under which Apex would purchase $337,500 of the Debtor's future receivables in exchange for $250,000 upfront cash.
  - The Debtor brought fraudulent and preferential transfer claims against Apex.
- **The Debtor did receive reasonably equivalent value.**
  - The Court found that the MCA agreement was void under NY usury law, but this alone did not determine whether the Debtor received reasonably equivalent value in exchange for the payments made to Apex.
  - Reasonably equivalent value is based on actual value given and received, not what is necessarily contemplated by the applicable contract.
  - The repayments made to Apex were, in the aggregate, less than the total sum actually advanced by Apex to the Debtor ($245,000).
- **The payment made was not in the ordinary course of business.**
  - The payment of $30,159.42 was inconsistent with "the established pattern of payments between [the] parties" which were in the amount of $18,750.
  - The Court determined this was a unique, one-time payment, made after litigation was pursued, and after the parties reached a settlement, and therefore was outside the ordinary course of dealings between the parties.

MCAs & Avoidance Actions

In re Martinez Quality Painting and Drywall v. Newco Capital Group VI, LLC, Case No. 22-30357 (AAE), Adv. Proc. No. 24-03039, 2025 WL 828882 (Bankr. W.D.N.C. Mar. 14, 2025)

- **Facts**:
  - The Debtor sought to avoid certain transfers made under two MCA agreements as actual and constructively fraudulent transfers and recover the approximately $800,000 in excess amounts transferred to the defendant.
  - The defendant moved to dismiss, arguing, among other things, that the Debtor received reasonably equivalent value.
- **The complaint alleged sufficient facts with respect to reasonably equivalent value to survive the motion to dismiss stage.**
  - Fourth Circuit test: (i) did the debtor receive value, and (ii) was the payment reasonably equivalent to the value extended?
  - The complaint alleged that the Debtor paid approximately $800,000 to the defendant, and that the MCA agreement contemplated payments to the Debtor that were less than $575,000.
  - The Court determined that the fact-intensive inquiry into reasonably equivalent value could not be decided at the motion to dismiss stage, but the Debtor pled sufficient facts to avoid some portion of the transfers.

CLERK, U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

THE DATE OF ENTRY IS ON
THE COURT'S DOCKET

The following constitutes the ruling of the court and has the force and effect therein described.

Signed August 4, 2025

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re: **FRESH ACQUISITIONS, LLC,** ***et al.*** **Post-Confirmation/Liquidating Debtors.**	**Chapter 11** **Case No. 21-30721-sgj-11** **(Jointly Administered)**
DAVID GONZALES, TRUSTEE OF THE FRESH ACQUISITIONS LIQUIDATING TRUST **Plaintiff.** **v.** **ALLEN JACKIE JONES, et al.,** **Defendants.**	**Adv. No. 22-3087-sgj** **Civ. Act. No. 3:22-cv-2659-M**

MEMORANDUM OPINION AND ORDER: (A) DECLARING THAT POST-CONFIRMATION LIQUIDATING TRUSTEE'S ENTRY INTO LITIGATION FUNDING AGREEMENT, WITHOUT NOTICE OR COURT AUTHORITY, WAS IMPROPER AND, AS A RESULT, LIQUIDATING TRUST HAS NO CONTRACTUAL OBLIGATION RELATING TO SAME; (B) DIRECTING APPOINTMENT OF A REPLACEMENT POST-CONFIRMATION LIQUIDATING TRUSTEE; AND (C) REQUIRING EXPANDED GLOBAL MEDIATION

I. INTRODUCTION

This order arises in a post-confirmation Chapter 11 context. It arises against the backdrop of seven post-confirmation adversary proceedings that are being prosecuted by a liquidating plan trustee, as plaintiff (the "Liquidating Trustee"). The seven adversary proceedings have now gone on for approximately three years, at great expense, with no end in sight. It has been almost four years since a liquidating plan was confirmed. There has been no distribution to unsecured creditors—nor does one look likely anytime in the near future. The bankruptcy court recently (on June 5, 2025) held a status conference to inquire as to what might be done to speed things along and to encourage more attempts at mediation. The court learned somewhat inadvertently—in response to its inquiries—that the Liquidating Trustee entered into a ***litigation funding agreement***—more than a year after his tenure began as a post-confirmation trustee, without any prior notice (pre- or post-confirmation) to the court or the creditors/trust beneficiaries. According to certain defendants being sued by him, this litigation funding agreement was hampering the prospect of settlement in the post-confirmation adversary proceedings.

This court was surprised to hear about a litigation funding agreement. The court never heard about it as a possibility in connection with plan confirmation (or otherwise) nor approved it. The court has gone back and scoured the bankruptcy court docket, the Disclosure Statement that the court approved, the Plan that the court confirmed, the form of Liquidating Trust Agreement presented as part of the confirmation evidence (as well as the Liquidating Trust Agreement that was ultimately executed), and the Confirmation Order. Nothing. As a result of this revelation at the June 5, 2025 status conference, on June 18, 2025, this court issued a *Memorandum and Opinion Requiring Liquidating Trustee to: (A) File Litigation Funding Agreement, Unsealed and Unredacted, on Main Bankruptcy Case Docket; and (B) Appear and Show Cause Regarding His*

Authority (or Lack Thereof) to Unilaterally Enter Into Such Agreement ("*Show Cause Order*"). DE # 1112 in main bankruptcy case and DE # 404 in above-referenced adversary proceeding. The Liquidating Trustee resisted filing the litigation funding agreement unsealed or without redaction on the public bankruptcy docket (arguing it was work product or irrelevant), but this court required it to be filed unsealed and unredacted.

As explained in the *Show Cause Order*, the Liquidating Trustee expressed the view at the June 5, 2025 status conference that, since the litigation funding agreement was entered into ***post-confirmation***, he was not required to give notice or obtain court approval and there is no problem, he says, since he controls all litigation decisions (not the litigation funder).

The court held an evidentiary hearing on the *Show Cause Order* on July 30, 2025. The court heard further testimony from the Liquidating Trustee and also heard from two expert witnesses who testified generally about the subject of litigation funding agreements. Based on the evidence and arguments, this court has decided that, even though the Liquidating Trustee entered into the litigation funding agreement post-confirmation—at a time when bankruptcy courts have less oversight and limited bankruptcy subject matter jurisdiction—he nevertheless acted improperly, and this court has subject matter jurisdiction to address it.

First, the solicitation package that went out for a creditor vote in the above-referenced bankruptcy case (i.e., the approved Disclosure Statement, an Exhibit D liquidation analysis attached thereto, the Plan, and Plan documents), as well as the confirmation evidence presented at the confirmation hearing, ***did not disclose litigation funding as a possible means to fund post-confirmation litigation***.

Second, the Liquidating Trust Agreement that was submitted as part of the confirmation hearing did not grant the Liquidating Trustee authority to borrow funds post-confirmation (although neither the Liquidating Trustee nor litigation funder will refer to the litigation funding

as a "loan"). As a result of this lack of disclosure and lack of authority, the Trust will have no contractual liability to the litigation funder.

Third, even if the Liquidating Trust Agreement did grant broad enough authority to the Liquidating Trustee to enter into a litigation funding agreement, this court cannot possibly find here (given the exorbitantly expensive terms of the litigation funding—later described) that the Liquidating Trustee exercised reasonable business judgment or acted as a prudent fiduciary. Pursuant to Bankruptcy Code sections 105(a) and 1142, and Bankruptcy Rule 3020(d), this court is compelled to conclude that the Liquidating Trustee's entry into the litigation funding agreement was an abuse of discretion, harmful to the creditors/trust beneficiaries, and will order that a new liquidating trustee be promptly appointed in substitution of the current Liquidating Trustee. While this is not normally something within the purview of the U.S. Trustee (i.e., appointing a post-confirmation trustee), the court is directing the U.S. Trustee's office, pursuant to this court's power under sections 105(a) and 1142(b) and Bankruptcy Rule 3020(d), to appoint a suitable candidate from its list of panel trustees, since there is no oversight committee under the Liquidating Trust Agreement to perform the task of voting on a new trustee, and, in fact, the Liquidating Trust Agreement has an unworkable requirement of a 75% vote of the beneficiaries of the Liquidating Trust to replace the Liquidating Trustee (it is impossible to perform the math on that, since there are still many unresolved proofs of claim, including a $150 million (or more) priority claim of the IRS).

Finally, the court also is ordering an expanded global mediation to occur that shall include not only the new replacement liquidating trustee and the defendants in the seven adversary proceedings, but also the current Liquidating Trustee and his professionals (who may be subject to disgorgement of fees, as set forth herein) as well as the litigation funder (who paid $2.325

million towards these professionals' fees and may want to explore a consensual way to put this mess behind it).[1]

II. FINDINGS OF FACT

A. Timeline.

On **April 20, 2021**, Fresh Acquisitions, LLC and fourteen related entities in the restaurant business (collectively, the "Debtors") filed Chapter 11 bankruptcy cases (collectively, the "Bankruptcy Case").

On **December 20, 2021**, after approving a section 363 sale of substantially all of the assets of the Debtors, the bankruptcy court confirmed a Chapter 11 Plan liquidating plan (the "Plan"), DE # 498, that was proposed by the Official Committee of Unsecured Creditors ("UCC") appointed in the Bankruptcy Case. *See* the "Confirmation Order." DE # 586. The Plan was a typical liquidating "pot plan," pursuant to which a trust (the "Liquidating Trust" or "Trust") was created, and an individual named David Gonzales, with a firm called Caliber Advisors, LLC in Scottsdale, Arizona, was selected to be the Liquidating Trustee. Mr. Gonzales had been a financial advisor to the UCC pre-petition, and apparently the UCC wanted him to serve as the Liquidating Trustee because he was already somewhat familiar with issues that would be litigated post-confirmation. The Debtors, in opposition, had argued that conversion to a Chapter 7 case, after the sale, would be a more cost-efficient way to wind down the estate than the UCC Plan. Not surprisingly, the UCC disagreed. The UCC's Disclosure Statement that the court approved, in the section entitled "XII. Liquidation Analysis, Best Interest of Creditors," stated:

> *The Committee believes that the orderly liquidation proposed under the Plan is likely to generate greater distributions to creditors than would occur in a Chapter 7 liquidation.* ***Here, the Liquidating Trustee is extremely familiar with the structure of the Debtors' past operations and has already prepared a comprehensive claims analysis****. He has already testified in the Bankruptcy Court*

[1] The litigation funder did show up and participate in a constructive way at the Show Cause Hearing.

> *at length about the potential Causes of Action and has gained momentum in developing a necessary strategy for pursuing litigation.* ***This will save cost [sic] in having a new trustee and new counsel enter into the case and virtually start over. As shown on Exhibit D, the costs of the Litigation Trustee will be a total of $600,000 over the estimated five-year term of the Plan. Payments to a Chapter 7 trustee calculated under Section 326 of the Bankruptcy Code would be a higher amount at about $625,000.*** *Certainly, claimants will receive Distributions under the Plan of at least as much as they would receive in a Chapter 7 liquidation and thus, the Plan meets the best interests of creditors test.*
>
> *The Debtors believe a Chapter 7 liquidation may be more efficient and less costly, and the Chapter 7 trustee is more likely than not to retain Committee professionals to minimize delay and maximize the Committee's purported momentum. The Committee believes that there are no assurances that a Chapter 7 trustee would invest the effort to pursue the Causes of Action to the extent that the Liquidating Trustee would pursue them. It seems much more likely that he/she would hire local professionals with whom he/she has worked with in the past.*

DE # 499, pp 45-46 (emphasis added). The Exhibit D that was attached estimated overall "Litigation Costs" between $150,000 and $350,000 per year. Exhibit D also estimated "Trustee Costs" at $120,000 year (a $10,000 flat fee per month for the Liquidating Trustee). It estimated "Accounting and other" costs at $100,000 the first year of the Plan, and then $60,000 per year thereafter. The Plan was projected to be five years in duration, during which there would be $6.7 million in payments made to priority tax claimants (which would be a 100% dividend) and $9,650,198 in payments to general unsecured creditors (which would be an estimated 13% dividend). To be clear, the UCC's Disclosure Statement and Plan estimated a 5-year period to liquidate the Causes of Action. DE # 499, p. 30. As explained below, things have not turned out remotely close to this forecast by the UCC and its professionals.

The Plan went effective on January 4, 2022. DE # 591. In accordance with the terms of the Plan, the Confirmation Order, and the Fresh Acquisitions Liquidating Trust Agreement (the "Liquidating Trust Agreement"), all of the Debtors' assets, as defined in section 541 of the Bankruptcy Code, including "Causes of Action," were transferred to and vested in the Liquidating Trust. The Liquidating Trustee was granted standing to prosecute the Causes of Action.

On the effective date of the Plan, the holders of general unsecured claims against the substantively consolidated Debtors received a pro-rata beneficial interest in the Liquidating Trust "in full and final satisfaction" of their claims. The Liquidating Trust received a sum of cash (approximately $345,000[2]) to seed the trust. In reviewing the Liquidating Trust Agreement [DE # 499-1, Ex. C], the court now observes, with regret, that ***there was no "Oversight Committee" of trust beneficiaries***, as we typically see, so as to provide a type of "corporate governance" to the Liquidating Trustee. The court is not sure why. The Liquidating Trustee makes decisions for the Trust beneficiaries (the holders of administrative, priority, and unsecured claims) and 75% of that group can vote to remove or replace the Liquidating Trustee.

The Liquidating Trustee (David Gonzales, the former financial advisor to the UCC) immediately took on his role as of the Effective Date of the Plan and hired the former lawyers for the UCC to represent him (Dickinson Wright PLLC).

On **September 12, 2022**, approximately nine months after confirmation, despite the Liquidating Trustee being ***"extremely familiar with the structure of the Debtors' past operations"*** and having ***"already prepared a comprehensive claims analysis"*** and having ***"gained momentum in developing a necessary strategy for pursuing litigation,"*** he finally got around to filing the above-referenced Adversary Proceeding ("Original Adversary Proceeding"). The long-awaited original complaint was 71-pages long, plus eight exhibits, and it named 22 defendants (plus additional "John and Jane Does" and other unknown, fictitious entities) and set forth 27 causes of action. These 27 causes of action (which were mostly, if not entirely, alleged against "insiders" or "affiliates" of the Debtors) ranged from alleged fraudulent transfers, to mismanagement, to breach of fiduciary duties, to misappropriation of government PPP funds, and numerous other torts

[2] *See Declaration of David Gonzales*, p.3, ¶ 20. DE # 1126-1.

and remedies. The court soon ordered severance—in other words, a carving up of the Original Adversary Proceeding into seven different adversary proceedings (the "Seven Adversary Proceedings"),[3] after numerous defendants argued that the complaint filed in the Original Adversary Proceeding contained improper "group pleading" (in other words, there were broad allegations against the general group of defendants in the Original Adversary Proceeding without giving clear notice regarding which allegations and claims were being asserted against whom).

On **July 6, 2023**, ten months after filing the Original Adversary Proceeding, the Liquidating Trustee filed separate "amended" complaints in each of the Seven Adversary Proceedings. Thereafter, in these Seven Adversary Proceedings, the court has seen: (a) motions to withdraw the reference and jury demands (and joinders) filed by certain of the 22 defendants (which were granted, since the defendants clearly had jury trial rights, although the bankruptcy court was designated to handle pre-trial matters); (b) Rule 12(b)(6) motions to dismiss from virtually every single defendant (none were granted); (c) numerous discovery disputes (instigated with motions to compel and motions for protective orders); (d) *Daubert* motions; and (e) 15 separate motions and cross-motions for summary judgment (each of which included 3,000+ pages of aggregate appendices). The six cross motions for summary judgment that the court has ruled upon thus far (in three of the Seven Adversary Proceedings) have been denied,[4] meaning that at least three of the Seven Adversary Proceedings will go to jury trial. It seems likely that all Seven Adversary Proceedings will go to trial. Meanwhile, the District Judge who is assigned to preside over the ultimate jury trials has recently retired.

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[3] The six new adversary proceedings created were Adversary Proceeding Nos. 23-03054, 23-03055, 23-03056, 23-03057, 23-03058, and 23-03059.

[4] The defendant's motions for summary judgment as to plaintiff's conspiracy to commit fraudulent transfer claim in each of the three adversary proceedings were granted. *See Memorandum Opinion and Order Denying Cross-Motions for Summary Judgment as to Plaintiff's Fraudulent Transfer Claims and Granting Defendant's Motion for Summary Judgment as to Plaintiff's Conspiracy to Commit Fraudulent Transfer Claim*. DE # 130 (23-03054), DE # 125 (23-03055 and 23-03056).

On **May 3, 2023** (yes, we are going backwards in time now), three months before the Original Adversary Proceeding was separated into the Seven Adversary Proceedings, and unbeknownst to the court or creditors/trust beneficiaries, the Liquidating Trustee entered into a **"Master Prepaid Forward Purchase Agreement by and Between Litchfield Ventures, LLC and Fresh Acquisitions Liquidating Trust,** which was then amended on **October 9, 2024** (collectively, the "Litigation Funding Agreement"). Nothing was filed on the docket to disclose this, nor did Gonzales disclose to the trust beneficiaries at any time prior to entering into the Litigation Funding Agreement that he would be doing so.

On **August 22, 2024** (now, coming up on three years since plan confirmation, and 15 months after entry into the Litigation Funding Agreement) the Liquidating Trustee filed a "Notice of Trustee's Status Report to Beneficiaries" (Status Report")." DE # 1097. The Status Report was extremely dense with information and legal advocacy regarding the Causes of Action against the numerous defendants and the Liquidating Trustee's "stunning discovery finds." Buried in the Status Report (which is 15 pages, plus 7 pages of rather sensational email attachments), there is one sentence that generically references the fact that the Liquidating Trustee had obtained litigation financing. Specifically, after noting that the Debtors' "Owners" were and are "covered by a $2 million D&O policy paying all of their legal fees," the Status Report stated: "The Trustee countered this strategy by securing litigation financing that he believes will be ample to withstand a full trial if necessary." DE # 1097, p. 5 (middle of paragraph 8). That's it.

On **June 5, 2025,** the court had *sua sponte* set a status conference for the simple reason of exploring what might be done to hurry along the Liquidating Trustee's Seven Adversary Proceedings—including having a discussion regarding more mediation (it was attempted unsuccessfully once before). As noted earlier, the court learned, to its surprise, that ***the***

Liquidating Trustee had entered into the Litigation Funding Agreement post-confirmation and that the agreement—according to some defendants—was hampering the prospect of a settlement.

On **June 16, 2025**, the court was presented, over the objection of the Liquidating Trustee, with a copy of the Litigation Funding Agreement. The court certainly understands that not all litigation funding agreements are the same. Presumably, sometimes law firms simply enter into them directly with funders, and the funding might not be that remarkable (for example, the litigation funder might share in a law firm's contingency fee—assuming that is legal in a particular state). The litigation funding is likely, generally pricey, because of the inherent risks and the typically non-recourse nature of it. But the Litigation Funding Agreement here seemed rather amazing to the court. As noted earlier, the term "Forward Purchaser" is used, rather than the term "funder" or "lender." The Liquidating Trustee is referred to as "Forward Seller." It indicates that it is governed by Delaware law. There is no mention of the bankruptcy court or case number. The Litigation Funding Agreement does at least indicate that the Liquidating Trustee has the sole and exclusive right to settle any claim (and the court notes that the approved Disclosure Statement indicated that post-confirmation settlements in excess of $100,000 must be presented to the bankruptcy court for approval). DE # 499 at p. 36. But, the Liquidating Trustee has to provide all details about any settlement to the litigation funder (i.e., the "Forward Purchaser") in writing within two business days (details include such things as offers, demands, proposals, and substance of discussions). So, I guess one might say there were two stages of vetting that the Liquidating Trustee needed to go through before finalizing any settlement: first, with the litigation funder; then, with the bankruptcy judge. As far as pricing, there is a guaranteed funding commitment of $2,325,000 (all of which has now been funded). The promised "return" to the litigation funder is three multiplied by whatever the ***litigation funder*** funds (here, that would be $6,975,000), plus a

12% return[5] on the difference between the overall litigation proceeds and $6,975,000. If there is a default, the "Default Rate" of interest to be charged is 20% per annum compounded monthly.

Using a hypothetical, if ***tomorrow***, the Liquidating Trustee won (or obtained through a settlement) litigation proceeds of **$10 million**, the litigation funder would receive $6,975,000 **plus** 12% of $3,025,000 (the difference between $10 million and $6,975,000) which would equal another **$363,000**. Thus, **$7,338,000** on a **$2,325,000** investment.[6] This would leave only **$2,662,000** for the Liquidating Trustee to use toward paying creditors in the context of a $10 million verdict or settlement. As shown further in Part II.B. below, the Liquidating Trustee's counsel is currently owed **$2,126,278.09** in unpaid fees (even after being paid handsomely with the previously undisclosed litigation funding). Thus, this would actually mean approximately **$500,000** being available for prepetition creditors in the context of a **$10 million** verdict/settlement that occurs tomorrow.

Using another hypothetical, if ***tomorrow***, the Liquidating Trustee realized litigation proceeds of $30 million, the litigation funder would receive $6,975,000 **plus** 12% of $23,025,000 (the difference between $30 million and $6,975,000) which would equal another $2,763,000. Thus, **$9,738,000** on a **$2,325,000** investment.[7] The Liquidating Trustee in this scenario of a **$30 million** verdict/settlement tomorrow realizes **$10,262,000** for him, his professionals, and thereafter the prepetition creditors. Again, as shown further in Part II.B. below, the Liquidating Trustee's counsel is currently owed $2,126,278.09 in unpaid fees (even after being paid handsomely with the previously undisclosed litigation funding). Thus, this would actually mean approximately

[5] This was increased from an original 8% in the October 9, 2024 Amendment to the Litigation Funding Agreement.

[6] *See* DE # 415, p.11 of 29 in Adv. Proc. No. 22-3087.

[7] *See* DE # 415, p.11 of 29 in Adv. Proc. No. 22-3087.

$8,135,721.91 being available for prepetition creditors in the context of a **$30 million** verdict/settlement tomorrow.

Using still another hypothetical, if ***tomorrow***, the Liquidating Trustee realized litigation proceeds of $20 million, the litigation funder would receive $6,975,000 **plus** 12% of $13,025,000 (the difference between $20 million and $6,975,000) which would equal another $1,563,000. Thus, **$8,538,000** on a **$2,325,000** investment. The Liquidating Trustee in this scenario of a **$20 million** verdict/settlement tomorrow realizes **$11,462,000** for him, his professionals, and thereafter the prepetition creditors. Again, as shown further in Part II.B. below, the Liquidating Trustee's counsel is currently owed $2,126,278.09 in unpaid fees (even after being paid handsomely with the previously undisclosed litigation funding). Thus, this would actually mean approximately **$9,335,721.91** being available for prepetition creditors in the context of a **$20 million** verdict/settlement tomorrow.

Obviously, the Liquidating Trustee (and the creditors), as well as the litigation funder, do better if a very large verdict/settlement is obtained. The problem here, among others, is that there is no settlement/verdict that is going to happen ***tomorrow***. And the litigation funding has run out. And the Liquidating Trustee and his counsel continue to accumulate fees. Other random observations: (1) a broker named Fincorp Associates, LLC (individual name Les Baer) obtained a $75,000 broker fee for arranging the litigation funding (this was not disclosed anywhere before being disclosed, generically, in Gonzales's declaration filed in response to the court's Show Cause Order in which he discloses the payment of a "small" and "modest" (but unspecified amount) broker fee); (2) the Liquidating Trustee gave the litigation funder a security interest in the litigation proceeds and the claims themselves; (3) the Liquidating Trustee must consult with the litigation funder regarding any new counsel brought in; and (4) there are indemnities provided by the Liquidating Trustee to the litigation funder.

On **June 18, 2025**, the court issued the Show Cause Order which ordered the Liquidating Trustee to appear on July 30, 2025 at 1:30 p.m. before the bankruptcy court and show cause ("Show Cause Hearing") as to whether his entry into the Litigation Funding Agreement was legally proper (presenting all arguments as to why—despite an apparent lack of disclosure in the Disclosure Statement and lack of authority in the Liquidating Trust Agreement) and also whether the Litigation Funding Agreement was entered into in the exercise of reasonable business judgment. The Show Cause Order indicated that the Liquidating Trustee would be permitted to put on any testimony regarding whether the Litigation Funding Agreement reflects reasonable market terms and whether (unbeknownst to the court) this is a standard practice of post-confirmation Chapter 11 trustees (i.e., entering into a litigation funding agreement post-confirmation and, in particular, doing this without any foreshadowing to the court or creditors at least pre-confirmation, in connection with plan confirmation). The Show Cause Order indicated that the court would consider all remedies, potential sanctions, and potentially an order voiding the Litigation Funding Agreement, depending on the argument and evidence of the Liquidating Trustee.

B. The Liquidating Trustee's Professional Fees and Costs, Post-Confirmation.

While the Liquidating Trustee's counsel was not required to file fee applications during this post-confirmation phase of the case (which is, of course, not unusual post-confirmation in Chapter 11), the court entered a "*Sua Sponte Order Directing Fee Reporting by the Liquidating Trustee*" on May 13, 2022—even before the Original Adversary Proceeding was filed—after former Debtors' counsel raised concern about the Liquidating Trustee's overzealous litigation tactics in a contested matter. The latest report filed by the Liquidating Trustee shows the following pertinent information: (a) Liquidating Trustee's counsel has been paid **$2,215,908.49** for post-confirmation fees and expenses (but it has billed/incurred a total of **$4,342,186.58**; thus, Dickinson Wright PLLC is owed **$2,126,278.09** currently—and the Seven Adversary Proceedings are

nowhere close to going to jury trial); (b) the Liquidating Trustee's financial advisory firm Caliber, of which the Liquidating Trustee is the only employee, has been paid **$371,737.80** for post-confirmation fees and expenses (it has billed $380,212.80)—and this is in addition to the Liquidating Trustee's individual $10,000 flat monthly fee, for which he has been paid **$330,000** (thus, a total of **$701,737** paid to the Liquidating Trustee and his one-man firm); (c) other professionals (tax accountant and a firm handling a contract matter of some sort) have cumulatively been paid **$13,214**). DE # 1111. **Roughly $3 million paid (with at least $2,126,278.09 unpaid)**. The fees and expenses have been funded mostly from the Litigation Funding since, as noted earlier, the Liquidating Trust was seeded with only $345,000 cash and has only received a few hundred thousand dollars in settlements.[8]

C. The Liquidating Trustee's Testimony and the Plan Documents.

The Liquidating Trustee testified at the *Show Cause Hearing* on July 30, 2025, that he has served as a trustee in bankruptcy approximately a half-dozen times (although he has years of collection experience as a banker). He represented that he believed, based on advice of counsel, that he had no obligation to disclose the Litigation Funding Agreement and no need to obtain court approval. He also testified that he never even considered entering into any litigation funding until around December 2022 or January 2023 (more than a year after confirmation) when the defendants in the Original Adversary Proceeding started putting up strong resistance. As a reminder, the Original Adversary Proceeding complaint was 71-pages long, plus eight exhibits, and it named 22 defendants (mostly or entirely insiders) and set forth 27 causes of action. It asserted $100 million in damages. The testimony and argument at the confirmation hearing had been that Mr. Gonzales

[8] Per Gonzales's declaration, the Trust had recovered approximately $670,000 in "preferences, settlements, reimbursements and refunds." DE # 1126-1, pp. 3-4, ¶ 20. The court notes that this amount is nearly twice the $375,000 amount disclosed by the Liquidating Trustee in his August 22, 2024 Status Report as having been recovered by him from his post-confirmation settlements/litigation since his appointment in January 2022. DE # 402, ¶ 6.

was up-to-speed on the claims and theories. It seems shocking to this court that he would not have anticipated massive resistance to a $100 million adversary proceeding, asserting 27 causes of action, against 22 defendants. In any event, Mr. Gonzales testified that he had never used litigation funding in the past. He testified that he never reached out to any local counsel in the Northern District of Texas to see if they might accept representation of him on a contingency basis. The former UCC counsel (Dickinson Wright PLLC), that he hired post-confirmation—that seemed so eager and willing to represent him at confirmation—apparently, did not want to be employed on a contingency basis. He believes that the Litigation Funding Agreement presents market-based terms. He hired a broker at a cost of $75,000 to connect him to a litigation funder. He did not anticipate that the litigation costs, post-confirmation, would ever grow as large as they have—which happened because of the allegedly unanticipated resistance from the defendants in the Seven Adversary Proceedings. The Liquidating Trustee and his counsel still believe that they will win big and that there will be an eventual payout to unsecured creditors. But meanwhile, the Liquidating Trustee acknowledges that ***he has not yet objected to several IRS proofs of claim that total at least $150 million in amount (priority)***. When pressed whether, ultimately, general unsecured creditors might perhaps receive no distribution, for the reason of these IRS claims alone, he testified that he believed the IRS's proofs of claim will be allowed at zero in amount, but he has not been able to afford to hire accountants to sort it out. When asked about his firm Caliber's receipt of **$371,737.80** for post-confirmation fees and expenses, on top of his $330,000 individual fees (flat $10,000 per month for 33 months), he testified that this was for independent contractors he hired that were CPAs and were helping with other proof of claim objections (not the IRS). However, they had done nothing to work on the IRS's massive claims. Moreover, video deposition testimony was played where he had testified inconsistently from the testimony at the Show Cause

Hearing (with regard to whether there were any Caliber employees or contractors assisting him in this Bankruptcy Case at all).

A careful review of the Disclosure Statement, the Plan, the Confirmation Order, and the Liquidating Trust Agreement show that there was no hint of ***the possibility of*** litigation funding—nothing that this court can find to put the court or creditors on notice of it being a possibility that might impact distributions to creditors under the Plan (note that 106 creditors cast ballots in favor of the Plan and 7 creditors cast ballots to reject the Plan). There are well over a dozen provisions in these collective documents that might be considered pertinent. In the Disclosure Statement, Article VI.D., states that "The Liquidating Trust's professionals shall be compensated at their respective hourly rates or on a contingency fee basis as agreed to by the Liquidating Trustee, without further motion, application notice, or other order of the Court. The fees and expenses of the Liquidating Trust's professionals ***shall be satisfied from the Liquidating Trust Assets***." (Emphasis added). The Plan defines "Liquidating Trust Assets" as "all of the Debtors' Assets transferred to the Liquidating Trust." The Plan further states, at Article I, Section 7, that the "fees and expenses of the Professionals ***shall be paid from the Liquidating Trust Assets***." (Emphasis added.) There is also a defined term in the Plan for "Liquidating Trust Administrative Reserves" defined as cash "in an amount necessary to satisfy reasonable costs and expenses of the Liquidating Trustee," and it shows no hint of supplementation of it with litigation funding. Finally, as noted earlier, very pertinent is the Exhibit D attached to the Disclosure Statement that showed "Projected Cash Available for Distribution." It showed projected "Litigation Costs" ranging from $150,000 to $350,000 per year over five years (along with Trustee's monthly fee amounting to $120,000 per year).

The Liquidating Trustee counters that the Liquidating Trust Agreement provided at Article IV, paragraph 7, that "the Liquidating Trustee shall not be required to obtain any approvals from

the Bankruptcy Court . . . and/or provide notice . . . to implement the terms of this Liquidating Trust Agreement, including, without limitation, the sale, transfer, disposal or contribution of any Liquidating Trust Assets retained by the Liquidating Trust . . ." The Liquidating Trustee says that the Litigation Funding Agreement is similar in nature to a "sale" or "transfer" of the Liquidating Trust Assets (in that it is essentially a sale of future proceeds therefrom, or a "waterfall" therefrom, in exchange for immediate cash). This court disagrees. The litigation funder here represents that it uses the title "Master Prepaid Forward Purchase Agreement" on the Litigation Funding Agreement for "tax and structural reasons" (suggesting that the funding is deemed to be an upfront prepayment for a purchase of litigation proceeds with the actual sale being settled at a future date when the litigation proceeds are realized). DE # 415 in Adv. Proc. No. 22-3087, p. 14 of 19. Whatever tax or other motivations exist here, the litigation funder was, in essence, providing capital in exchange for a later, hoped-for return. The litigation funder took a security interest in the claims and proceeds (the court is not aware if it was perfected). This was not anything contemplated in the Plan documents (including the draft Liquidating Trust Agreement) that went out for a creditor vote.[9] Moreover, to the extent the Liquidating Trust Agreement is ambiguous on this point, the ambiguity must be construed against the drafter of it (i.e., the Liquidating Trustee and his counsel).

D. The Expert Witness Testimony.

The litigation funder here, Litchfield Ventures, LLC ("Litchfield"), is an affiliate of GLS Capital, LLC ("GLS"). Litchfield was created for the specific litigation funding involved here.

[9] *Contrast* the different approach taken in the Sears Chapter 11 bankruptcy case. Motion of the Official Committee of Unsecured Creditors for Entry of an Order . . . Authorizing Entry by the Debtors' Estates Into The Litigation Funding Arrangement with Benchmark 21p, L.P., ¶ 44, [DE # 10407],] in *In re Sears Holdings Corp.*, No. 18-23538 (RDD) (Bankr. S.D.N.Y. Apr. 21, 2022) (noting that the Liquidating Trust Agreement approved under the chapter 11 plan authorized the Liquidating Trust Board created thereunder to incur financing to pursue litigation).

Litchfield has its own investors—the court did not inquire who they are.[10] GLS has been in existence since 2018 and is based in Chicago. It is apparently an active player in the commercial litigation funding industry, and it represented that it had never met the Liquidating Trustee or had any relationship with the relevant attorneys at Dickinson Wright PLLC. Prior to this, it had no familiarity with these Debtors or the bankruptcy.

Litchfield presented expert testimony from two experts in the field of litigation funding agreements. One was a law professor (Professor Tom Baker from University of Pennsylvania), and the other was a director at the global investment bank known as Stout Risius Ross, LLC (Joel E. Cohen). Both witnesses seemed knowledgeable regarding litigation funding agreements and seemed to acknowledge that litigation funding is an expensive product because of the risks involved (i.e., the non-recourse nature of it and the general uncertainty and delay of various litigation outcomes). They seem to think that the Litigation Funding Agreement here was within a standard range of market terms for these types of agreements. While the court has little doubt that these witnesses are very knowledgeable, one witness (Baker) testified that he had probably seen a "handful" of these agreements in his lifetime (because they are rarely made public). He knows about market terms from his "research and teaching" and from talking to participants in the industry. The other witness (Cohen) testified that he similarly had only seen a few actual litigation funding agreements. ***It is hard for a judge to determine if something is reasonable or within normal market terms when the experts admit that they have not seen too many***. Certainly, there has been commentary about the opacity of litigation funding agreements. *See* Samir Parikh, *Opaque Capital and Mass-Tort Financing*, YALE L.J. FORUM (Oct. 2023). They are rarely filed

[10] The court believes it could have. *See* ND TX LR 3.1(c) (local District Court Rule requiring a "Certificate of Interested Persons" to be filed with a civil complaint, which includes "legal entities that are financially interested in the outcome of the case").

on court dockets. Sometimes they are even protected from discovery. *See, e.g., Fleet Connect Sols LLC v. Waste Connections US, Inc.*, No. 2:21-CV-00365-JRG, 2022 U.S. Dist. LEXIS 1292167, at *7 (E.D. Tex. June 29, 2022); *In re DesignLine Corp.*, 565 B.R. 341, 344 (Bankr. W.D. N.C. 2017) (describing the trustee's ongoing efforts to seal information relating to litigation funding arrangement and the court's ultimate ruling that permitted shielding only of the proposed litigation budget); *In re Superior Nat. Ins. Gr.*, 2014 WL 51128, at *4 (Bankr. C.D. Cal. 2014) (requiring disclosure of litigation financing arrangement but permitting the trustee to seal terms relating to the amount of financing and how the money is to be used). *But see Dean v. Seidel*, 2021 WL 1541550, at *2 (N.D. Tex. 2021) (litigation funding agreement approved when presented with trustee's motion to employ special litigation counsel; appeal to Fifth Circuit was dismissed for appellant's lack of standing). *See generally* Kara Bruce, *The Promise and Peril of Third-Party Litigation Finance in Bankruptcy*, 44 No. 4 BANKR. LAW LETTER NL 1 (Apr. 2024) (for an extensive discussion of these issues).

III. CONCLUSIONS OF LAW

A. Bankruptcy Subject Matter Jurisdiction.

The court had bankruptcy subject matter jurisdiction to issue the *Show Cause Order* and to have conducted the *Show Cause Hearing*, pursuant to 28 U.S.C. §§ 1334 & 157—despite it being close to four years post-confirmation—since the issues involved bear on the interpretation, execution, and/or implementation of a confirmed plan. The Fifth Circuit has stated that, while bankruptcy subject matter jurisdiction is broad, it narrows once the debtor confirms its reorganization plan, because confirmation dissolves the debtor's bankruptcy estate. It has further elaborated that "related to" bankruptcy subject matter jurisdiction, post-confirmation, narrows to "matters pertaining to the implementation or execution of the plan." *In re GenOn Mid-Atlantic Development, L.L.C.,* 42 F.4th 523, 534 (5th Cir. 2022); *In re Enron*, 535 F.3d 325, 335 (5th Cir.

2008); *Craig's Stores of Tex., Inc. v. Bank of La. (In re Craig's Stores of Tex., Inc.)*, 266 F.3d 388, 390 (5th Cir. 2001). *See also U.S. Brass Corp. v. Travelers Ins. Grp. (In re U.S. Brass Corp.)*, 301 F.3d 296, 304 (5th Cir. 2002); *In re Chesapeake Energy Corporation*, 70 F.4th 273 (5th Cir. 2023).

There can also be "related to" post-confirmation bankruptcy subject matter jurisdiction in a situation in which a bankruptcy court seeks to enforce one of its orders. *Galaz v. Katona (In re Galaz)*, 841 F.3d 316, 322-23 (5th Cir. 2016). Enforcement of prior orders of the bankruptcy court is implicated here. The bankruptcy court issued an order during the Bankruptcy Case approving the Disclosure Statement as adequate that never disclosed the possibility of litigation funding and its potential, significant impact on creditor recoveries. The bankruptcy court similarly issued an order during the Bankruptcy Case approving the UCC's Plan and Liquidating Trust Agreement which never contemplated the possibility of litigation funding.

The Plan in this Bankruptcy Case also happened to contain typical "Retention of Jurisdiction" provisions at Article VIII.

B. <u>Lack of Disclosure and Authority.</u>

As set forth above, there was no disclosure to voting creditors that a tranche of large litigation funding might come ahead of them in payment. This is troubling from a section 1125 perspective. The Plan documents simply were silent on this point and that is unacceptable. In addition to lack of disclosure, the Liquidating Trust Agreement is not worded in a way that contemplated giving the Liquidating Trustee this authority.

C. <u>Lack of Reasonable Business Judgment.</u>

In any event, it is impossible for this court to find or conclude that that Litigation Funding Agreement here (even if the Liquidating Trustee had authority to enter into it—which he did not) was entered into in the exercise of reasonable business judgment, or reflected the actions of a prudent fiduciary. The hypotheticals shown earlier show the net recovery to the Liquidating

Trustee at a $10 million, $20 million, or $30 million settlement/verdict. The problem is that neither a settlement nor a verdict is anywhere on the horizon; the litigation funding is exhausted; the Liquidating Trustee's professionals are owed millions and will presumably continue to accrue millions; and there remain pending $150 million-plus in priority IRS claims that the Liquidating Trustee feels will be favorably resolved, but he has not hired tax experts yet to say that with certainly. This is not good.

The court is mindful of the wise words from Judge Posner of the Seventh Circuit many years ago, in a slightly different context (involving a Chapter 7 trustee):

> The . . . trustee's case . . . invites consideration of ***the exercise of litigation judgment*** by a Chapter 7 trustee. The filing of lawsuits by a going concern is properly inhibited by concern for future relations with suppliers, customers, creditors, and other persons with whom the firm deals (including government) and by the cost of litigation. The trustee of a defunct enterprise does not have the same inhibitions. A related point is that while the management of a going concern has many other duties besides bringing lawsuits, the trustee of a defunct business has little to do besides filing claims that if resisted he may decide to sue to enforce. ***Judges must therefore be vigilant in policing the litigation judgment exercised by trustees in bankruptcy***, and in an appropriate case must give consideration to imposing sanctions for the filing of a frivolous suit. The Bankruptcy Code forbids reimbursing trustees for expenses incurred in actions not "reasonably likely to benefit the debtor's estate," 11 U.S.C. § 330(a)(4)(A)(ii)(I), and authorizes an "appropriate sanction" against parties who file such a claim. Bankruptcy Rule 9011(b)(2), (c)(1)(B); *In re Bryson*, 131 F.3d 601, 603–04 (7th Cir. 1997); *In re Cohoes Industrial Terminal, Inc.*, 931 F.2d 222, 227 (2d Cir. 1991). Not "reasonably likely to benefit the debtor's estate" may well be a correct description of this suit.

Maxwell v. KPMG, LLP, 520 F.3d 713, 718 (7th Cir. 2008) (emphasis added). Here, the issue is different than in the *Maxwell* case (the court does not believe that the Liquidating Trustee has brought frivolous claims), but the Liquidating Trustee's litigation judgment is still implicated. The Liquidating Trustee obtained litigation funding ***without adequate disclosure to creditors and the court or authority***. And it is very expensive. ***This is bankruptcy where creditor recoveries are of paramount concern***. The creditors in this case were warned that their ultimate recovery was

uncertain. But they were advised in the Disclosure Statement that the projected professional fees would run from $150,000 to $350,000 per year, and they were never told that the Liquidating Trustee might pledge their recoveries in favor of pricey financing if things did not go according to plan. When the Liquidating Trustee pivoted to the pricey litigation funding, it was done with no transparency. Transparency is a hallmark of bankruptcy. As the court indicated at the June 5, 2025 status conference, the court is having trouble seeing how "the juice will ever be worth the squeeze" here. It would appear that the unapproved Litigation Funding Agreement has ensured that.

For the reasons set forth above:

IT IS ORDERED that the Liquidating Trustee acted improperly by entering into the Litigation Funding Agreement without there being a disclosure of it as a possible means to fund post-confirmation litigation, as required by Bankruptcy Code section 1125.

IT IS FURTHER ORDERED that the Liquidating Trust Agreement did not grant the Liquidating Trustee authority to borrow funds post-confirmation or undertake litigation funding.

IT IS FURTHER ORDERED that, as a result of this lack of disclosure and lack of authority, the Liquidating Trust has no contractual liability to the litigation funder.

IT IS FURTHER ORDERED that, even if the Liquidating Trust Agreement did grant broad enough authority to the Liquidating Trustee to enter into a litigation funding agreement, the Liquidating Trustee did not exercise reasonable business judgment or act as a prudent fiduciary here, given the exorbitantly expensive terms of the litigation funding.

IT IS FURTHER ORDERED that the Liquidating Trustee's entry into the litigation funding agreement was an abuse of discretion, harmful to the creditors/trust beneficiaries, not permitted under the terms of the Confirmation Order, the Disclosure Statement, the Plan, or the Liquidating Trust Agreement, and constituted an abuse of the bankruptcy process.

IT IS FURTHER ORDERED that, in order to enforce its prior orders and to prevent an abuse of process, a new liquidating trustee shall be promptly appointed in substitution of the current Liquidating Trustee. While this is not normally something within the purview of the U.S. Trustee (i.e., appointing a post-confirmation trustee), the court is directing it, pursuant to this court's power under sections 105(a) and 1142(b) and Bankruptcy Rule 3020(d), to appoint a suitable candidate from its list of panel trustees, since there is no oversight committee under the Liquidating Trust Agreement to perform the task of voting on a new trustee, and, in fact, the Liquidating Trust Agreement has an unworkable requirement of a 75% vote of the beneficiaries of the Liquidating Trust to replace the Liquidating Trustee.

IT IS FURTHER ORDERED that the following parties shall engage in an expanded global mediation as soon as practicable: the new replacement liquidating trustee; the defendants in the Seven Adversary Proceedings; the current Liquidating Trustee, David Gonzales, and his professionals including Caliber and Dickinson Wright PLLC (who may all be subject to disgorgement of fees); and Litchfield, the litigation funder.

###END OF MEMORANDUM OPINION AND ORDER###

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF IOWA

IN RE:	
BDC GROUP, INC.,	Chapter 11
Debtor	Bankruptcy No. 23-00484

OPINION ON MOTION TO RECOGNIZE LIEN AND MOTION FOR SUMMARY JUDGMENT

The matters before the Court are secured creditor Keystone Savings Bank's ("KSB's") Motion to Recognize Lien and Motion for Summary Judgment. The Official Committee of Unsecured Creditors ("OCUC") filed an objection and a counter Motion for Summary Judgment. The Court held a telephonic hearing and took the matter under advisement on the papers submitted. Soon thereafter, the case converted to Chapter 7. The question arose whether the issue between KSB and the Chapter 11 OCUC (no longer a party) was still a live controversy. After several status conferences, the Chapter 7 trustee adopted and restated the position of the OCUC resisting KSB's motion. The Court held a hearing on the matter on March 28, 2024, and took the matter under advisement. This is a core proceeding under 28 U.S.C. § 157(b)(2)(K).

I. Statement of the Case

BDC Group, Inc. ("BDC") was a solutions-based provider for broadband and communication infrastructure development. BDC filed for Chapter 11 bankruptcy on June 13, 2023. KSB moved the Court to recognize its security interests and its claim of a lien on Debtor's Chapter 5 avoidance actions and proceeds. It then filed a Motion for Summary Judgment on the issue. KSB argues that BDC's multiple pre-petition security agreements pledge substantially all its property—including the bankruptcy Chapter 5 actions—to secure debt owed to KSB. The OCUC argued that Chapter 5 actions only come into being upon the commencement of the bankruptcy case, and there is no legal basis for KSB's security interests to reach them. The case converted to Chapter 7 and eventually the Chapter 7 trustee adopted the position of the OCUC. For the reasons that follow, the Court rejects KSB's arguments and concludes its lien rights do not extend to Chapter 5 avoidance actions.

II. Legal Standard

Summary judgment is appropriate if the evidence demonstrates that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Transcon. Ins. Co. v. W.G. Samuels Co., 370 F.3d 755, 757 (8th Cir. 2004). "Summary judgment is appropriate when only questions of law are involved." Sarachek v. Wahls (In re Agriprocessors), Ch. 7 Case No. 08-02751, Adv. No. 10-09196, 2012 Bankr.

LEXIS 2452, at *6 (Bankr. N.D. Iowa May 30, 2012) (citing Anderson v. Hess Co., 649 F.3d 891, 894 (8th Cir. 2011)). Courts must evaluate admissible evidence in the light most favorable to the non-moving party. Iowa 80 Grp. v. IRS, 406 F.3d 950, 952 (8th Cir. 2005). Here, the parties filed cross motions for summary judgment and the same standards apply. In re McDonald, No. AP 18-09036, 2021 WL 1234456, at *3 (Bankr. N.D. Iowa Mar. 30, 2021). The Court agrees with the parties that there are no disputed material facts.

III. FINDINGS OF FACT

The parties agreed at the hearing and in their filings that there are no issues of material fact. The following are the undisputed material facts. The security agreements executed in favor of or held by KSB and related UCC financing statements identify "general intangibles" as collateral. KSB timely filed a proof of claim in BDC's bankruptcy case asserting its rights against all of its collateral.

IV. CONCLUSIONS OF LAW AND DISCUSSION

Because there are no disputes of material fact, the moving party must demonstrate that it "is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The law is governed largely by the recent Eighth Circuit case, Pitman Farms v. ARKK Food Co. (In re Simply Essentials), 78 F.4th 1006 (8th Cir. 2023). In Simply Essentials, the Eighth Circuit held that avoidance actions are property of the estate that a trustee can sell under § 541(a) of the Bankruptcy Code. Id. at 1011. In reaching

its conclusion, the Eighth Circuit noted (in one of two holdings on property of the estate) that avoidance actions are property of the estate under § 541(a)(1) because "the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings." Id. at 1009. This statement about "an inchoate interest in the avoidance actions" is the focus of the issue raised here. The parties argue about whether BDC's inchoate interest in avoidance actions before bankruptcy was sufficient to give KSB a lien on avoidance actions that arose after the case was filed through the pledge of "general intangibles."

A. Existing Case Law Has Rejected KSB's Arguments

The weight of the case law that existed before the Simply Essentials decision flatly rejected the arguments KSB makes here. "[A] pre-petition lien does not attach to rights or actions by the trustee of a bankruptcy estate that did not exist prior to the bankruptcy filing." In re Pierport Dev. & Realty, 491 B.R. 544, 549 (Bankr. N.D. Ill. 2013) (citing In re Tek-Aids Indus., 145 B.R. 253, 256 (Bankr. N.D. Ill. 1992)). The trustee's claims arise "as of the date of the bankruptcy filing and [are] not subject to any creditor's pre-petition lien." Id. at 550.

> Avoidance actions, **including those arising under state law**, can only be brought by the trustee after the petition is filed under the trustee's section 554(b) rights. These claims, therefore, arise post-petition and must be considered after-acquired property belonging to the estate. Further, because the **Debtor does not own the right to pursue a fraudulent transfer action in bankruptcy (since that action belongs to the trustee post-petition under section 544(b)), the Debtor could not have encumbered or assigned that right prepetition**.

Official Comm. of Unsecured Creditors v. UMB Bank (In re Residential Cap., LLC), 497 B.R. 403, 414 (Bankr. S.D.N.Y. 2013) (emphasis added). See also In re Connolly Geaney Ablitt & Willard, P.C., 585 B.R. 644 (Bankr. D. Mass. 2018) (relying on In re Residential Cap. and holding that pre-petition liens do not attach to avoidance recoveries); In re AMKO Fishing Co., No. 1:15-BK-00489, 2018 WL 3748820 (B.A.P. 9th Cir. Aug. 7, 2018) ("[T]he Trustee accedes to general unsecured creditors' right to bring a fraudulent conveyance action [or other Chapter 5 actions], **which the debtor cannot otherwise encumber.**") (emphasis added); In re Ludford Fruit Prod., Inc., 99 B.R. 18, 25 (Bankr. C.D. Cal. 1989) ("To conclude that preference actions are the proceeds of collateral held pursuant to a pre-petition security interest would not only violate logic but also the policy behind the avoidance powers.").

The leading treatise, Collier on Bankruptcy, is consistent with this body of caselaw:

> Once a bankruptcy case commences, however, because all recoveries under the avoiding powers are property of the estate, administered almost exclusively by the trustee for the benefit of the estate as a whole rather than for any creditor individually, **it is difficult to see how such recoveries can be other than "after-acquired property" within the meaning of section 552(a), rather than proceeds of prepetition collateral under section 552(b)(1).** This is true for fraudulent transfers as well as preferences, and no persuasive distinction seems possible along these lines. Prebankruptcy state law preferences exist, and may be asserted postbankruptcy under section 544(b) of the Bankruptcy Code. And the assertion by a trustee of state fraudulent transfer law under section 544(b) allows for an expanded recovery under the rule of *Moore v. Bay*, as well as section 550, underscoring the fact that the recoveries that are property of the estate under section 541(a)(3) **are**

> **peculiarly postpetition in nature**. Indeed, a creditor may not sue to recover a state law fraudulent transfer once a case in bankruptcy is commenced, because this would be taking a chose in action from the estate, thereby violating the automatic stay. **On the whole, therefore, the more persuasively reasoned opinions do not permit secured creditors to share in recoveries obtained by bankruptcy trustees or estate representatives pursuant to the avoiding powers, even where such creditors may have independent, traceable rights to those funds**.

5 Collier on Bankruptcy ¶ 552.02[5][d] (16th ed. 2020) (emphasis added).

B. Effect of Simply Essentials Decision on Existing Case Law

Nothing from Simply Essentials changes this well-established law. Simply Essentials never addressed this issue at all. KSB also never discusses this well-established case law other than to suggest it all predates Simply Essentials and has somehow been overruled. KSB does not even have an independent right to recovery which (as noted above) would give it the best—but still insufficient—argument. KSB is only trying to claim the trustee's post-petition right of recovery on avoidance actions for its own. That right to recovery is "peculiarly postpetition in nature." 5 Collier on Bankruptcy ¶ 552.02[5][d] (16th ed. 2020). It arises post-petition and only for the trustee or debtor in possession ("DIP") to pursue, and only for the benefit of the estate—not a single creditor.

The Eighth Circuit recognized in Simply Essentials that the "debtor in possession or the Trustee" is the party with the rights to the avoidance action—not Debtor. 74 F.4th at 1009–10. The Court recognized avoidance actions are allowed

solely for the benefit of the estate and its creditors—not debtor or one of its creditors—and "belong to the estate". Id. The case did not purport to change this well-established law. KSB argues that because the Eighth Circuit noted (in one of its two alternative holdings on property of the estate) "that the debtor has an inchoate interest in avoidance actions prior to the commencement of the bankruptcy proceeding," this somehow necessarily changed the law and gives KSB a security interest in the trustee's actions that arise after the bankruptcy filing. KSB reads far too much into the Eighth Circuit's comment about "an inchoate interest" of the debtor.

1. *Debtor's Inchoate Interest is Narrowly Defined in Simply Essentials*

KSB seems to believe Simply Essentials defines Debtor's inchoate property interest in avoidance actions as equating to debtor's inchoate right to pursue and recover on those actions. Thus, KSB argues Debtor assigned these rights pre-petition to KSB as collateral, and KSB now controls or has a right to the recoveries on those actions. Simply Essentials says no such thing. The Eighth Circuit carefully defined what the rights of the various parties are:

> [A]voidance actions are used to undo transfers [of property] made by the debtor prior to the commencement of the bankruptcy that were made **voidable by the Bankruptcy Code.** Because debtors have the right to file for bankruptcy and the **debtor in possession or the Trustee may file avoidance actions** to recover property [for the estate], the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings.

In re Simply Essentials, 78 F.4th at 1009 (emphasis added). The Eighth Circuit thus narrowly limited Debtor's right in those avoidance actions to the act of filing the bankruptcy, which triggers the ability to have those transfers possibly undone by the trustee or DIP for the benefit of all creditors. Nowhere does Simply Essentials say Debtor's pre-petition inchoate right extends to or matures into the Debtor's right to recovery of the value of avoidance. That is not possible under the law. Simply Essentials specifically limits the inchoate right of debtor to something that is essentially legal—a right to file **bankruptcy** and invoke the Bankruptcy Code including its powers to have the trustee or DIP undo debtor's own transfers. Debtor's remaining inchoate right after invoking the Bankruptcy Code is limited to the remote right to participate in a distribution if enough recovery is made that all creditors are paid in full.

2. *KSB's Broad Reading of Debtor's Inchoate Interest Conflicts with Fundamental Bankruptcy Principles*

KSB's entire argument hinges on an assumption that the pre-petition inchoate right of Debtor is much broader and includes the right to receive the trustee's avoidance recovery, which KSB can claim as part of its "general intangibles" collateral. The Eighth Circuit again, says no such thing. It simply reiterates the long-established law that the filing of bankruptcy creates Chapter 5 avoidance actions, places them under the exclusive control of the trustee or DIP (or a creditor the Court approves to act in the Trustee's place), and specifies the recovery is solely

for the benefit of the estate—and its creditors. Id. Again, the law is well-established on these points. Briar Cap. Working Fund Cap. v. Remmert (Matter of S. Coast Supply Co., 91 F.4th 376, 382 (5th Cir. 2024), cert. denied sub nom. Remmert v. Briar Cap. Working Fund Cap., LLC., 144 S. Ct. 2631 (2024); In re Connelly Geaney Ablitt & Willard, P.C., 585 B.R. 644, 649–51 (Bankr. D. Mass. 2018); In re Residential Cap., 497 B.R. at 414–15; In re EPD Investment Co., No. 2:10-BK-62208-ER, 2018 WL 947636 at *8–10 (Bankr. C.D. Cal. Feb. 17, 2018); In re Pierport Dev. & Realty, 491 B.R. at 549. The only thing the Debtor controls in any of this is simply the right to file bankruptcy—a legal right to trigger the trustee's or DIP's rights to pursue these recoveries for the estate. When Debtor files, it gives those actions a chance to come into legal existence. It is the crucial and necessary step to allow the avoidance actions—which could not exist pre-petition—to exist. They come into existence solely by statute upon filing and solely for the benefit of the estate.

a. Debtor's Inchoate Right Before Bankruptcy is a Narrow Legal Right Not Subject to a Lien

The inchoate right KSB argues for—the right of the Debtor to file avoidance claims and to recover money for itself—did not and could not exist pre-petition, or ever. The best way to understand this is to look to what KSB could have collected upon that was tied to the inchoate interest if bankruptcy was never filed. See Butner v. United States, 440 U.S. 48, 55 (1979) (explaining that property interests, including security interests, should be defined and analyzed the same inside and outside of

bankruptcy). The answer is nothing. Trustee's avoidance actions do not exist outside of bankruptcy. The inchoate property rights Debtor had pre-petition never encompassed—nor could they ever encompass—any collectible value outside bankruptcy. That does not mean that the inchoate right described in Simply Essentials never exists. It exists as a right that likely has no monetary value, except in the unlikely event that enough is recovered by the estate that all creditors would be paid and there would still be money available for the Debtor. The right, however, is one with strategic and legal value for Debtor in deciding to file for bankruptcy. It would not—in any event—be a "general intangible" right of **debtor** with value pre-petition that KSB could claim as collateral. There is simply no lienable property interest KSB has access to at any time.

This legal or other remote right with limited to no value or transferability nevertheless becomes property of the estate. In re Ryerson, 739 F.2d 1423, 1425 (9th Cir. 1984) (property interest, even if not transferable, becomes estate property); In re Jones, 487 B.R. 224, 229 (Bankr. D. Ariz. 2012) ("[T]here is no requirement that the debtor be able to transfer the interest, or that creditors be able to reach it, for the interest to be part of the estate"). This concept of the debtor's pre-petition inchoate property interest having no monetary value is not unusual. A somewhat similar inchoate dower right was discussed in In re Ventura, 582 B.R. 755 (Bankr. N.D. Iowa 2018). This Court noted that:

> Iowa law provides that, while the spouse is alive, a statutory dower share is an **inchoate, contingent interest** but is nonetheless a property right that attaches during the spouse's life. The nature of the statutory dower interest as a property right under Iowa law compels the Court to find that it became property of the estate.

Id. at 765 (emphasis added). The inchoate dower interest becomes part of the bankruptcy estate, "but it [is] impossible to transfer that interest to Trustee—and so it [is] also impossible for Trustee to 'use, sell, or lease' the interest." Id. Like Ventura, this case has an "inchoate interest" of the pre-petition Debtor that enters the estate—but has no monetary value nor can it be administered by the estate. Here, like Ventura, the pre-petition inchoate interest could not be sold or transferred at any point by the Debtor itself.

The inchoate, contingent dower interests and the inchoate, contingent Chapter 5 interests are certainly not identical in every way. Dower rights vest in the holder upon the holder's spouse's death. Id. at 766. This could happen before or after bankruptcy. Up until that point, the dower holder cannot transfer the interest. Here, there can be no "vesting" or maturing of the claim for **Debtor**. The avoidance actions only are available for the trustee or DIP. The inchoate right of Debtor never produces value unless it is the rare case where all other creditors are paid and money still remains. Simply stated, this case is another "strange case where the interest is technically property of the estate under § 541," but it has no continuing value for practical purposes to the debtor—unless all other creditors are paid in full. Id.

b. Debtor Had No Ownership Interest in Avoidance Actions

KSB has no basis on which to claim a lien on "Debtor's causes of action" because the avoidance actions were **never Debtor's causes of action**. In re Residential Cap., 497 B.R. at 414 ("[B]ecause the Debtor does not own the right to pursue a fraudulent transfer action in bankruptcy … the Debtor could not have encumbered or assigned that right prepetition.") (citing numerous cases). Avoidance actions come into being by statute, not as a continuation of rights already held by Debtor pre-petition. Matter of S. Coast Supply Co., 91 F. 4th at 382 (a preference action "is a right of action created by federal bankruptcy law."); In re Pierport Dev. & Realty, 491 B.R. at 549 (citing In re Tek-Aids Indus., 145 B.R. 253, 256 (Bankr. N.D. Ill 1992) (holding that the right to bring a preference under § 547 arises as a special provision under the Bankruptcy Code)). The Debtor never had—nor could it have—any such right pre-petition.

The only possible rights that existed pre-petition to carry over into avoidance actions are those that existed under state law for **all other creditors**—to use for collections if no bankruptcy case was ever filed. In re AMKO Fishing Co., No. 1:15-BK-00489, 2018 WL 3748820 (B.A.P. 9th Cir. Aug. 7, 2018) ("[T]he Trustee accedes to general unsecured creditors' right to bring a fraudulent conveyance action [or other Chapter 5 actions], **which the debtor cannot otherwise encumber**.") (emphasis added). See also In re Connelly Geaney Ablitt & Willard, P.C., 585 B.R.

at 649 (state law avoidance claims can only be brought by trustee under §544(b) and "[d]ebtor does not own the right to pursue a fraudulent transfer action in bankruptcy (since that action belongs to the trustee post-petition under section 544(b))."); In re Residential Cap., 497 B.R. at 414 ("Avoidance actions, including those arising under state law, can only be brought by the trustee **after** the petition is filed.") (emphasis added). In fact, Simply Essentials cited Nat'l Tax Credit Partners L.P. v. Havlik, 20 F.3d 705, 708–09 (7th Cir. 1994) as stating: "[T]he right to recoup a fraudulent conveyances, **which outside of bankruptcy may be invoked by a creditor**, is property of the estate that only a trustee or debtor in possession may pursue once a bankruptcy is under way." 78 F. 4th at 1010 (emphasis added).

KSB is not claiming any lien rights in those actions that existed for all creditors outside of bankruptcy. KSB had no security agreement with all creditors that suggested any such thing—and it has never asserted such rights. Yet, KSB is claiming rights in a thing that was only created post-petition—the bankruptcy trustee's avoidance actions. KSB's claim is that it has such rights through the Debtor even though **avoidance actions**, by their very terms, **arise as a creditor's right outside bankruptcy**, and in bankruptcy are available only for the benefit of all creditors. KSB is entirely without a basis for such a claim. The trustee or DIP never had any security agreement with KSB. "All creditors" similarly had no such agreement with KSB.

c. KSB's Argument Conflicts with Existing Law and Undermines the Actual Holding of Simply Essentials

Nowhere did Simply Essentials suggest that a pre-petition debtor can recover monetarily from post-petition avoidance actions. Under the law, that is not possible unless all other creditors are paid in full first. See 11 U.S.C. 726(a) (statutory distribution scheme placing Debtor last in the distribution order). Simply Essentials certainly did not say anything like that or suggest Debtor could give such rights as collateral to one pre-petition creditor. KSB would have this Court believe Simply Essentials was a radical decision that fundamentally changed many aspects of the well-settled law. KSB is arguing that now a trustee or DIP's rights to recover avoidance actions for the estate can be taken away by a pre-petition Debtor who decided to assign those rights (as collateral) for the sole benefit of a single pre-petition creditor. KSB is suggesting that Simply Essentials set up a new role where a pre-petition debtor can funnel the benefit of those avoidance actions for one creditor until that creditor's claims have been satisfied. KSB is essentially arguing Simply Essentials changed three bedrock principles noted by numerous citations above: (1) avoidance actions arise by statute post-petition; (2) the trustee or DIP has the sole right to pursue avoidance actions, and (3) those avoidance actions can only be pursued for the benefit of all the estate's creditors, unless the Trustee or DIP sells them after filing. Nothing in Simply Essentials supports such a radical conclusion.

The Simply Essentials opinion did not make any such holdings. Simply Essentials reiterated, not undercut, all of these bedrock principles.

KSB's reading of Simply Essentials would entirely undermine the actual holding and result of the opinion. The Eighth Circuit concluded avoidance actions are property of the estate that the **trustee** can sell "**for the benefit of** the estate." 78 F. 4th at 1008 (emphasis added). KSB argues for a reading of the case that would undercut or effectively gut that result. KSB believes the case allows the pre-petition Debtor to provide Trustee's avoidance actions as a single creditor's collateral and that single creditor could claim all the benefit of those actions until it, not the other creditors of the estate, was paid in full. The trustee or DIP would not be able to sell any avoidance actions for the estate because a pre-petition creditor could lock them up for its sole benefit. This is the opposite of the result and rationale of Simply Essentials. The only reading of the case that makes it consistent with itself and the existing law is the one adopted by this Court. This Court rejects KSB's reading as a matter of law and common sense.

d. KSB's Cited Case Law Does Not Apply to Avoidance Actions

KSB cites case law for the proposition that "[w]here the parties include an after acquired property clause, inchoate choses in action are brought within the grasp of the security interest." In re Heron, Burchette, Ruckett, & Rothwell 148 B.R. 660, 683 (Bankr. D.D.C. 1992) (citing supporting cases). This rule applies only to

Debtor's causes of action that **Debtor** has an interest in pre-petition—but happen to fully mature post-petition. This rule does not apply here, where Debtor has no right in the action that would allow Debtor to pursue it outside of bankruptcy if it matured. See Butner, 440 U.S. at 55 (rights of creditors defined and analyzed the same inside and outside of bankruptcy). Simply stated, Debtor has no actionable right here, as those avoidance rights arise in trustee or DIP after filing—and only in all other creditors (if at all) before filing. That could never happen here because bankruptcy avoidance actions only come into being after filing and do not take life from Debtor's rights in Debtor's pre-petition past. The only theoretical related rights that existed pre-petition were those under state law for all creditors—not Debtor.

This result does not deprive KSB of key collateral it bargained for or on which it based its lending decisions. KSB is simply aggressively pursuing an argument to **add** to its collateral based on case law arising well after it made its bargain. KSB's collateral is not being reduced from what it bargained for or had reason to believe was available. KSB's collateral, in the simplest terms, is not expanded by the language from the Simply Essentials opinion about Debtor's inchoate pre-petition interest.

3. *KSB Ignores Simply Essentials Holding Under 11 U.S.C. § 541(a)(7)*

KSB also almost entirely ignores the second and equally applicable holding from Simply Essentials—which requires no consideration of Debtor's inchoate

interest at all. That second and equally applicable holding was: "the avoidance actions **clearly qualify** as property of the estate under subsection (7) which includes 'any interest in property that the estate acquires **after** the commencement of the case.' The Bankruptcy Code makes these assets **available to the estate after** the **commencement of the case**." 78 F. 4th at 1009 (emphasis added). KSB has no argument about how it could possibly have full control or benefit of the avoidance actions as it claims—and still be consistent with this holding. In short, these assets cannot be covered entirely by KSB's lien and still be available to the estate for the benefit of all creditors.

KSB's only arguable response to Simply Essentials section 541(a)(7) holding is that the "after-acquired" avoidance actions are "proceeds" of KSB's collateral interest in Debtors pre-petition inchoate right. This argument contradicts section 541(a)(7) and the Simply Essentials conclusion that avoidance actions arise and are acquired by the estate post-petition. There is no tie to a pre-petition right of Debtor because, under section 541(a)(7), the estate acquired the right post-filing when it came into being. This provides no basis for KSB's lien arguments.

a. Case Law Rejects KSB's Arguments that Avoidance Actions are Proceeds of Pre-petition Collateral

Even if the Court were to assume KSB has a recognizable pre-petition security interest in avoidance actions (which it does not), the Court rejects KSB's proceeds

argument as being directly contrary to the law. Section 552 addresses the post-petition effect of security interests. It states:

> Except as provided in subsection (b) of this section, **property acquired by the estate** or by the debtor **after the commencement of the case is not subject to any lien** resulting **from** any **security agreement** entered into by the debtor **before the** commencement of the **case**.

11 U.S.C. § 552(a) (emphasis added). Subsection(b)(1) states, in relevant part:

> … if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest … extends to property of the debtor acquired before the commencement of the case and to **proceeds** … of such property, then such security interest extends to such **proceeds** … acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law.

11 U.S.C. §552(b)(1) (emphasis added). KSB argues under these sections that its lien on general intangibles includes the inchoate right of Debtor before bankruptcy and extends to the avoidance actions the estate acquires after the bankruptcy is filed because these actions are "proceeds" of that pre-petition inchoate interest. Similar arguments, again, have been almost uniformly rejected by case law which KSB does not even acknowledge. "Proceeds" only covers "property that is directly attributable to prepetition collateral, without addition of estate resources." In re Residential Cap., 501 B.R. at 612. See also In re Twin Pines, LLC, 2021 WL 312674 at *18 (Bankr. D.N.M. Jan. 29, 2021) (same). The Courts have generally found this rule to stem from and be consistent with Supreme Court case law that prohibited "the creation of an enforceable lien upon a subject **not existent when the bankruptcy became**

effective or even arising from, or connected with, preexisting property, but brought into **being solely as the fruit of the subsequent labor of the bankrupt**." In re Barbara K Enterprises Inc., 2008 WL 24 39679 at *10 (Bankr. S.D.N.Y. 2008) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 243 (1934) (emphasis added). Here, avoidance actions by the trustee or DIP did not exist at filing and, at a minimum, are the quintessential things that require the addition of estate resources to succeed and produce a recovery. In fact, Simply Essentials recognized this very point by noting that estates often do not have the resources to pursue those actions—and instead of letting them go with no recovery, Trustees can sell them to get a recovery. 78 F. 4th at 1010.

Avoidance actions arise post-petition as after-acquired property, not proceeds. In re Stallings, 290 B.R. 777, 783 (Bankr. D.Id. 2003) ("It must be emphasized that subsection (b)(1) creates and exception for proceeds … generated by prepetition collateral, and not for 'after-acquired' property obtained by the … estate postpetition") (citing Collier on Bankruptcy ¶ 552.02[1] 552–7). The actions do not stem from or arise out of property of the debtor acquired pre-petition that was changed, converted, substituted, or replaced with some other property. In Matter of Strick Chex Columbus Two, LLC, 542 B.R. 914, 919 (Bankr. N.D. Ga. 2015). Debtor does not own the right to avoidance actions. In re Residential Cap., 497 B.R. at 414. Again, Debtor could not have encumbered those actions pre-petition. Even if so,

there is no pre-petition collateral that could possibly produce post-petition "proceeds." Id. They arise as a brand-new thing only after bankruptcy is filed. That is the second holding of Simply Essentials under § 541(2)(7). Debtor has no pre-petition right to collect on or recover from those actions—it is simply never a right debtor would or could have. When those rights are created, they are **created** post-petition in the trustee or a DIP, solely for one of them to pursue, and solely for the benefit of the estate. The filing that creates them thus makes their entire existence post-petition. They do not spring from something pre-petition. In re EDP Inv. Co., 2018 WL 947636 at *9–10 (Bankr. C.D. Cal. Feb. 17, 2018) (drawing key distinction between rights that arise entirely post-petition as being after acquired property and proceeds of pre-petition collateral.). They are not something that exist or can be used by debtor ever in a pre-petition setting.

The case of In re Connolly Geaney Ablitt & Willard, P.C. recited all these authorities and arguments at length before concluding the Residential Capital analysis was particularly persuasive. 585 B.R. 644, 651–63 (Bankr. D. Mass. 2018) (citing and quoting Residential Cap., 497 B.R. at 414). Similarly, in In re EDP Investment Co., the court held that:

> [A]ll recoveries under the avoiding powers are property of the estate, administered almost exclusively by the trustee for the benefit of the estate as a whole rather than for any creditor individually, it is difficult to see how such recoveries can be other than 'after-acquired property' within the meaning of section 552(a), rather than proceeds of prepetition collateral under section 552(b)(1).

2018 WL 947636 at *9–10 (Bankr. C.D. Cal. 2018) (quoting 5-552 Collier on Bankruptcy ¶ 552.02)). Proceeds are something received in **exchange for** or upon the sale of **collateral**. Id.

> The Bankruptcy estate's right to sue under 11 U.S.C. § 547 is not received by the bankruptcy estate in exchange for the transfer of any property. Rather, it is a special power Congress grants to the fiduciary in charge of a bankruptcy estate, trustee or debtor in possession, to implement the equal distribution of assets among the various classes of claims in the estate. To conclude that preference actions [or any avoidance claims] are the proceeds of collateral held pursuant to a pre-petition security interest would not only violate logic but also the policy behind the avoidance powers.

Id. (citing In re Integrated Testing Products Corp., 69 B.R. 901, 904–05 (D.N.J. 1987)). This Court adopts and reiterates these cases' detailed rationales and finds they are fully applicable after the decision in Simply Essentials. These cases fully dispose of KSB's remaining arguments.

4. *KSB's Arguments Conflict with Simply Essentials Emphasis on Maximizing Value of the Estate*

In fact, KSB's arguments violate the principles set forth by Simply Essentials in another important way referenced above. Simply Essentials noted that its decision to allow sale of avoidance actions "is consistent with the congressional intent behind including a fiduciary duty to maximize the value of the estate." 78 F. 4th at 1010. The 5th Circuit, in adopting the Simply Essentials holding, specifically noted how the Eighth Circuit "succinctly explained" that the decision furthered the policy of

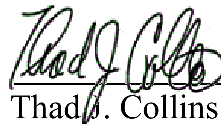
maximizing the estate for all creditors. KSB's position—in addition to being wrong as a matter of law—would do the opposite—diminish what is available to the estate and funnel it all to KSB, a single creditor.

V. CONCLUSION/ORDER

For the foregoing reasons, KSB's motions are denied.

Ordered:

September 10, 2024



Thad J. Collins
Chief Bankruptcy Judge

589 B.R. 614
United States Bankruptcy Court,
N.D. Illinois, Eastern Division.

IN RE: Anthia R. HILL and Network Salon Services, LLC, Debtors.
Frances Gecker, not individually, but solely in her capacity as chapter 7 trustee for the bankruptcy estates of Anthia R. Hill and Network Salon Services, LLC Plaintiff,
v.
LG Funding, LLC, a New York limited liability company, Defendant.

Case No. 16 B 17113 (Jointly Administered)
|
Adv. No. 17 A 00072
|
Signed August 15, 2018

Synopsis
Background: Chapter 7 trustee brought adversary proceeding to avoid prepetition transfers and to disallow transferee's claim.

Holdings: The Bankruptcy Court, Jacqueline P. Cox, J., held that:

[1] while merchant cash advance (MCA) transactions pursuant to which debtor sold its accounts receivable at discount to company that provided financing for its business were not treated as "loans" under New York law, this was not to say that these MCA transactions did not create antecedent "debts," of kind required to support trustee's preference claims;

[2] prepetition debt that debtor incurred to company in the business of making merchant cash advances (MCAs) was incurred in the ordinary course;

[3] parties' deviation from terms of their merchant cash advance (MCA) agreement did not affect the ordinariness of payments;

[4] debtor had to be regarded as having received "reasonably equivalent value" in form of MCA advance, of kind sufficient to foreclose any constructively fraudulent transfer claim by trustee; and

[5] statute authorizing court to disallow a claim filed by any entity in receipt of a transfer avoidable under specified provisions of the Bankruptcy Code had no application where recipient of challenged transfers had not filed proof of claim.

Judgment for defendant.

Procedural Posture(s): Judgment.

West Headnotes (29)

[1] **Bankruptcy** Recovery of preferences or fraudulent conveyances
Bankruptcy Bankruptcy judges
Bankruptcy court, even as non-Article-III court, had constitutional authority to enter final order on trustee's preference avoidance claim, as matter "stem[ming] from the bankruptcy itself." U.S. Const. art. 3, § 1 et seq.; 11 U.S.C.A. § 547(b).

[2] **Bankruptcy** Preferences
Preference provision is integrally bound up with the Bankruptcy Code's overall scheme for ensuring equitable distribution among creditors; indeed, preferences are avoidable precisely because they enable some creditors to receive more than their fair distribution under the Code. 11 U.S.C.A. § 547(b).

[3] **Bankruptcy** Antecedent debt or contemporaneous consideration
While merchant cash advance (MCA) transactions pursuant to which Chapter 7 debtor sold its accounts receivable at discount to company that provided financing for its business were not treated as "loans" under New York law, this was not to say that these MCA transactions did not create antecedent "debts," of kind required to support trustee's preference claims against company, by obligating debtor to

turn over an agreed portion of its receivables to company until the nondiscounted value of receivables was repaid. 11 U.S.C.A. § 547(b)(2).

1 Case that cites this headnote

[4] **Usury** Loans or sales of credit
Usury Criminal Responsibility

Merchant cash advance (MCA) transactions pursuant to which Chapter 7 debtor sold its accounts receivable at discount to company that provided financing for its business, not being in nature of "loans" under New York law, could not be criminally usurious. N.Y. Penal Law § 190.40.

1 Case that cites this headnote

[5] **Usury** Validity of contract or indebtedness

Under New York law, the penalty imposed on lender for making usurious loans is to have the loans declared void in future enforcement actions brought by lender.

[6] **Bankruptcy** Evidence

Statements made by attorney for one merchant cash advance (MCA) business in separate lawsuit was hardly a judicial admission by another MCA business in avoidance proceeding brought by trustee of Chapter 7 estate of debtor that entered into prepetition MCA transactions with this other business.

[7] **Bankruptcy** Evidence; witnesses

"Judicial admissions" are statements made in a pleading, such as a complaint, an answer, or a response to request for admission, and not extrajudicial statements.

[8] **Bankruptcy** Ownership of interest transferred

"Interest of the debtor in property," as that phrase is used in bankruptcy statute authorizing trustee to avoid prepetition transfers of such interests upon showing that they were preferential, refers to property that would have been property of the estate had it not been transferred. 11 U.S.C.A. § 547(b).

[9] **Bankruptcy** Ownership of interest transferred

Generally, transfer involves "interest of the debtor in property," for preference purposes, if it deprives bankruptcy estate of something which could otherwise be used to satisfy claims of creditors. 11 U.S.C.A. § 547(b).

[10] **Bankruptcy** Antecedent debt or contemporaneous consideration

Prepetition payments that Chapter 7 debtor made to company that had previously provided merchant cash advances (MCAs) to its business, in exchange for assignment of debtor's right to recover on accounts receivable, were made "for the benefit of" this company on account of "antecedent debt," as those terms were used in preference provision. 11 U.S.C.A. § 547(b)(2).

[11] **Bankruptcy** Effect to give more than under bankruptcy distribution

Payments that Chapter 7 debtor made less than 90 days prepetition, at time when it was presumptively insolvent, in payment of antecedent debt that it owed to company that provided merchant cash advances (MCAs) to its business, plainly enabled company to receive more than it would otherwise have received in hypothetical Chapter 7 liquidation, as required by preference statute, where value of debtor's assets was dwarfed by its roughly $4 million in debt, and unsecured creditors like company would have received no distribution on their claims. 11 U.S.C.A. § 547(b)(5).

[12] **Bankruptcy** Transfers in Ordinary Course of Business

"Ordinary course of business" exception to preference statute is meant to leave undisturbed normal commercial and financial relationships

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and to protect recurring, customary credit transactions which are incurred and paid in ordinary course of business of both the debtor and its transferee. 11 U.S.C.A. § 547(c)(2).

1 Case that cites this headnote

[13] **Bankruptcy** Preferences

Burden was on creditor asserting "ordinary course of business" defense to Chapter 7 trustee's preference claims to prove that both the debt and the transfers in payment of that debt were in the ordinary course of business between debtor and creditor. 11 U.S.C.A. § 547(c)(2).

1 Case that cites this headnote

[14] **Bankruptcy** Preferences

"Ordinary course of business" defense to preference claim must be established by a preponderance of the evidence. 11 U.S.C.A. § 547(c)(2).

2 Cases that cite this headnote

[15] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

Threshold requirement for creditor to successfully assert "ordinary course of business" defense to preference claim, that underlying debt on which challenged payment was made must have been incurred in the ordinary course of business, focuses on when the debt was created, and then, on whether debt was created in the ordinary course. 11 U.S.C.A. § 547(c)(2).

[16] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

In deciding whether the underlying debt on which challenged payment was made was incurred in the ordinary course of business, as required for payee to successfully assert "ordinary course of business" defense to preference claim, courts examine the normality of such incurrences in each party's business operations generally. 11 U.S.C.A. § 547(c)(2).

[17] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

Prepetition debt that Chapter 7 debtor incurred to company in the business of making merchant cash advances (MCAs), in exchange for advances which debtor used for more than three years to keep its business afloat financially, was incurred in ordinary course of business of both parties, as required for company to successfully assert "ordinary course of business" defense to trustee's preference claims, though debtor, after selling its accounts receivable at discount, became increasingly cash-strapped and, at time it filed for bankruptcy, was using MCA advances that it received from one company to fulfill its contractual obligations to others. 11 U.S.C.A. § 547(c)(2).

[18] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

Among factors that courts consider in deciding whether alleged preferential payments were ordinary in relation to past practices between debtor and creditor, so as to support "ordinary course of business" defense by creditor, are the following: (1) length of time that parties were engaged in the transactions at issue; (2) whether the amount or form of tender differed from past practices; (3) whether debtor or creditor engaged in any unusual collection or payment activity; and (4) whether creditor took advantage of debtor's deteriorating financial condition. 11 U.S.C.A. § 547(c)(2).

[19] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

In some instances, an "ordinary course of business" may be established, for purposes of allowing transferee to assert statutory defense to trustee's preference claim, by the terms of the parties' agreement, until that agreement is somehow or other modified by actual performance. 11 U.S.C.A. § 547(c)(2).

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2 Cases that cite this headnote

[20] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

Fraud disqualifies application of the "ordinary course of business" exception to preference statute. 11 U.S.C.A. § 547(c)(2).

[21] **Bankruptcy** Normal payment; credit or business transactions; settlement or agreement

Parties' deviation from terms of merchant cash advance (MCA) agreement, based on Chapter 7 debtor's deposit, into account to which creditor providing these advances had access, not just the proceeds of accounts receivable that debtor had sold to creditor at discount, but MCA advances that debtor received from other creditors, was not in nature of a fraud, and did not affect the ordinariness of payments that creditor received during 90-day preference period or prevent creditor from successfully asserting "ordinary course of business" defense to trustee's preference claims. 11 U.S.C.A. § 547(c)(2).

[22] **Bankruptcy** Intent of debtor

Trustee does not have to prove that debtor acted with intent to defraud in order to avoid transfer as constructively fraudulent to creditors. 11 U.S.C.A. § 548(a)(1)(B).

[23] **Bankruptcy** "Reasonably equivalent value" in general

Test used to determine whether debtor received "reasonably equivalent value," of kind sufficient to preclude avoidance of transfer as constructively fraudulent to creditors, requires court to determine the value of what was transferred and to compare it to what was received. 11 U.S.C.A. § 548(a)(1)(B).

[24] **Bankruptcy** "Reasonably equivalent value" in general

Determination as to whether debtor received "reasonably equivalent value," of kind sufficient to preclude avoidance of transfer as constructively fraudulent to creditors, does not involve the application of fixed formula; rather, transactions are examined on a case-by-case basis. 11 U.S.C.A. § 548(a)(1)(B).

[25] **Bankruptcy** "Reasonably equivalent value" in general

Factors that bankruptcy court may consider in deciding whether debtor received "reasonably equivalent value," of kind sufficient to preclude avoidance of transfer as constructively fraudulent to creditors, include the fair market value of what was transferred and received, whether transaction took place at arm's length, and good faith of transferee. 11 U.S.C.A. § 548(a)(1)(B).

[26] **Bankruptcy** "Reasonably equivalent value" in general

Debtor that, prior to its Chapter 7 filing, sold $176,432 of accounts receivable to company for a merchant cash advance (MCA) of only $125,000, but from whose account the MCA company had debited only $112,979 as of commencement of bankruptcy case, had to be regarded as having received "reasonably equivalent value" in form of MCA advance, of kind sufficient to foreclose any constructively fraudulent transfer claim by trustee, especially given parties' good faith in entering into this MCA transaction to obtain funding for debtor's business. 11 U.S.C.A. § 548(a)(1)(B).

1 Case that cites this headnote

[27] **Bankruptcy** Effect of avoidable transfer and surrender thereof

Bankruptcy statute authorizing court to disallow a claim filed by any entity in receipt of a transfer avoidable under specified provisions of

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the Bankruptcy Code had no application where recipient of challenged transfers had not filed proof of claim. 11 U.S.C.A. § 502(d).

1 Case that cites this headnote

[28] **Statutes** Plain Language; Plain, Ordinary, or Common Meaning

When interpreting statute, courts begin with its plain language.

[29] **Statutes** Defined terms; definitional provisions

Statutes Context

Statutory terms or words will be construed according to their ordinary, common meaning unless they are defined by statute or the statutory context requires a different definition.

Attorneys and Law Firms

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MEMORANDUM OPINION

Jacqueline P. Cox, United States Bankruptcy Judge

The matter before the Court arises from the adversary complaint filed by the plaintiff, Frances Gecker, as the chapter 7 trustee (the "Trustee") of the jointly administered bankruptcy estates of Network Salon Services, LLC ("Network Salon") and Anthia R. Hill ("Ms. Hill," collectively, the "Debtors"), against the defendant, LG Funding LLC ("LG Funding"), to recover alleged preferential and constructively fraudulent transfers pursuant to 11 U.S.C. §§ 547(b) and 548(a)(1)(B), and to disallow claims against the bankruptcy estate filed by LG Funding pursuant to 11 U.S.C. § 502(d). For the reasons that follow, judgment is granted in favor of LG Funding on all three counts.

I. BACKGROUND

The following facts are derived from the parties' Joint List of Stipulated Facts and Documents [Dkt. 50] and the evidence heard at trial on May 24, 2018.

Network Salon was a distributor of beauty products founded in 2004 by Ms. Hill's husband, Brian Hill; it was located in Chicago, Illinois. While Mr. Hill managed the business and its financial affairs, Ms. Hill performed warehouse and shipping work for the business. At that time, Ms. Hill neither owned nor managed any part of the business. Until 2010, Network Salon struggled financially, which required Mr. Hill to work elsewhere to keep the company and his family afloat.

In 2011, Ms. Hill took over the operation of Network Salon following the brief illness and subsequent death of Mr. Hill. Ms. Hill had no business or financial training or experience prior to taking over the business. At first Ms. Hill was able to effectively run the business. However, it ran into problems accessing products and selling them profitably. She soon became overwhelmed by the financial issues that both her family and Network Salon were experiencing and could not obtain traditional loans through various lenders.

She received a solicitation from Merchant Capital Advance, a merchant cash advance firm, telling her she could access $250,000 by submitting bank records. That deal went through; $250,000 was transferred into the business' bank account and $1090 payments were taken out of the business' account on a daily basis pursuant to that transaction.

LG Funding is a New York commercial finance company engaged in the merchant cash advance ("MCA") business. The MCA industry provides working capital to businesses, particularly small businesses who suffered financially as a result of the 2008 financial crisis.

***619** In an MCA transaction, the merchant sells its accounts receivable for a discounted amount that is paid by the MCA company up-front. The MCA company, as purchaser, recovers the receivables by taking a pre-

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determined percentage of the merchant's receipts until the MCA company is paid in full.

Network Salon and LG Funding entered into two MCA transactions within two years prior to the date that Network Salon and Ms. Hill filed their chapter 7 bankruptcy petitions on May 20, 2016, ("the Petition Date"). The first contract is dated November 3, 2015 (the "First Agreement"); the second is dated January 8, 2016 (the "Second Agreement," collectively, the "Agreements"). Each agreement was made using LG Funding's standard form contract; each agreement was signed by Ms. Hill as owner of Network Salon. Ms. Hill also signed personal guaranties in connection with each transaction. Each agreement contains the following terms describing the nature of the transactions:

> Merchant hereby sells, assigns, and transfers to LG (making LG the absolute owner) in consideration of the funds provided ("Purchase Price") specified below, all of Merchant's future accounts, contract rights and other obligations arising from or relating to the payment of monies from Merchant's customers' [sic] and/or third party payors (the "Receipts" defined as all payments made by cash, check, credit or debit card, electronic transfer or other form of monetary payment in the ordinary course of the merchant's business), for the payment of Merchant's sale of goods or services until the amount specified below (the "Purchased Amount") has been delivered by Merchant to LG.
>
> The Purchased Amount shall be paid to LG by Merchant's irrevocably authorizing only one depositing account acceptable to LG (the "Account") to remit the percentage specified below (the "Specified Percentage") of the Merchant's settlement amounts due from each transaction, until such time as LG receives payment in full of the Purchased Amount.
>
> ...
>
> 1.9 Sale of Receipts. Merchant and LG agree that the Purchase Price under this Agreement is in exchange for the Purchased Amount and that such Purchase Price **is not intended to be, nor shall it be construed as a loan from LG to Merchant.** Merchant agrees that the Purchase Price is in exchange for the Receipts pursuant to this Agreement equals the fair market value of such Receipts.

Trustee's Exs. 18 and 28 (emphasis added). Each agreement contains a choice of law provision which selects New York law as the governing law of the contract. *See* Paragraph 4.5.

In total, LG Funding paid Network Salon $125,000 to purchase an interest in a percentage of Network Salon's receivables; in return, Network Salon became obligated to pay LG Funding $176,432. Network Salon granted LG Funding access to a specific bank account, from which LG Funding could, pursuant to the Agreements, make debits to obtain funds due it. LG Funding was also allowed access to Network Salon's operating account. Transcript, p. 14. Under the First Agreement, LG Funding could debit no more than $3,999 from Network Salon's bank account each week. After debiting a $1,500 administrative fee from Network Salon's account on November 9, 2015, LG Funding debited $3,999 from the account each week from November 16, 2015 through March 28, 2016. Under the Second Agreement, LG Funding debited an additional $2,500 from Network Salon's account each week. Thus, from January 19, ***620** 2016 through March 28, 2016, LG Funding was debiting a total of $6,499 each week from Network Salon's account. During the ninety days preceding the Petition Date, LG Funding debited $38,994 from the account (the "Transfers"). Overall, Network Salon remitted $112,979 to LG Funding.

Overall, Ms. Hill entered into MCA agreements with at least thirteen MCA businesses, including LG Funding, in order to continue operation of Network Salon and to support her family from January 2013 until the Petition Date. In the six months prior to filing the instant bankruptcy case, Network Salon owed money to at least seven different MCA companies pursuant to multiple agreements. As of November 3, 2015, there were eleven UCC-1 financing statements filed against Network Salon in the office of the Illinois Secretary of State.

By March 2016, Network Salon was paying MCA providers over $30,000 each business day out of fourteen different bank accounts maintained by Network Salon. The capital that Network Salon obtained under the MCA transactions was often used to pay off other MCA transactions.

On May 20, 2016, the Petition Date, Network Salon and Ms. Hill filed petitions under chapter 7 of the Bankruptcy Code; an order was entered for joint administration of the estates. The Trustee was appointed to administer the estates. This adversary proceeding was commenced by the Trustee against LG Funding to recover funds transferred by Network Salon to LG Funding pursuant to the Agreements.

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II. JURISDICTION

The federal district courts have original and exclusive jurisdiction of all cases under the Bankruptcy Code, title 11 of the U.S. Code. 28 U.S.C. § 1334(a). Federal district courts may refer any or all cases under title 11, and any or all proceedings arising under title 11 or arising in or related to a case under title 11, to the bankruptcy judges for the district. 28 U.S.C. § 157(a). The District Court for the Northern District of Illinois refers its bankruptcy cases to the Bankruptcy Court for the Northern District of Illinois. Northern District of Illinois Internal Operating Procedure 15(a).

[1] Bankruptcy courts have authority to hear and determine all cases under title 11, and all core proceedings arising under title 11, or arising in a case under title 11, and may enter appropriate orders and judgments, subject to review in the federal district courts. 28 U.S.C. § 157(b)(1). This is an action to avoid and recover preferential and constructively fraudulent transfers, and to disallow claims by LG Funding against Network Salon. As such, this court has jurisdiction to hear and resolve these matters pursuant to 28 U.S.C. § 157(b)(2)(B), (F) and (H). Further, this court has jurisdiction to enter final orders on preference claims, regardless of whether a claim was filed by the defendant, as the proceeding "stems from the bankruptcy itself." *KHI Liquidation Trust v. Wisenbaker Builder Servs., Inc. (In re Kimball Hill, Inc.)*, 480 B.R. 894, 905 (Bankr. N.D. Ill. 2012) (citing *Stern v. Marshall*, 564 U.S. 462, 498-99, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011)).

III. DISCUSSION

In its adversary complaint, the Trustee propounds three counts: preferential transfer, constructive fraudulent transfer, and disallowance of claim. The Court will examine each of these counts in turn.

A. Count I - Preferential Transfer

[2] In Count I of the adversary complaint, the Trustee alleges that the payments that Network Salon made to LG Funding under the agreements constituted ***621** preferential transfers within the meaning of 11 U.S.C. § 547(b). "The provision for recovering preferences is integrally bound up in the overall scheme for ensuring equitable distribution among creditors.... Preferences are avoidable precisely because they enable some creditors to receive more than their fair distribution under the Bankruptcy Code." *West v. Freedom Med., Inc. (In re Apex Long Term Acute Care–Katy, L.P.)*, 465 B.R. 452, 463 (Bankr. S.D. Tex. 2011). This statutory provision provides:

> (b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property–
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made–
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if–
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer has not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b).

The Trustee asserts that the alleged preferential transfers were made within ninety days prior to the Petition Date, pursuant to § 547(b)(4)(A). Certain seemingly preferential transactions are excluded from avoidance under § 547(b), however, as codified in subsection (c). Specifically, LG Funding pursues the defense found in subsection (c)(2), which provides:

> (c) The trustee may not avoid under this section any transfer–
>
> ...
>
> (2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or

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financial affairs of the debtor and the transferee, and such transfer was–

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms[.]

11 U.S.C. § 547(c)(2)(A) and (B).

[3] As a threshold matter, LG Funding argues that it was not a creditor, and that the payments were not received from Network Salon due to an antecedent debt. LG Funding asserts that under New York law, MCA contracts represent the sale of accounts receivable; they are not considered to be loans. In turn, the Trustee argues that the transactions constituted criminally usurious loans, due to the high interest rates of the transactions, and further that LG Funding has admitted that the transactions were loans during this litigation.

[4] There are many cases which support the proposition that the agreements between LG Funding and Network Salon are not loans. ***622** *Wilkinson Floor Covering, Inc., v. Cap Call, LLC, et al.*, 59 Misc. 3d 1226(A), 2018 N.Y. Slip Op. 50709(U), 2018 WL 2293196 (Table) (N.Y. Sup. Ct., N.Y Cty. 2018) ("[B]ecause plaintiffs' obligation to pay [defendants] future receivables is conditioned on plaintiffs' receipt of such, the agreements at issue are not loans."). *See also LG Funding, LLC v. City N. Grill Corp.*, 2018 WL 1219403, at *2, 2018 N.Y. Misc. LEXIS 728, at *4 (N.Y. Sup. Ct., Nassau Cty. 2018) (collecting cases). Since these transactions are not considered loans under New York law, they cannot be criminally usurious. *Rapid Capital Fin., LLC v. Natures Mkt. Corp.*, 57 Misc.3d 979, 66 N.Y.S.3d 797, 801–02 (N.Y. Sup. Ct., Westchester Cty., 2017) ("Because review of the terms of the agreement establishes as a matter of law that it is a purchase agreement rather than a loan, defendants' usury defense has no merit, and must be dismissed pursuant to CPLR 3211(b).").

The fact that the transactions in this matter do not constitute loans, however, does not mean that Network Salon did not owe a debt to LG Funding. In fact, in litigation in which LG Funding has been involved, New York courts describe the money owed by a merchant in a cash advance transaction as a debt. *See, e.g.*, *LG Funding, LLC v. Fla. Tilt, Inc.*, No. 15-CV-631(PKC)(VMS), 2015 WL 4390453, at * 4 (E.D.N.Y. July 15, 2015) ("Along with FTI, Cartaya has not paid the debt owed by FTI and thus has breached that guaranty.") Further, the Bankruptcy Code defines a debt as a liability on a claim. 11 U.S.C. § 101(12). A "claim" within the meaning of the Bankruptcy Code is either a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment[.]" 11 U.S.C. § 101(5). LG Funding does not argue that it had no right to payment, and, in fact, argues the opposite— that it had the right to debit Network Salon's account under the Agreements. Thus, while New York law does not define the Agreements as loans, the transactions created a debt that Network Salon owed to LG Funding.

The Trustee's assertion that the Debtors' transactions with LG are usurious and for that reason are either fraudulent or not ordinary is mistaken. The Agreements state that New York law governs their enforcement and interpretation. New York law provides that a person is guilty of the fraud crime of criminal usury in the second degree, a class E felony when:

> not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period.

N.Y. PENAL LAW § 190.40 (McKinney 2018) (Stipulated - Joint List of Stipulated Facts and Documents, Dkt. 50, ¶ 234).

[5] Putting aside New York court rulings that MCA transactions are not loans, New York usury law does not help the Trustee. Under New York law the penalty for making usurious loans is to have the loan declared void in future enforcement actions brought by the lender. *DLJ Mortgage Capital, Inc. v. Smith*, 2007 N.Y. Slip Op. 32745(U) ¶ 3, 2007 WL 2814513 (Sup. Ct. 2007) ("This goes considerably further than New York's usury law, a violation of which only voids the loan and does not require the note-holder to disgorge past payments and interest.").

Even if the court found that the transaction was a loan, New York criminal law would not allow borrowers a private cause

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of action. ***623** *In re Merhi*, 518 B.R. 705, 719 (Bankr. E.D.N.Y. 2014). The usury statute does not help the Trustee.

[6] **[7]** The Trustee asserts that LG Funding made a judicial admission that the MCA transactions were loans because it cited a deposition of Ms. Hill in its Motion for Summary Judgment. Dkt. 49, p.38. The court disagrees. Ms. Hill's deposition was taken by a defendant in a different adversary proceeding, *Gecker v. Yellowstone Capital LLC,* 17 AP 00076. The transactions in issue were referred to as loans rather than MCAs. Such statements are not admissions. *See Kohler v. Leslie Hindman, Inc.*, 80 F.3d 1181, 1185 (7th Cir. 1996) ("[A] statement made in one lawsuit cannot be a judicial admission in another." Words used by Yellowstone's attorney in a different case in questioning Ms. Hill are hardly admissions by LG Funding in this separate lawsuit. The court notes that judicial admissions are statements made in a pleading, such as a complaint, an answer or in a response to a request for an admission, not an extrajudicial statement. *Murrey v. U.S.,* 73 F.3d 1448, 1455 (7th Cir. 1996).

The Trustee argued generally that LG Funding precipitated Network Salon's slide into bankruptcy and put it out of business. Trustee's Proposed Findings of Fact and Conclusions of Law, Dkt. 49, ¶ 53. The court disagrees. The Debtors may have been on the brink of bankruptcy or insolvency before the first MCA was executed. The Debtors' entry into bankruptcy may have been delayed by selling the accounts receivable to the MCAs and borrowing funds from LQD. In any event the Trustee has not accused the Defendant of causing or deepening Network Salon's insolvency. [1] In addition, causing a debtor's insolvency is not an element of preference recovery.

Now that LG Funding's threshold argument has been addressed, the Court will discuss each element of § 547(b).

1. Transfer of an Interest of the Debtor in Property

[8] **[9]** "The phrase an interest of the debtor in property refers to property that would have been property of the estate had it not been transferred." *Martino v. Miszkowicz (In re Miszkowicz)*, 513 B.R. 553, 559 (Bankr. N.D. Ill. 2014) (internal quotations omitted) (citing *Maxwell v. Penn Media (In re marchFirst, Inc.*), Ch. 7 Case No. 01-B-24742, Adv. No. 03-A-1141, 2010 WL 4027723, at *5 (Bankr. N.D. Ill. Oct. 14, 2010)). "Generally, property belongs to the debtor for purposes of § 547 if its transfer will deprive the bankruptcy estate of something which could otherwise be used to satisfy the claims of creditors." *Danning v. Bozek* (*In re Bullion Reserve of N. Am.*), 836 F.2d 1214, 1217 (9th Cir. 1988).

There is no dispute as to the first element of Count I. The Trustee alleges in the Adversary Complaint that Network Salon paid LG Funding $112,979. (Dkt. 1, Adv. Comp. ¶ 64). LG Funding, in its Amended Answer, admits that this is the amount which was remitted to it under the Agreements. (Dkt. 20, Amended Answer, ¶ 64). As such, the Court finds that the transactions at issue were transfers of an interest of Network Salon in property under § 547(b).

2. The Transfers Were Made for the Benefit of a Creditor on Account of an Antecedent Debt Owed by the Debtor Before Such Transfer was Made

[10] The Bankruptcy Code defines the term creditor as an entity that has a claim against the debtor that arose at the time of ***624** or before the order for relief ..." 11 U.S.C. 101(10)(A).

Although LG Funding claims that it had a right to payment when it debited Network Salon's account, it argues that it is not a creditor. As discussed above, there is no doubt that Network Salon owed a debt to LG Funding after it provided funds to Network Salon. Although LG Funding did not file proofs of claim in these bankruptcy cases, it has a claim within the meaning of the Bankruptcy Code since it argues that it had a right to payment. There is no doubt that LG Funding is Network Salon's creditor.

Further, the parties have stipulated that each debit that LG Funding made from Network Salon's bank account was made pursuant to the Agreements and for its benefit within the meaning of § 547(b). Joint List of Stipulated of Facts and Documents, Dkt. 50, ¶¶ 222, 223. The court finds that the transfers in issue were made for the benefit of LG Funding on account of an antecedent debt owed by Network Salon before the transfers were made.

3. The Transfers Were Made while Debtors Were Insolvent

The Bankruptcy Code defines the term insolvent as follows:

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(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of—

(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title[.]

11 U.S.C. § 101(32)(A).

According to Schedules D and E/F filed by Ms. Hill, the total amount of secured and unsecured claims against her total over $4,000,000 (Bankr. Case No. 16-B-17113, Dkt. 1, pp. 8, 9, 21). On her Schedule A/B, Ms. Hill listed the total of her personal property at $1800, and on Schedule C claimed all of that as exempt. (Bankr. Case No. 16-B-17113, Dkt. 20, p. 10).

Network Salon's Summary of Assets and Liabilities discloses that it owned at filing property valued at $200 with liabilities of $4,181,845. (Bankr. Case No. 16-B-17117, Dkt. 18).

Section 547(f) of the Bankruptcy Code states that in preference actions debtors are presumed to have been insolvent on and during the 90 days prior to filing for bankruptcy relief. Defendant LG Funding has not offered any evidence to rebut the presumption. Due to the Debtors's financial situation and the presumption, the court finds that Network Salon was insolvent during the 90-day period that ended on May 20, 2016.

4. The Transfers Were Made Within 90 Days of Filing

Section 547(b)(4)(A) of the Bankruptcy Code provides that the preference period for non-insiders is ninety days before the date on which a debtor files a petition seeking bankruptcy relief. The parties have stipulated that LG Funding is not affiliated with or in any way related to Network Salon or Ms. Hill and for that reason is a non-insider; the ninety day period is applicable. The preference look-back period is longer for insiders.

The parties have also stipulated that within the ninety day period prior to the Petition Date, Network Salon transferred $38,994 to LG Funding through debits of Network Salon's bank account. (¶ 224 actually states that the ninety day period extended ***625** from February 22, 2016 to March, 28, 2016) Joint List of Stipulated Facts, Dkt. 50, ¶ 224. This element is uncontested and the Court finds this fourth element satisfied.

5. Defendant Received More than It Would Have if the Transfers Had Not Been Made

[11] Under the fifth and final element, courts look to whether the defendant creditor received more through the transfers than it would have under chapter 7. *See Miszkowicz,* 513 B.R. at 560–61. LG Funding has not filed a proof of claim in either of the underlying jointly administered bankruptcy cases. As such, LG Funding may not benefit from a distribution on claims from the Debtor's bankruptcy estate.

The Debtors jointly owed their creditors approximately $4,000,000. Their total assets are approximately $2000, $1800 for Ms. Hill and $200 for Network Salon. If the Trustee recovers on this preference claim the bankruptcy estate will have approximately $40,000; after accounting for the $600,000 owed its secured creditor LQD, unsecured creditors would recover nothing. *See* Schedule D: Dkt. 1, p. 8 for Anthia Hill - 16-11713 and Schedule D: Dkt. 1, p. 5 for Network Salon - 16-11717. LG Funding received via the $38,000 payment alleged to be a preference more than it would have received as a chapter 7 distribution had the transfer not been made. *Miszkowicz,* 513 B.R. at 560-61.

B. The Ordinary Course Defense to Preference Liability

[12] **[13]** **[14]** LG Funding asserts a defense to the preference claim, arguing that even if the Trustee has proven the elements of § 547(b) by a preponderance of the evidence, the transfers may not be avoided due to the ordinary course exception. This exception to preference liability, provided for in § 547(c)(2) of the Bankruptcy Code, applies to transfers which are (1) made in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and (2) where the transfer was made in the ordinary course of the business or financial affairs of the debtor and the transferee; or made according to ordinary business terms. 11 U.S.C. § 547(c)(2)(A) and (B). The ordinary course exception is meant to "leave undisturbed normal commercial and financial relationships and protect recurring, customary credit transactions which are incurred and paid in the ordinary course of business of both the

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debtor and the debtor's transferee." *Kleven v. Household Bank, F.S.B.*, 334 F.3d 638, 642 (7th Cir. 2003) (citing *In re Armstrong*, 231 B.R. 723, 729 (Bankr. E.D. Ark. 1999)). LG Funding has the burden of proving by a preponderance of the evidence that both the debt and the transfers in payment of that debt were incurred in the ordinary course of business between Network Salon and LG Funding. *In re Midway Airlines, Inc.*, 69 F.3d 792, 797 (7th Cir. 1995).

1. Transfers Made in Payment of a Debt Incurred by the Debtor in the Ordinary Course of Business

[15] **[16]** The first element of this defense requires that the debt for which the transfers were made be incurred in the ordinary course of business. This threshold requirement focuses on "when the debt was created and then whether the debt was created in the ordinary course." *Baumgartner-Novak v. Eckman* (*In re Eckman*), 447 B.R. 546, 550 (Bankr. N.D. Ohio 2010). In making this determination, courts examine "the normality of such incurrences in each party's business operations generally." *Speco Corp. v. Canton Drop Forge, Inc.* (*In re Speco Corp.*), 218 B.R. 390, 398 (Bankr. S.D. Ohio 1998) ***626** (quoting *Youthland, Inc. v. Sunshine Girls of Fla., Inc.* (*In re Youthland, Inc.*), 160 B.R. 311, 314 (Bankr. S.D. Ohio 1993)).

[17] LG Funding is in the business of providing merchant cash advances to small businesses. In fact, no evidence was presented to show that LG Funding engaged in any other type of financing. LG Funding purchased a portion of Network Salon's future receivables. Entering into these types of transactions with small businesses was therefore in the ordinary course of business for LG Funding, and neither party has presented evidence to the contrary.

Ms. Hill recalls having a conversation with someone at Yellowstone Capital who told her they would put her in touch with another entity or person; she then got a call from someone at LG Funding. Trial Transcript, ("Transcript") p. 88.

Network Salon began receiving financing from MCA companies in January 2013, and continued to enter into this type of transaction until the 2016 Petition Date. The Trustee argues that it was not in the ordinary course of business for Network Salon to enter into this type of debt because the business was struggling financially and that its desperation for capital caused it to enter into these agreements. Network Salon began entering into merchant cash advance transactions with other MCAs in January of 2013, nearly two years before Network Salon entered into the Agreements with LG Funding. Throughout that period, Network Salon regularly did business with other MCA companies; in fact, Network Salon entered into MCA transactions with fourteen different MCA companies; Network Salon had fourteen bank accounts. Transcript, p.5.

Ms. Hill testified that it was ordinary for Network Salon to sign up for MCAs and that LG Funding did nothing out of the ordinary in the way that it debited the bank account from which it was paid. Transcript, pp. 111, 116. She also testified that aside from entering into a second MCA with LG Funding that it did not request that it be paid more than what was regularly paid. *Id.*, p. 115. Due to the length of time and the consistency of Network Salon entering into these kinds of transactions, the court finds that entering into these types of transactions became a normal, ordinary part of Network Salon's business. Thus, the Agreements were entered into within the ordinary course of business from the perspective of both parties. The first element of the ordinary course of business defense has been satisfied.

When LG Funding entered into the Agreements Network Salon was the subject of 11 UCC-1 filings by other entities. According to New York law, "[A] transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party." N.Y.U.C.C. Law § 9-332(b). As a transferee of funds from a deposit account LG Funding took the funds free of security interests.

2. Transfers Were Made in the Ordinary Course of Business

[18] **[19]** The second element of the ordinary course of business defense requires a showing that the transfers were made in the ordinary course of business between the parties or according to ordinary business terms.

> Among factors courts consider in determining whether transfers are ordinary in relation to past practices are: (1) the length of time the parties were engaged in the transactions at

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> issue; (2) whether the amount or form of tender differed from past practices; (3) whether the ***627** debtor or creditor engaged in any unusual collection or payment activity; and (4) whether the creditor took advantage of the debtor's deteriorating financial condition.

Solow v. Ogletree, Deakins, Nash, Smoak & Stewart (In re Midway Airlines), 180 B.R. 1009, 1013 (Bankr. N.D. Ill. 1995) (quoting *In re Grand Chevrolet, Inc.*, 25 F.3d 728, 732 (9th Cir. 1994)). While these are some of the factors a court may consider, it is not an exhaustive list. *Kleven*, 334 F.3d at 642. "In some instances ... the ordinary course of business may be established by the terms of the parties' agreement, until that agreement is somehow or other modified by actual performance." *Id.* at 643.

The Trustee argued in her Pretrial Brief [Dkt. 48] and at trial, that the transactions could not have occurred in the ordinary course of business because LG Funding was not entitled to take the money that it did from Network Salon's account. The Trustee's position is that under the Agreements, LG Funding could take only funds which Network Salon had received "for the payment of Merchant's sale of goods or services." Paragraph 1.9 - Sale of Receipts term of Agreements. Trustee's Exs. 18 and 28. The Trustee contends that the funds LG Funding debited from Network Salon's account were derived from other lenders and MCA companies when the Agreements state that "Payments made to LG in respect to the full amount of the Receipts shall be conditioned upon Merchant's sale of products and services and the payment therefore by Merchant's customers in the manner provided in Section 1.1." Paragraph 1.1 provides that the Merchant shall appoint a bank to obtain electronic fund transfer services and allow LG Funding to deduct amounts owed it from settlement amounts otherwise due to the Merchant from electronic transactions, to pay LG Funding by allowing it to withdraw funds by debiting the account.

In response to the Trustee's argument, LG Funding asserts that the argument should be rejected as the Trustee did not assert this theory until shortly before trial, after the close of discovery. At trial, LG Funding argued the theory on its merits, stating that money is fungible and, therefore, as long as Network Salon was receiving income from its goods and services, LG Funding could debit the account that it was given access to, regardless of where the funds in that particular account originated.

Both Network Salon and LG Funding deviated from the contract term allowing LG Funding access to certain funds. Network Salon deposited funds from other MCAs into the account LG Funding had access to and LG took those other funds.

[20] [21] The Trustee argues that this is similar to cases where courts have ruled that transactions based on fraud are not ordinary and for that reason creditors can not stand on the ordinary course defense. *See* *Computer World Solution, Inc. v. Apple Fund, L.P. (In re Computer World Solution, Inc.)*, 427 B.R. 680, 690 where this court found that the circumstances surrounding a loan's inception and repayment, as well as its recording in the Debtor's books and records were fraudulent; *Jobin v. McKay (In re M & L Bus. Mach. Co.)*, 84 F.3d 1330, 1339-40 (10th Cir. 1996) (determining that the ordinary course of business defense was not applicable to payments by a fake business set up to defraud people). Fraud disqualifies application of the ordinary course defense. However, this case is different. Neither the Plaintiff nor the Defendant committed fraud herein. Each party engaged in the routine, regular sale of accounts receivable and regularly disregarded the condition that LG Funding take proceeds of sales. ***628** This is not fraud. The court notes that the Trustee has not presented legal authority regarding whether deviations from contract terms in this manner vitiates the defense. Both Network Salon and LG Funding benefitted from this.

This court agrees with well-settled precedent that money is fungible. *See, e.g.*, *Boyer v. Belavilas*, 474 F.3d 375, 377–78 (7th Cir. 2007); *In re Quade*, 496 B.R. 520, 528 (Bankr. N.D. Ill. 2013). The parties stipulated that Network Salon deposited funds from other MCAs in the LG Funding account. Joint List of Stipulated Facts and Documents, ¶¶ 183 and 186. This is also evidenced by the fact that the three deposits to the LG account in November 2015 were $75,000 from LG; $4000 from the proceeds of an MCA transaction and $4000 from proceeds of a loan from LQD. Joint List of Stipulated Facts and Documents, Dkt. 50, ¶ 134. The court can not say with certainty whether any funds in the accounts included proceeds from the sale of goods and services.

The court noted previously that someone representing Yellowstone, another MCA entity, referred LG Funding to the Plaintiff. Neither the creditors nor Network Salon were prejudiced by how the payments were made. In addition,

the evidence shows that the MCA entities that Network Salon dealt with regularly funded each others' payments and agreements when Ms. Hill deposited funds into accounts dedicated to other MCAs. This satisfies the "term of the industry element" in section 547(c)(2)(B). The Debtors were able to stay in business and support Ms. Hill's family from 2013 to 2016 using MCAs. Their dire circumstances were unfortunate, however, the transactions did not amount to fraud on the part of Debtors or LG Funding.

Since the court agrees with LG Funding on the merits, it will not reach the issue of whether the Trustee's argument on this issue was raised in a timely manner.

LG Funding provided capital in the amount of $125,000 to Network Salon. In return, Network Salon granted LG Funding an interest in a percentage of its receivables. The terms of the Agreements provided that Network Salon would remit payment of the receivables "until the amount specified below (the "Purchased Amount") has been delivered by Merchant to LG." In order for LG Funding to collect this amount, the contract also dictated the method of payment: "The Purchased Amount shall be paid to LG by Merchant's irrevocably authorizing only one depositing account acceptable to LG ... to remit the percentage specified below ... of the Merchant's settlement amounts due from each transaction, until such time as LG receives payment in full of the Purchased Amount." *See* Trustee's Exs. 18 and 28.

Pursuant to these terms, LG Funding debited money from Network Salon's bank account to recover the purchased receivables up to the specified amount under the Agreements. The parties in this matter were engaged in MCA transactions for nearly five months, from November 9, 2015 through March 28, 2016, during which time Network Salon remitted funds to satisfy its obligations under the terms of the Agreements.

LG Funding operates in the MCA industry, entering into MCA agreements on a regular basis. Network Salon, through Ms. Hill, began obtaining capital through MCA agreements nearly two years prior to entering into the agreements with LG Funding. Once the Agreements were signed, they were performed, in large part, according to their terms over the span of a few months. The court finds that the transfers to LG Funding were made in the ordinary course of business of the Network ***629** Salon and LG Funding; the second element of this defense has been satisfied.

The Trustee's § 547(b) claim under Count I must be denied because the transfers were made in the ordinary course of the parties' business and financial affairs.

C. Count II- Constructive Fraudulent Transfer

In Count II of the Complaint, the Trustee alleges that the payments that Network Salon made to LG Funding are constructive fraudulent transfers within the meaning of 11 U.S.C. § 548(a)(1)(B). This provision provides, in relevant part:

> (a)(1) The trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily–
>
> ...
>
> (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> > (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
> >
> > > (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
> > >
> > > (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or
> > >
> > > (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548(a)(1)(B).

[22] Under the constructive fraudulent transfer provision, a trustee can avoid a transfer made for less than reasonably equivalent value if the debtor was insolvent at the time of the transfer, or became insolvent as a result of the transfer. *Id.* A claim brought under this section does not require proof of an intent to defraud. *4100 W. Grand LLC v. TY Grand LLC (In re 4100 West Grand LLC)*, 481 B.R. 444, 452 (Bankr. N.D.

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Ill. 2012) (citing *In re FBN Food Servs., Inc.*, 82 F.3d 1387, 1394 (7th Cir. 1996)).

As addressed above in the court's discussion of Count I, several elements of Count II have already been proven by the Trustee. In particular, it has been proven that (1) there were transfers of an interest of the Debtor in property; (2) the transfers occurred within two years of the Petition Date; and (3) the Debtor was insolvent when the transfers were made. The court's previous insolvency finding covered the period of the presumption, 90 days. The evidence shows that Network Salon was insolvent from 2013 to 2016.

[23] **[24]** **[25]** The Trustee has to prove that Network Salon received less than reasonably equivalent value from LG Funding through the transactions. *Barber v. Golden Seed Co.*, 129 F.3d 382, 387 (7th Cir. 1997). "The test used to determine reasonably equivalent value in the context of a fraudulent conveyance requires the court to determine the value of what was transferred and to compare it to what was received." *Id.* (citing *In re Vitreous Steel Prods. Co.*, 911 F.2d 1223, 1234–35 (7th Cir. 1990)). This determination does not involve the application of a fixed formula; the transactions are examined on a case-by-case basis. *Barber,* 129 F.3d at 387 ("[R]easonable ***630** equivalence should depend on all the facts of each case." In 2016, the Seventh Circuit said in the context of tax sales "[W]e apply to Illinois tax sales the same factors used to determine reasonably equivalent value in other § 548 cases, including the fair market value of what was transferred and received, whether the transaction took place at arm's length, and the good faith of the transferee." *Smith v. SIPI, LLC, et al. (In re Smith)*, 811 F.3d 228, 240 (7th Cir. 2016) (internal citation omitted) (Compliance with Illinois property tax sale procedures is not sufficient to establish that a tax sale was for reasonably equivalent value for fraudulent transfer purposes).

[26] The parties stipulated that, pursuant to the Agreements, LG Funding transferred $125,000 to Network Salon in exchange for a portion of its future receivables, with Network Salon incurring the obligation to pay LG Funding $176,432. LG Funding could debit up to 15% of Network Salon's receivables until the total amount of $176,432 was paid. Pursuant to the Agreements, Network Salon transferred $112,979 in total to LG Funding. This amount was transferred to LG Funding through automatic debits by LG Funding of Network Salon's account(s). The debits occurred approximately once a week from November 9, 2015 through March 28, 2016. *See* Def's Ex. 2. Overall, Network Salon received $125,000 from LG Funding, but only gave value of $112,979 in return.

The Agreements provide that LG Funding paid fair market value for Network Salon's receivables. They state that: "Merchant agrees that the Purchase Price is in exchange for the Receipts pursuant to this Agreement equals the fair market value of such Receipts." Trustee's Exs. 18 and 28, ¶¶ 1.9 in each Agreement.

The court finds that each Agreement was formed in good faith. LG Funding assumed the risk of non-payment; if Network Salon ceased producing income, LG Funding could not have been paid. LG Funding did not order or require the Debtors to put the proceeds of other MCA transactions into the accounts LG Funding had access to.

Based on the evidence presented, the court finds that Network Salon received reasonably equivalent value under the Agreements. For that reason the transactions with LG Funding were not constructively fraudulent transfers. The Trustee has not carried her burden of proving Count II.

C. Count III- Disallowance of Claims

[27] Count III of the Trustee's complaint asks the Court to disallow any claims filed by LG Funding until it returns the transfers alleged to be preferential and fraudulent to the Trustee. In support of this, the Trustee cites 11 U.S.C. § 502(d), which provides that "the court shall disallow any claim of any entity ... that is a transferee of a transfer avoidable under [sections 547 or 548] of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable ..." This provision presupposes that a transferee has filed a proof of claim in a debtor's bankruptcy case.

[28] **[29]** In statutory interpretation, courts begin with the plain language of the statute. *Cent. States, Se. & Sw. Areas Pension Fund v. Fulkerson*, 238 F.3d 891, 895 (7th Cir. 2001). "Statutory terms or words will be construed according to their ordinary, common meaning unless these are defined by the statute or the statutory context requires a different definition." *Id.* (citing *Walters v. Metro. Educ. Enterprises., Inc.*, 519 U.S. 202, 207, 117 S.Ct. 660, 136 L.Ed.2d 644 (1997)). The plain language ***631** of § 502(d) provides that a court may "disallow any *claim* of any entity" whose transfer is avoidable under the specified subsections. 11 U.S.C. § 502(d) (emphasis added). LG Funding, however, has not filed a proof of claim in the chapter 7 bankruptcy cases of Ms. Hill and Network

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Salon. Because no proof of claim has been filed, § 502(d) is inapplicable; the relief requested can not be granted. The Trustee recovers nothing under Count III.

IV. CONCLUSION

The Trustee has failed to meet her burden to establish by a preponderance of the evidence that the transfers were preferential or constructively fraudulent and therefore subject to avoidance. LG Funding has succeeded in establishing that the transfers were made in the ordinary course of business, defeating the Trustee's § 547(b) preference claim. The constructive fraudulent conveyance claim fails because Network Salon received reasonably equivalent value in the transactions in issue. Judgment will be entered in favor of Defendant LG Funding on all Counts.

This Memorandum Opinion constitutes the court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate Judgment Order will be entered consistent with this Opinion.

All Citations

589 B.R. 614, 66 Bankr.Ct.Dec. 65

Footnotes

1 The court doubts that such a count would be actionable under New York law. *See In re Global Service Group, LLC*, 316 B.R. 451 (Bankr. S.D.N.Y. 2004); *In re Fleming Packaging Corp.*, 2005 WL 2205703 (Bankr. C.D. Ill. 2005).

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2025 WL 1550541

NOT FOR PUBLICATION

United States Bankruptcy Court, S.D. New York.

IN RE: J.P.R. MECHANICAL INC. d/b/a JPR Mechanical, et al., Debtor.
Marianne T. O'Toole, solely in her capacity as Chapter 7 Trustee of the Estate of J.P.R. Mechanical Inc. d/b/a/ JPR Mechanical, Plaintiff,
v.
Radium2 Capital, LLC, f/k/a Radium2 Capital, Inc., Defendant.
Marianne T. O'Toole, solely in her capacity as Chapter 7 Trustee of the Estate of J.P.R. Mechanical Services Inc., Plaintiff,
v.
Radium2 Capital, LLC, f/k/a Radium2 Capital, Inc., Defendant.

Case No. 19-23480 (DSJ)
|
Adv. Pro. No. 21-07079 (DSJ),
Adv. Pro. No. 21-07082 (DSJ)
|
Signed May 30, 2025

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DECISION ON MOTION OF PLAINTIFF FOR PARTIAL SUMMARY JUDGMENT

DAVID S. JONES, UNITED STATES BANKRUPTCY JUDGE

***1** The summary judgment motions before this Court seek to avoid three transfers made to the defendant pursuant to merchant cash advance agreements. Numerous decisions of New York state courts, several decisions of the District Court, and one opinion of the Second Circuit have analyzed agreements like these to determine whether they constitute loans notwithstanding that they are styled as being, or at least resembling, asset-sale agreements. Usually, those decisions deal with claims of usury or civil-RICO violations. This decision addresses how the avoidable preference provisions of the Bankruptcy Code apply to merchant cash advance agreements. The Court concludes that here the Trustee has established an absence of any material factual dispute and is entitled to avoid the transfers at issue.

Frequently under merchant cash advance agreements, a funder advances money to a company in exchange for a specified percentage of that company's future revenues up to a certain amount, while the funder and the company agree on an estimate of those future revenues such that the funder may draw a fixed sum from the company's bank account daily until the funder receives the agreed-upon amount. Also frequently, the company may request a change to the daily draw amount if its revenues drop, and the agreements generally provide for reconciliation of the daily draw amounts against the company's actual revenues. Courts determining whether these arrangements are true asset sales, or, on the other hand, are in reality loans, look to the substance of the parties' conduct and their agreements.

In bankruptcies, transfers made by a struggling and soon to be bankrupt company under a merchant cash advance agreement may be the subject of clawback demands by the company's bankruptcy trustee, with a central issue being whether the payments were on account of debt owed to the merchant cash advance provider. Here, the Trustee argues that she is entitled to summary judgment allowing the estate to avoid three transfers, all made under a merchant cash advance agreement at a time when the future debtor was insolvent. The Court agrees, drawing heavily from Judge Liman's thorough and well-reasoned decision in *Fleetwood Services, LLC v. Ram Capital Funding, LLC*, No. 20-cv-5120 (LJL), 2022 WL 1997207 (S.D.N.Y. June 6, 2022) ("*Fleetwood*"). At bottom, the parties' agreements and their course of conduct – including even that Radium2 filed proofs of claim in this case labeling itself a creditor who is owed money on account of the agreements at issue – establishes that the obligations that led to the transfers constituted debts as a matter of law, and, as such, were subject to avoidance in the circumstances the Trustee has shown are present here.

JURISDICTION

This Court has jurisdiction over this bankruptcy case, these adversary proceedings, and these motions pursuant to 28 U.S.C. §§ 157(b), 1334, and the Amended Standing Order of Reference M-431, dated January 31, 2012 (Preska, C.J.). These adversary proceedings and these motions are core proceedings under 28 U.S.C. § 157(b)(2)(F) as proceedings to avoid and recover alleged preferences.

BACKGROUND

***2** J.P.R. Mechanical Inc. ("Debtor" or "JPR") filed for Chapter 7 bankruptcy on August 16, 2019. J.P.R. Mechanical Services Inc. ("Services" and together with JPR, the "Debtors"), an affiliate of JPR, filed for bankruptcy at the same time. The Debtors operated as an HVAC subcontractor on large projects that proved beyond their ability to viably carry out. Trying to stave off collapse, they turned to merchant cash advance financing with multiple funders, including defendant Radium2 Capital, LLC ("Radium2" or "Defendant").

The Debtors ultimately failed. Their claims registers reflect around $200 million in claims. Marianne T. O'Toole, the Chapter 7 Trustee of the Debtors' procedurally consolidated bankruptcy estates ("Trustee" or "Plaintiff"), brought two adversary proceedings to recover certain prepetition transfers made to Radium2 as avoidable preferences and disallow claims filed by Radium2.[1] The Trustee served detailed requests for admissions, to which Radium2 failed to respond. The Trustee has moved for summary judgment in the JPR Lawsuit and the Services Lawsuit, and Radium2 also failed to timely respond to those motions, although it did file an untimely response and oppose the motions at a hearing. The Trustee's motion was accompanied by the statement required by Local Bankruptcy Rule 7056-1 identifying material facts as to which the movant asserts there is no genuine dispute; Radium2 filed a counterstatement that failed to specifically respond to each assertedly undisputed fact identified by the Trustee. This failure by Radium2 violated the express requirements of the Local Bankruptcy Rule which dictate that a failure to file specifically-targeted responses is deemed an admission of the matters stated in the movant's statement. Radium2 did file short and somewhat conclusory declarations of its principal. *See* Aff. of Troy Caruso, JPR Lawsuit, ECF No. 39; Aff. of Troy Caruso, Services Lawsuit, ECF No. 40.

FACTS

In the months before filing for bankruptcy, JPR had entered into at least four agreements with Radium2, each titled "Agreement for the Purchase and Sale of Future Receipts." Of those agreements, three are at issue in these adversary proceedings: the one effective April 8, 2019, Holecek Decl. Ex. M, JPR Lawsuit, ECF No. 26-16 (the "April Agreement"), the one made as of June 28, 2019, Holecek Decl. Ex. O, JPR Lawsuit, ECF No. 26-18 (the "June Agreement"), and the one dated July 26, 2019, Holecek Decl. Ex. M, Services Lawsuit, ECF No. 27-16 (the "July Agreement" and together with the April Agreement and the June Agreement, the "Agreements"). *See* Examination of Troy C. Caruso ("Tr.") 84:2-10, 70:2-22, Holecek Decl. Ex. L., JPR Lawsuit, ECF No. 26-15. New York law governs the Agreements. April Agreement § 20; June Agreement § 20; July Agreement § 20. Each of the Agreements provides for an immediate cash advance to JPR and purports to sell twenty-five percent of JPR's future receipts to the Defendant up to certain specified targets, *see, e.g.*, April Agreement at 1, with the Defendant to collect the supposedly purchased receivables through daily transfers from JPR's designated bank account, *see, e.g.*, April Agreement at 1, and with JPR restricted from diverting revenue to affiliated businesses, *see, e.g.*, April Agreement § 13.11. The Agreements' relevant terms are detailed in this decision's legal analysis section and, to avoid repetition, not here.

***3** On May 31, 2019, JPR wired $1,470,102.02 to the Defendant (the "May Transfer"). Debtor's May 2019 Bank Statement from Signature Bank for Account ending *6727 (the "May Statement") at 10, Holecek Decl. Ex. D, JPR Lawsuit, ECF No. 26-7. On July 3, 2019, JPR wired $750,002.50 to the Defendant (the "July 3 Transfer"). Debtor's July 2019 Bank Statement from Signature Bank for Account ending *6727 (the "July Statement") at 4, Holecek Decl. Ex. E, JPR Lawsuit, ECF No. 26-8. On July 17, 2019, Services transmitted $850,000 from its bank account to the Defendant (the "July 17 Transfer" and together with the May Transfer and the July 3 Transfer, the "Transfers"). Services' July 2019 Bank Statement from Signature Bank for Account ending *6743 (the "July Services Statement") at 5, Holecek Decl. Ex. D, Services Lawsuit, ECF No. 27-7. The May Transfer and the July 3 Transfer pertain to the JPR Lawsuit and the April and June Agreements; the July 17 Transfer pertains to the Services Lawsuit and, at most, the June or July Agreements.

The Court takes judicial notice that Radium2 filed proofs of claim in sums certain, identifying itself as a "creditor" holding a "claim" against the Debtors on account of unpaid amounts under the Agreements. *See* Claims 105 and 106,

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JPR Claims Register; Claim 14, Services Claims Register. Further, Radium2 has failed to raise any factual dispute as to the following facts set forth in the Trustee's requests for admissions in the JPR Lawsuit:

- Defendant received the May Transfer and the July 3 Transfer.
- For the May Transfer and the July 3 Transfer, neither the Defendant nor JPR intended either transfer to be in exchange for new value to be conveyed contemporaneously.
- For the May Transfer and the July 3 Transfer, no new value was exchanged contemporaneously.
- For each obligation paid by the May Transfer or the July 3 Transfer, such obligation was paid in a manner inconsistent with the prior course of business dealings between the Defendant and JPR.
- For each obligation paid by the May Transfer or the July 3 Transfer, such obligation was paid in a manner inconsistent with the practices of Defendant's industry.
- For each obligation paid by the May Transfer or the July 3 Transfer, such obligation was paid in a manner inconsistent with the practices of JPR's industry.
- For each obligation paid by the May Transfer or the July 3 Transfer, the obligation was not incurred by JPR as part of its normal business or financial affairs with the Defendant.
- The May Transfer and the July 3 Transfer were each inconsistent with ordinary business terms.
- The May Transfer and the July 3 Transfer were made for the benefit of the Defendant or another creditor.

Reqs. for Admis. at 4-6, Holecek Decl. Ex. C, JPR Lawsuit, ECF No. 26-6. Separately, in her un-responded-to requests for admissions in the Services Lawsuit, the Trustee requested that the Defendant admit that:

1. Defendant received the July 17 Transfer.
2. The July 17 Transfer was made during the ninety days before the petition date.
3. Defendant had a right to receive the July 17 Transfer in satisfaction of or on account of a then-existing obligation or debt owed by Services at the time the July 17 Transfer was made.
4. The July 17 Transfer was for the benefit of the Defendant or a creditor.
5. At the time the Defendant received the July 17 Transfer it was a creditor of Services.
6. The July 17 Transfer, when made, was on account of an antecedent debt owed to the Defendant by Services.
7. Services was insolvent at the time of the July 17 Transfer.
8. The Defendant has no evidence to rebut the presumption of insolvency during the ninety days before the petition date.
9. With respect to the July 17 Transfer, the Defendant received a greater percentage of what was owed to it, with respect to the obligations or debts satisfied by the July 17 Transfer, than it would have received had the July 17 Transfer not been made and Services liquidated under Chapter 7 of the Bankruptcy Code on the petition date.
10. With respect to the July 17 Transfer, the Defendant held no fully perfected security interest in the assets of Services, other than the July 17 Transfer, equal to or exceeding the amount of the July 17 Transfer that secured satisfaction of the obligation or debt on account of which the July 17 Transfer was made.

***4** 11. Neither the Defendant nor Services intended the July 17 Transfer to be in exchange for new value to be conveyed contemporaneously.

12. No new value was exchanged contemporaneously with the July 17 Transfer.
13. For each obligation paid by the July 17 Transfer, such obligation was paid in a manner inconsistent with the prior course of business dealings between the Defendant and Services.
14. For each obligation paid by the July 17 Transfer, such obligation was paid in a manner inconsistent with the practices of the Defendant's industry.
15. For each obligation paid by the July 17 Transfer, such obligation was paid in a manner inconsistent with the practices of the industry in which Services operated.

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16. For each obligation paid by the July 17 Transfer, the obligation was not incurred by Services as part of its normal business or financial affairs with the Defendant.

17. The July 17 Transfer was inconsistent with ordinary business terms.

18. The Transfers were made for the benefit of the Defendant or another creditor.

Reqs. for Admis. at 4-6, Holecek Decl. Ex. C, Services Lawsuit, ECF No. 27-6.

Defendant never responded to the Trustee's requests for admissions. Holecek Decl. ¶ 7, JPR Lawsuit, ECF No. 26-3; Holecek Decl. ¶ 7, Services Lawsuit, ECF No. 27-3. Nor did Defendant's untimely counterstatements under Local Bankruptcy Rule 7056-1 identify evidence to rebut each assertedly undisputed fact listed in the Trustee's properly submitted statements of undisputed facts.

LEGAL STANDARDS

A. General Procedural Rules Governing Summary Judgment

Federal Rule of Bankruptcy Procedure 7056 applies Rule 56 of the Federal Rules of Civil Procedure to adversary proceedings. Fed. R. Bankr. P. 7056. "The court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). "[A] party opposing a properly supported motion for summary judgment may not rest upon the mere allegations or denials of his pleading, but must set forth specific facts showing that there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (internal quotations omitted). Absent such a contest from the non-moving party, "[t]he moving party is entitled to a judgment as a matter of law because the non-moving party has failed to make a sufficient showing on an essential element of [its] case with respect to which [it] has the burden of proof." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (internal quotations omitted).

However, the "failure to oppose a motion for summary judgment alone does not justify the granting of summary judgment." *Vermont Teddy Bear Co. v. 1-800 Beargram Co.*, 373 F.3d 241, 244 (2d Cir. 2004). This Court could have deemed the Trustee's motions unopposed due to the Defendant's failure to timely file an opposition in violation of a clear order of the Court. *See Watson v. Geithner*, 355 F. App'x 482, 483 (2d Cir. 2009) (citing Davidson v. Keenan, 740 F.2d 129, 132 (2d. Cir. 1984)); *compare, e.g.*, Order Respecting Mots. to Withdraw, JPR Lawsuit, ECF No. 33 (setting deadline of February 12, 2025 for Defendant to file an opposition to these motions) *with* Def's. Mem. of Law in Opp'n to Trustee's Mot. for Summ. J. ("Def's. Mem. Regarding JPR"), JPR Lawsuit, ECF No. 38 (dated February 17, 2025 and filed February 19, 2025) *and* Def's. Mem. of Law in Opp'n to Trustee's Mot. for Summ. J. ("Def's. Mem. Regarding Services"), Services Lawsuit, ECF No. 39 (dated February 17, 2025 and filed February 19, 2025). Particularly because substantive review of a movant's showing is always required, this decision nevertheless takes into account Defendant's untimely opposition.

B. Procedural Rules Governing Requests for Admissions and Statements of Undisputed Material Fact

***5** The Federal Rules of Bankruptcy Procedure apply Federal Rule of Civil Procedure 36 in adversary proceedings. Fed. R. Bankr. P. 7036. Under that civil rule, "A matter is admitted unless, within 30 days after being served, the party to whom the request is directed serves on the requesting party a written answer or objection addressed to the matter and signed by the party or its attorney." Fed. R. Civ. P. 36(a)(3). Meanwhile, the Local Rules of this Court require parties seeking summary judgment to file a statement of the material facts as to which the moving party contends there exists no triable dispute; the non-moving party must file a counter-statement, and "[e]ach numbered paragraph in the statement of material facts required to be served by the moving party shall be deemed admitted for purposes of the motion unless specifically controverted by a correspondingly numbered paragraph in the statement required to be served by the opposing party." S.D.N.Y. Local Bankr. R. 7056-1(d).

The Trustee incorporated into her statements of undisputed material facts the facts deemed admitted by the Defendant's failure to respond to her requests for admissions. *See* Statement of Undisputed Material Facts ¶¶ 18-52, JPR Lawsuit, ECF No. 26-2; Statement of Undisputed Material Facts ¶¶ 13-32, Services Lawsuit, ECF No. 27-2. Those facts now sit doubly outside the Defendant's challenge. The Court's analysis in this decision not only applies those facts, but also explains why some of the Defendant's untimely attempts to challenge them would fail even if not procedurally barred.

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C. Merits: 11 U.S.C. §§ 547(b), (c)

Section 547 of the Bankruptcy Code defines which transfers of a debtor's property a bankruptcy trustee may avoid as preferential. This section promotes several policies of the Code, including 1) reducing the incentives creditors have to race to the courthouse when a viable enterprise faces temporary challenges, 2) preventing failing enterprises from favoring some creditors over others, and 3) promoting equality of distribution among similarly-situated creditors. *See Butler v. David Shaw, Inc.*, 72 F.3d 437, 441 n.6 (4th Cir. 1996); *DeRosa v. Buildex Inc.* (*In re F & S Cent. Mfg. Corp.*), 53 B.R. 842, 846 (Bankr. E.D.N.Y. 1985). The provision empowers a bankruptcy trustee to avoid any transfer of an interest of the debtor in property:

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). The Trustee has the burden to prove the Transfers avoidable under Section 547(b); if the Trustee does so, the Defendant has the burden to establish the elements of any statutory defenses. *See id.* § 547(g). "One who relies upon an affirmative defense to defeat an otherwise meritorious motion for summary judgment must adduce evidence which, viewed in the light most favorable to and drawing all reasonable inferences in favor of the non-moving party, would permit judgment for the non-moving party on the basis of that defense." *Domino Media, Inc. v. Kranis*, 9 F. Supp. 2d 374, 385 (S.D.N.Y. 1998) (quoting *Frankel v. ICD Holdings S.A.*, 930 F. Supp. 54, 65 (S.D.N.Y. 1996)), *aff'd*, 173 F.3d 843 (2d Cir. 1999). Defendant's untimely opposition papers raise the following issues:

1) Whether the Agreements are loans; if the Trustee establishes that they are, that advances the Trustee's affirmative case, and

***6** 2) Whether the Defendant and JPR and Services entered into and performed the contracts between them, including making the Transfers, in the ordinary course of business and according to ordinary business terms; if the Defendant establishes this, it would make out the ordinary transaction defense under Section 547(c)(2), and

3) Whether, through the Transfers, the Defendant received more than it would have received in a liquidation of the Debtors on the petition date.

See Def's. Mem. Regarding JPR at 3-9; Aff. of Troy Caruso, JPR Lawsuit; Def's. Mem. Regarding Services at 3-9; Aff. of Troy Caruso, Services Lawsuit, ECF No. 40.

ANALYSIS OF THE TRUSTEE'S AFFIRMATIVE CASE

A. The Agreements are Loans

To find a transfer avoidable as a preference, a court must find that the debtor made the transfer to or for the benefit of a creditor, for or on account of an antecedent debt owed before the debtor made the transfer. 11 U.S.C. § 547(b)(1)-(2). A creditor is an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." *Id.* § 101(10)(A). The Code defines a "claim" as any:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

Id. § 101(5). The Code also defines a "debt" as "liability on a claim." *Id.* § 101(12). Loans to a debtor made prepetition and

not paid off before the petition date count as "claims" in that debtor's bankruptcy. *Id.* § 101(5).

Thus, if the Trustee can establish that the Agreements are loans, then it will follow that 1) JPR made the May Transfer and the July 3 Transfer to a creditor and 2) JPR made the May Transfer and the July 3 Transfer "on account of an antecedent debt owed by the debtor before such transfer was made." *Id.* § 547(b). This follows because "[a] debt is incurred, for purposes of 11 U.S.C. § 547(b)(2), when it arises and not when payment becomes due." *Cassirer v. Herskowitz (In re Schick)*, 234 B.R. 337, 347 (Bankr. S.D.N.Y. 1999) (citations omitted). Thus, if the Agreements count as loans, the Debtor made the May Transfer and the July 3 Transfer "on account of an antecedent debt owed by the debtor," 11 U.S.C. § 547(b)(2). *See Nisselson v. Salim* (*In re Big Apple Volkswagen, LLC*), No. 11-2251 (JLG), 2016 WL 1069303, at *8, 2016 Bankr. LEXIS 834, at *31-32 (Bankr. S.D.N.Y. Mar. 17, 2016).

"Under New York law, the initial interpretation of a contract is a matter of law for the court to decide." *K. Bell & Assocs., Inc. v. Lloyd's Underwriters*, 97 F.3d 632, 637 (2d Cir. 1996) (internal quotations omitted). If the Court finds the contract ambiguous, the proper interpretation of the contract becomes a question of fact. *Id.* As to whether the Agreements constitute loans under New York law, neither party argues that any of the contractual language here is ambiguous. The Court therefore will evaluate that language to classify the Agreements as a matter of law. Cf. *Broker Genius, Inc. v. Volpone*, 313 F. Supp. 3d 484, 500 (S.D.N.Y. 2018) ("Here, the parties have not suggested that the Terms of Use are ambiguous. Nor have they directed the Court to any extrinsic evidence of the contract's meaning. The Court therefore follows the parties' lead .... Since the Terms of Use are unambiguous, it is for the Court to interpret them as a matter of law." (internal citations and quotations omitted)); *see also, e.g., Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-cv-5120 (LJL), 2022 WL 1997207, at *8-14 (S.D.N.Y. June 6, 2022) (interpreting a contract as a matter of law to classify it as a loan under New York law); *In re Grand Union Co.*, 219 F. 353, 356-59 (2d Cir. 1914) (same).

***7** "The hallmark of a loan is that the lender 'is absolutely entitled to repayment under all circumstances,' or put otherwise, the 'principal sum' 'is repayable absolutely.' " Fleetwood, 2022 WL 1997207, at *9 (quoting *LG Funding, LLC v. United Senior Props. of Olathe, LLC*, 122 N.Y.S.3d 309, 312, 181 A.D.3d 664 (App. Div. 2d Dep't 2020)). "Under New York law, which governs the Agreement[s], 'substance—not form—controls' when a court determines whether a transaction is a loan." *Fleetwood Servs., LLC v. Richmond Cap. Grp. LLC*, No. 22-1885-cv, 2023 WL 3882697, at *2 (2d Cir. June 8, 2023) (quoting *Adar Bays, LLC v. GeneSYS ID, Inc.*, 37 N.Y.3d 320, 179 N.E.3d 612, 621-22 (N.Y. 2021)). "New York courts usually weigh three factors in making that determination: '(1) whether there is a reconciliation provision in the agreement; (2) whether the agreement has a finite term; and (3) whether there is any recourse should the merchant declare bankruptcy.' " *Id.* (quoting *Principis Cap., LLC v. I Do, Inc.*, 160 N.Y.S.3d 325, 327, 201 A.D.3d 752 (App. Div. 2d Dep't 2022)). Within the first two of these factors, courts examine whether the merchant could practicably invoke the reconciliation provision, *see Fleetwood*, 2022 WL 1997207, at *13 ("The Fleetwood Agreement nominally has a reconciliation provision .... But that provision functions in such a way that renders it largely illusory."), and whether, even if the agreement purports to have no maturity date, it has a "de facto fixed term," *Lateral Recovery LLC v. Queen Funding, LLC*, No. 21 Civ. 9607 (LGS), 2022 WL 2829913, at *6, 2022 U.S. Dist. LEXIS 129032 (S.D.N.Y. July 20, 2022).

More broadly, "[t]he 'three factors provide only a guide' to the analysis; 'they do not dictate the conclusion.' " *Lateral Recovery, LLC v. Cap. Merch. Servs., LLC*, 632 F. Supp. 3d 402, 452 (S.D.N.Y. 2022) (quoting *Fleetwood*, 2022 WL 1997207, at *9). Courts also consider whether the agreement at issue identifies the accounts purchased and whether the "purchaser" may possess, use or convey them, which party bears responsibility for collecting the accounts, and the number of payments a merchant can miss before finding itself in default. Fleetwood, 2022 WL 1997207, at *10-11. Courts also at times consider a question the parties did not emphasize here: whether the daily payment rates appear to be good faith estimates of the merchant's revenues. *Davis v. Richmond Cap. Grp., LLC*, 150 N.Y.S.3d 2, 4, 194 A.D.3d 516 (App. Div. 1st Dep't 2021). "The root of all of these factors is the transfer of risk. Where the lender has *purchased* the accounts receivable, the borrower's debt is extinguished and the lender's risk with regard to the performance of the accounts is direct, that is, the lender and not the borrower bears the risk of non-performance by the account debtor." *Endico Potatoes, Inc. v. CIT Grp./Factoring, Inc.*, 67 F.3d 1063, 1069 (2d Cir. 1995) (emphasis in original).

As noted, the Agreements are styled as agreements by which Radium2 purchased future receivables, with a cash payment to JPR up front and a stream of daily payments in specified amounts in exchange. April Agreement at 1; June Agreement

at 1; July Agreement at 1. The Agreements allow the Debtor to request changes to the daily payment. *See* April Agreement § 2; June Agreement § 2; July Agreement § 2. However, the Debtor could request such a modification only once per month, and only on a going-forward basis. April Agreement § 2; June Agreement § 2; July Agreement § 2. Nothing in the Agreements requires the Defendant to remit back to the Debtors any amounts by which the Debtors have been overcharged during any given month. Thus, the Agreements lack true reconciliation provisions. *Compare K9 Bytes, Inc. v. Arch Cap. Funding, LLC,* 57 N.Y.S.3d 625, 632–33, 56 Misc.3d 807 (Sup. Ct. 2017) ("The reconciliation provisions allow the merchant to seek an adjustment of the amounts being taken out of its account based on its cash flow (or lack thereof). If a merchant is doing poorly, the merchant will pay less, and will receive a refund of anything taken by the company exceeding the specified percentage.") *and IBIS Cap. Grp., LLC v. Four Paws Orlando LLC,* No. 608586/16, 2017 WL 1065071, at *3 (N.Y. Sup. Ct. Mar. 10, 2017) ("In order to ensure that IBIS will not inadvertently receive any money other than the purchased future sales proceeds, the Agreement provides a reconciliation mechanism by which IBIS will return to Four Paws anything that does not represent future sales proceeds.") *with Queen Funding,* 2022 WL 2829913, at *6, 2022 U.S. Dist. LEXIS 129032, at *15 (ruling a merchant cash advance agreement to be a usurious loan even when it had a reconciliation provision because such reconciliation provision did not bind the purported lender to actually perform the reconciliation). Applying these principles here, the Agreements lacked reconciliation provisions that would cause Radium2 not to receive more than the share of receivables purportedly purchased because the Agreements do not bind the Defendant to pay back any money collected that exceeds the specified percentage of the Debtors' revenues. This factor accordingly weighs in favor of classifying the Agreements as loans.

***8** The Agreements have no stated maturity date or finite term, but the Defendant's principal admitted in a deposition in this case, offered by the Trustee and uncontroverted by Defendant, that the Agreements had de facto fixed terms. *See* Tr. 51:20-23 (When asked "How long is this out there for?" Defendant's principal responded "They're all different. It depends. Usually it's an amount of days, it's the payment deducted by what you're purchasing."). For this reason, the Agreements lack the indefinite term that characterizes transfers of ownership. *Cf. Fleetwood,* 2022 WL 1997207, at *11 ("Richmond [the purported lender] has none of the rights of ownership—it does not have the right to possess, use, or convey any of the accounts it supposedly has purchased." (citing *Ownership, Black's Law Dictionary* (11th ed. 2019) ("Ownership rights are general, permanent, and heritable."))). As another judge in this District has observed in similar circumstances, "a de facto fixed term plausibly exists. The period of payment can be easily calculated by dividing the amount [ ] owe[d] by the amount of daily payments. A failure to pay will not indefinitely extend the term because the [Agreements] provide[ ] that a default will occur if [more than four] daily payments are not made during the term of the [A]greements and the [the Debtors] do[ ] not contact [the Defendant] in advance." *Queen Funding,* 2022 WL 2829913, at *6, 2022 U.S. Dist. LEXIS 129032, at *16; April Agreement § 15; June Agreement § 15(h); July Agreement § 15(h). This factor too weighs in favor of classifying the Agreements as loans.

Although not dispositive, the third frequently-considered factor—the availability of recourse in the event of bankruptcy —does not point to classifying the Agreements as loans. The Agreements do not list the Debtor's bankruptcy as an event of default, and they even include language contemplating that the Debtor could go into bankruptcy and not default. *See* April Agreement § 4 ("[I]f the full Purchased Amount is never remitted because [Debtor's] business went bankrupt ... and [Debtor] has not breached this Agreement, [Debtor] would not owe anything to [Defendant] and would not be in breach of or default under this Agreement."); June Agreement § 4 (same); July Agreement § 4 (same).

However, the power of this factor is limited because Defendant is not entirely "without recourse" in the event the Debtor's bankruptcy caused the Debtor to fail to pay the Purchased Amount to the Defendant. The Defendant holds personal guarantees of "prompt and complete performance of all of [Debtor's] obligations under the [Agreements]" from the Debtor's principal, which the Defendant could exercise against the guarantor without first exercising any remedies under the Agreements. *See* Personal Guaranty of Performance §§ 2, 4, April Agreement Ex. A; Personal Guaranty of Performance §§ 2, 4, June Agreement Ex. A; Personal Guaranty of Performance §§ 2, 4, July Agreement Ex. A. Furthermore, default under any of the Agreements meant "the full uncollected Purchased Amount plus all fees and charges (including legal fees) due under this Agreement will become due and payable in full immediately" and "[Defendant] may debit [Debtor's] depositary accounts wherever situated by means of ACH debit or facsimile signature on a computer-generated check drawn on [Debtor's] bank account or

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otherwise for all sums due to [Defendant].” April Agreement § 16; June Agreement § 16; July Agreement § 16.

Almost any bankruptcy filing and the resulting automatic stay – especially the Chapter 7 liquidation the Debtor filed – would necessarily “interfere[ ] with [Defendant's] right to collect,” April Agreement § 15; June Agreement § 15; July Agreement § 15, and therefore cause a default. Furthermore, it seems unlikely that, in the event of bankruptcy, the Debtor could or would avoid another contractual event of default by “provid[ing] timely notice to [the Defendant] such that in any given calendar month” no more than four “ACH transactions attempted by [Defendant]” would be rejected by Debtor's bank. *See* April Agreement § 15; June Agreement § 15; July Agreement § 15. Thus, the Agreements’ provisions, despite not expressly defining bankruptcy as an event of default, make events that almost certainly would occur if a “seller of receivables” commenced a bankruptcy count as defaults, with results including triggering the personal guarantees. However, as the scope of the guarantor's liability does not extend beyond the scope of the Debtor's liability, this factor may weigh slightly but not decisively against classifying the Agreements as loans. *See Pirs Cap., LLC v. D & M Truck, Tire & Trailer Repair Inc.*, 129 N.Y.S.3d 734, 740, 69 Misc.3d 457 (Sup. Ct. N.Y. Cnty. 2020) (“At the same time, though, the scope of O'Neil’s obligations under the recourse provision of the guarantee is itself limited by the contingent nature of the *merchant's* obligations under the Agreement in light of the reconciliation provision.”).

***9** From a broader perspective, the Agreements have little similarity to an asset sale despite purporting to be one. The Defendant “purchased” a specified percentage of “all payments made by cash, check, ACH or other electronic transfer, credit card, debit card, bank card, charge card ... or other form of monetary payment in the ordinary course of [the Debtor's] business.” April Agreement at 1; June Agreement at 1; July Agreement at 1. “That language is so broad as to be essentially vacuous. It captures not just future accounts from [Debtor's] customers but gives [Defendant] the right to *all* [Debtor's] revenues[.]” *Fleetwood*, 2022 WL 1997207, at *11 (emphasis in original). Meanwhile, the Agreements lack provisions one would expect of a true asset purchase; for example, they do not empower the Defendant to collect directly from any of the Debtor's customers, and they do not identify any specific accounts receivable purchased by the Defendant. And, as the *Fleetwood* court found to be a significant indicator of a loan, “so long as [Debtor] has enough money to cover the daily payment amount ... [the Debtor] can use the proceeds [ ] however it likes—the receipts need not be deposited in an escrow account or otherwise held in trust for [Defendant's] benefit. [Debtor] enjoys the use of the proceeds.” *Id*

Further, under the Agreements, the Debtor, rather than the Defendant, faces the risk that any specific customer will fail to pay; a customer's failure to pay will not reduce the amount that the Debtor must transfer to the Defendant, or, put another way, the Debtor owes Radium2 the same daily amount whether Debtor does or does not collect on any given receivables, or all receivables. And, if the “Initial Daily Amount,” *see* April Agreement at 1; June Agreement at 1; July Agreement at 1, is not in the Debtor's bank account when Defendant seeks to draw it, “[the Defendant] is entitled to remedies against [the Debtor] and not against the account debtors.” *Fleetwood*, 2022 WL 1997207, at *10. These economic features, most fundamentally the reality that the Debtor bears the risk of non-collection of receivables with Radium2 bearing little if any of that risk, powerfully show the Agreements to be loans.

Finally, there is a virtually dispositive undisputed fact here: Radium2 has admitted under oath in proofs of claim that it filed in the JPR bankruptcy case that it is a “creditor” who has a “claim” for money it is owed by JPR. Radium2 filed Claims 105 and 106 against JPR on January 15, 2020. *See* JPR Claims Register. The proofs of claim filed by the Defendant state, “This form is for making a claim for payment in a bankruptcy case”; “Who is the current creditor?” to which the Defendant responded “Radium2 Capital, LLC”; and “How much is the claim?” to which the Defendant respectively responded “$1,854,474.86,” and “$1,638,975.00.” *See* Claims 105 and 106, JPR Claims Register. The Defendant's attorney signed the proofs of claim under penalty of perjury. For these reasons, the Defendant cannot deny that it is a creditor of the Debtor under 11 U.S.C. § 547(b)(1).

Weighing all the factors reviewed above, there is no genuine dispute of material fact that the Debtor made the Transfers to the Defendant “to or for the benefit of a creditor” and “on account of an antecedent debt owed by the debtor.”

B. The Defendant Has Also Admitted It Received the July 17 Transfer from Services on Account of an Antecedent Debt

The admitted facts cause the same result as to the July 17 Transfer at issue in the Services Lawsuit. The Defendant admitted 1) that it received the July 17 Transfer “in satisfaction of or on account of a then-existing obligation or

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debt owed to Defendant" by Services, 2) that "[t]he July 17 Transfer was for the benefit of Defendant," 3) that "[a]t the time Defendant received the July 17 Transfer, Defendant was a creditor of" Services, and 4) that the July 17 Transfer "was, at the time it was made, on account of an antecedent debt owed to Defendant by" Services. Statement of Undisputed Material Facts ¶¶ 16, 18-21, Services Lawsuit (citing Reqs. for Admis. at 4, Services Lawsuit). These admitted facts establish that the July 17 Transfer was a "transfer of an interest of the debtor in property (1) to or for the benefit of a creditor [and] (2) for or on account of an antecedent debt owed by the debtor before such transfer was made." 11 U.S.C. § 547(b)(1)-(2). In addition, Radium2 filed Claim 14 against Services on the same day it filed Claims 105 and 106 against JPR. *See* Services Claims Register. That proof of claim, like the others, states, "This form is for making a claim for payment in a bankruptcy case"; "Who is the current creditor?" to which the Defendant responded "Radium2 Capital, LLC"; and "How much is the claim?" to which the Defendant responded "$1,638,975.00." *See* Claim 14, Services Claims Register. The Defendant's attorney signed the proof of claim under penalty of perjury. For these reasons, the Defendant cannot deny that it is a creditor of Services under 11 U.S.C. § 547(b)(1).

C. The Transfers Occurred Within the 90 Days Before the Petition Date

***10** The Debtor made the May Transfer on May 31, 2019 and the July 3 Transfer on July 3, 2019. May Statement at 10; July Statement at 4. Services made the July 17 Transfer on July 17, 2019. July Services Statement at 5. The Debtor and Services filed for bankruptcy on August 16, 2019. Radium2 disputes none of these facts, which the Trustee has established in support of her motion. As all Transfers occurred after May 18, 2019, the Transfers occurred within the 90 days before the petition date.

D. The Insolvency of JPR and Services

Section 547(f) of the Bankruptcy Code presumes a debtor insolvent "on and during the 90 days immediately preceding the date of the filing of the petition." 11 U.S.C. § 547(f). "Where the transferee offers no evidence regarding solvency, the trustee may rely upon the statutory presumption." *In re Ajayem Lumber Corp.*, 143 B.R. 347, 351 (Bankr. S.D.N.Y. 1992). The Defendant's (untimely) opposition and the affidavit and counterstatement regarding material facts offer no evidence of Debtors' solvency at the time of the Transfers and do not otherwise challenge this presumption with respect to either JPR or Services. The Trustee thus has met her burden on this element in both lawsuits.

E. The Defendant Received More Than It Would Have in a Liquidation of JPR

There also is no genuine dispute that, had the Transfers not been made, the Defendant would not have received as much as it received through the Transfers for the debts JPR owed to it. Dime Community Bank held a UCC-1 financing statement dated January 17, 2019 encumbering all JPR's personal property and fixtures, including all bank accounts. UCC Financing Statement, Holecek Decl. Ex. Q, JPR Lawsuit, ECF No. 26-20. This financing statement predated the Agreements, and the Defendant does not challenge the financing statement's validity.

The Defendant argues that it could have recovered the Transfers through the Chapter 7 liquidation process even if they had not been made because the Defendant had "purchased" the "receivables" at issue. Under the strongest version of the Defendant's argument, through its asserted status as a "purchaser" under N.Y. U.C.C. Law § 9-332(b) it could have claimed the funds at issue from the Debtor's bank account free from the interest of Dime Community Bank. However, as found above, the Defendant never did "purchase" any receivables but rather made a loan to the Debtor. For this reason, had the Transfers not been made, the Defendant could not have successfully asserted its status as a "purchaser" to claim funds from the Debtor's bank account free of other parties' interests; it would have been determined to be a creditor with interests junior to those of Dime Community Bank. And there is no dispute that the liquidation of JPR and Services would yield creditors who were junior to Dime Community Bank little if anything, and decidedly less than the substantial payments whose avoidance the Trustee seeks.

Finally, although this decision's discussion of this element omits some corroborating detail, further discussion is unnecessary because the element's satisfaction is established by the Defendant's deemed admission of facts included in the Trustee's statement of undisputed facts. *See* Statement of Undisputed Material Facts ¶¶ 35-36, JPR Lawsuit (citing Reqs. for Admis. at 5, JPR Lawsuit).

F. The Defendant Received More Than It Would Have in a Liquidation of Services

Similarly, the Defendant concedes that the July 17 Transfer caused it to receive more than it would have received in a liquidation of Services absent that transfer. The Defendant admits "Defendant received a greater percentage of what was owed to Defendant (with respect to the obligation(s) or debt(s) satisfied by the July 17 Transfer) than Defendant would have received if the July 17 Transfer had not been made and [Services] conducted a liquidation of its business pursuant to Chapter 7 of the Bankruptcy Code on the Petition Date." Statement of Undisputed Material Facts ¶ 24, Services Lawsuit (citing Reqs. for Admis. at 5, Services Lawsuit). For this reason, the July 17 Transfer counts as preferential, because through it the Defendant received more than it would have in the counterfactual situation in which Services never made the July 17 Transfer and liquidated on the petition date.

***11** In sum, no genuine issues of material fact exist on any of the elements of Section 547(b) in either lawsuit, and, again, this conclusion is reinforced by the failure of Radium2 to respond to the Trustee's requests for admissions. The Trustee thus has established by uncontroverted evidence every element of her affirmative case that the Transfers qualify as avoidable preferences.

RADIUM2'S ONLY NON-WAIVED DEFENSE (THE ORDINARY TRANSACTION DEFENSE) FAILS

As noted above, the Defendant has the burden to prove each element of each affirmative defense it asserts under 11 U.S.C. § 547(c). 11 U.S.C. § 547(g). The Defendant's answers asserted multiple affirmative defenses under Section 547(c). However, as also noted above, in its (untimely) opposition briefs and supporting documents the Defendant argued and cited evidence to support only one of those defenses, the ordinary transaction defense of 11 U.S.C. § 547(c)(2). Defendant thereby waived the remainder of its asserted affirmative defenses for purposes of this motion. *Domino Media, Inc. v. Kranis*, 9 F. Supp. 2d 374, 385 (S.D.N.Y. 1998) ("One who relies upon an affirmative defense to defeat an otherwise meritorious motion for summary judgment must adduce evidence which, viewed in the light most favorable to and drawing all reasonable inferences in favor of the non-moving party, would permit judgment for the non-moving party on the basis of that defense." (quoting *Frankel v. ICD Holdings S.A.*, 930 F. Supp. 54, 65 (S.D.N.Y. 1996))), *aff'd*, 173 F.3d 843 (2d Cir. 1999); *see also Internet L. Libr., Inc. v. Southridge Cap. Mgmt., LLC*, No. 01 Civ. 6600 (RLC), 2005 WL 3370542, at *4 (S.D.N.Y. Dec. 12, 2005) (quoting same), *aff'd sub nom. ITIS Holdings Inc. v. Southridge Cap. Mgmt. LLC*, 329 F. App'x 299 (2d Cir. 2009); *Am. Auto. Ins. Co. v. Advest, Inc.*, No. 08 CIV. 6488 (LAK), 2009 WL 3490060, at *2 (S.D.N.Y. Oct. 28, 2009) ("[W]here the nonmoving party relies upon an affirmative defense to defeat summary judgment, it must adduce evidence which, viewed in the light most favorable to and drawing all reasonable inferences in favor of the non-moving party, would permit judgment for the non-moving party on the basis of that defense." (internal quotations omitted)).

To establish the ordinary transaction defense, a defendant must prove that 1) the debtor incurred the debts at issue in the ordinary course of the business or financial affairs between itself and the transferee and 2) either (A) the transfer at issue was made in the ordinary course of business of the debtor and the defendant (thus making it "subjectively" ordinary) or (B) the transfer at issue was made according to ordinary business terms (thus making it "objectively" ordinary). *See* 11 U.S.C. § 547(c). As detailed below, Radium2 failed to respond to requests for admission of facts that establish the non-applicability of this defense. That alone is dispositive, and, at any rate, the defense lacks merit.

A. The Ordinary Transaction Defense Fails on the Merits in the JPR Lawsuit

While the Debtor may have entered into the Agreements in the ordinary course of business, neither the May Transfer nor the July 3 Transfer were subjectively ordinary, and the Defendant points to no facts showing either was objectively ordinary.

In the ordinary course of business between them, JPR paid $13,673.47 per day to the Defendant under the April Agreement and intended to pay $107,142.86 per day to the Defendant under the June Agreement. *See* April Agreement at 1; June Agreement at 1. The May Transfer, for $1,470,102.02, *see* May Statement at 10, vastly exceeded the size of the daily payments under the April Agreement. It also far exceeded the 25% "specified percentage" of that day's receipts in JPR's designated bank account. *See id.* at 4-5. The Defendant has the burden to show such a transfer is "ordinary," 11 U.S.C. § 547(g), and the Defendant's papers give no explanation and identify no facts to support the improbable conclusion that a transfer from a debtor to a defendant that is more than 100 times larger than the routine transfers required by their contract falls within the ordinary course of business. This is especially so because the April Agreement lacked any set maturity date and, according to the Defendant's own expectations, its de facto maturity date fell in mid-November 2019, *see* Transaction History at 1, Holecek Decl. Ex. I, JPR Lawsuit, ECF No. 26-12 (listing an "E. Remittance

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Date" for the April Agreement as November 12, 2019). *Cf. HLI Creditor Tr. v. Metal Techs. Inc. (In re Hayes Lemmerz Int'l, Inc.)*, 337 B.R. 49, 54, 60, 62 (Bankr. D. Del. 2006) (ruling that a payment made five days ahead of a contractual repayment date counted as a payment made outside the ordinary course of business).

***12** JPR also never made any of the contemplated seven $107,142.86 daily payments that were supposedly called for under the June Agreement, *see* Transaction History at 2; with respect to the June Agreement, Defendant's only payment was the July 3 Transfer of $750,002.50, *see id.; see also* July Statement at 4-10. The absence of any other payments puts the lie to any suggestion that the standalone payment of $750,002.50 was in the ordinary course of business; that payment too falls outside the protection of Section 547(c)(2)(A).

The Defendant argues that because (allegedly) the Debtor and the Defendant made the Agreements in the ordinary course of business, "the ordinary course of business defense is applicable to repayment of such debt." Def's. Mem. Regarding JPR at 7. Leaving aside the Trustee's disagreement that JPR and the Defendant made the Agreements in the ordinary course of business, the Defendant's argument errs on the law. The statute states, "The trustee may not avoid under this section a transfer to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee." 11 U.S.C. § 547(c)(2)(A) (emphasis added). The Defendant must prove that it and the Debtor made the Agreements in their ordinary course of business and that JPR made the transfers at issue in the ordinary course of business. *See Kapila v. Media Buying, Inc.* (*In re Ameri P.O.S. Inc.*), 355 B.R. 876, 883-84 (Bankr. S.D. Fla. 2006) (emphasis added) (evaluating these two questions separately). The authorities cited by the Defendant are not to the contrary and thus fail to support its position. Each cited case analyzes the question of ordinariness of the contract separately from the question of the ordinariness of the challenged transfer. *See id.; In re Magic Circle Energy Corp.*, 64 B.R. 269, 273-74 (Bankr. W.D. Okla. 1986). The undisputed facts here show that JPR made neither the May Transfer nor the July 3 Transfer in the ordinary course of business between itself and the Defendant, and that alone defeats Defendant's asserted defense.

In addition, the Defendant presents no argument that the Debtor made the Transfers according to ordinary business terms. The Defendant's purported Local Rule 7056-1 counterstatement says conclusorily, "Defendant received payments consistent with the industry standard," Def's. Counterstatement ¶ 4, JPR Lawsuit, ECF No. 40, but that paragraph's citation to the affidavit of the Defendant's principal for factual support fails. The affidavit of the Defendant's principal makes no factual allegation that the Transfers occurred according to ordinary business terms as would arise between other parties to transactions like these. *See* Aff. of Troy Caruso, JPR Lawsuit (nowhere mentioning how other parties in the Debtor's industry or the Defendant's industry tend to make payments under contracts like these). The belated and conclusory statement in the Defendant's counterstatement is also foreclosed by JPR's failure to respond to the Trustee's request that the Defendant admit that the May Transfer and the July 3 Transfer were "inconsistent with ordinary business terms." Reqs. for Admis. at 6, JPR Lawsuit. As the Defendant never responded to the requests for admissions, the Defendant has admitted the May Transfer and the July 3 Transfer were inconsistent with ordinary business terms. *See* Holecek Decl. ¶ 7, JPR Lawsuit; Fed. R. Bankr. P. 7036; Fed. R. Civ. P. 36(a)(3).

B. The Admitted Facts Mean the Ordinary Transaction Defense Fails in the Services Lawsuit

***13** The record shows that Services made the July 17 Transfer to the Defendant outside of the ordinary course of business. The July Services Statement records five payments of $400.00 each made by Services to the Defendant in July 2019 leading up to the $850,000.00 July 17 Transfer. *See* July Services Statement at 4-5.

The admitted facts also establish that the ordinary transactions defense cannot protect the July 17 Transfer. Per the Statement of Undisputed Material Facts in the Services Lawsuit, "For each invoice or other obligation paid by the July 17 Transfer, the invoice or obligation was not incurred by [Services] as part of its normal business or financial affairs with Defendant." Statement of Undisputed Material Facts ¶ 31, Services Lawsuit (citing Reqs. for Admis. at 6, Services Lawsuit).

The Defendant has also admitted by operation of Rule 7036 and Local Bankruptcy Rule 7056-1 that "for each invoice or other obligation paid by the July 17 Transfer," such "obligation was paid later, earlier, or in a manner otherwise inconsistent with" 1) "the prior course of business

dealings" between the Defendant and Services, 2) "the general practices of Defendant's industry," and 3) the general practices of the industry in which Services operated. *Id.* ¶¶ 28-30 (citing Reqs. for Admis. at 5, Services Lawsuit). Lastly, by not controverting the facts set forth in the Statement of Undisputed Material Facts, Defendant has admitted that "The July 17 Transfer made by [Services] was inconsistent with ordinary business terms." *Id.* ¶ 32 (citing Reqs. for Admis. at 6, Services Lawsuit).

To the extent the Defendant challenges any of this in its untimely opposition papers, it makes the same futile argument it made in the JPR Lawsuit: that because (allegedly) Services and the Defendant made their agreement in the ordinary course of business, "the ordinary course of business defense is applicable to repayment of such debt." Def's. Mem. Regarding Services at 7. This argument fails because the Defendant must show both that it made its agreement with Services in the ordinary course of business and that Services made the July 17 Transfer either 1) in the ordinary course of business or 2) according to ordinary business terms. Proof of the first element does not prove either of the latter two alternative elements. At no point did the Defendant cite any evidence in the record in its favor regarding whether the July 17 Transfer occurred in the ordinary course of business or according to ordinary business terms. Thus, the Defendant's ordinary transaction defense fails in both lawsuits.

THE COURT DISALLOWS DEFENDANT'S CLAIMS

The Trustee has established that the Transfers count as avoidable preferences under Section 547(b) and that the Defendant has no defenses that protect the Transfers. Accordingly, under Section 550 of the Bankruptcy Code, the Trustee may recover the value of the Transfers from the Defendant. 11 U.S.C. § 550(a). For the same reason, because no party has disputed that the Defendant also has not "paid the amount[ ] or turned over any such property[ ] for which [the Defendant] is liable" under 11 U.S.C. § 550, *see id.* § 502(d), the Court disallows all the Defendant's claims against JPR and Services. To be precise, the Court disallows Claims No. 105 and 106 filed against JPR and Claim No. 14 filed against Services.

CONCLUSION

***14** The Court GRANTS the Trustee's motions and overrules the Defendant's objections to them. The Trustee shall submit an order effectuating this ruling. Defendant's time to appeal will run from the entry of that order.

It is so ordered.

All Citations

Slip Copy, 2025 WL 1550541, 74 Bankr.Ct.Dec. 155

Footnotes

1 The first adversary proceeding *is O'Toole v. Radium2 Capital, LLC*, No. 21-07079 (the "JPR Lawsuit"), brought to recover two transfers made by the Debtor. The second adversary proceeding is *O'Toole v. Radium2 Capital, LLC*, No. 21-07082 (the "Services Lawsuit" and its claims register the "Services Claims Register"), brought to recover a transfer made by Services. Citations to the docket or claims register of the procedurally-consolidated main bankruptcy case, *In re J.P.R. Mech. Inc.*, No. 19-23480, will read "Main Case" and "JPR Claims Register," respectively. Citations to the docket or claims register of the Services bankruptcy case, *In re J.P.R. Mech. Servs. Inc.*, No. 19-23481, will read "Main Services Case" and "Services Claims Register," respectively.

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United States Bankruptcy Court, D. Connecticut.

IN RE: Ho Wan KWOK, et al., Debtors.

Case No. 22-50073 (JAM) (Jointly Administered)
|
Signed February 15, 2024

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Re: ECF No. 2509

MEMORANDUM OF DECISION AND ORDER GRANTING IN PART MOTION TO EXTEND DEADLINES

Julie A. Manning, United States Bankruptcy Judge District of Connecticut

***1** Julie A. Manning, United States Bankruptcy Judge

I. INTRODUCTION

Before the Court is the Motion for Entry of Order Extending Deadline for Trustee to File Avoidance Actions (the "Motion to Extend Deadlines") filed by Mr. Luc A. Despins, in his capacity as Chapter 11 trustee (the "Trustee") for the bankruptcy estate of Mr. Ho Wan Kwok (the "Individual Debtor"). (ECF No. 2509.) For the reasons stated below, the Motion to Extend Deadlines is **GRANTED IN PART**.

II. BACKGROUND

On February 15, 2022, the Individual Debtor filed a voluntary Chapter 11 petition (the "Petition") in this Court. (ECF No. 1.) The Individual Debtor's case is jointly administered with two affiliated corporate Chapter 11 cases. (ECF Nos. 970, 1141.) For the reasons set forth therein, on June 15, 2022, the Court entered a memorandum of decision and order appointing a Chapter 11 trustee. (ECF No. 465.) *In re Kwok*, 640 B.R. 514 (Bankr. D. Conn. 2022). On July 8, 2022, Mr. Despins was appointed as the Trustee. (ECF No. 523.)

On January 9, 2024, the Trustee filed a motion (the "Notice Motion") to schedule a hearing on and establish notice and service procedures for a forthcoming motion to extend or toll the statute of limitations set by sections 108(a), 546(a), and 549(d) of title 11 (the "Bankruptcy Code"). (ECF No. 2494.) On January 15, 2024, in light of no objections to the Notice Motion having been timely filed, the Court took it on the papers. (ECF No. 2505.) On January 19, 2024, the Court granted the Notice Motion and entered an order scheduling a hearing on the Motion to Extend Deadlines, which had at that point been filed, and establishing notice and service procedures (the "Notice and Service Procedures Order"). (ECF No. 2515.)

On January 18, 2024, the Trustee filed the Motion to Extend Deadlines. (ECF No. 2509.) On January 31, 2024, the Trustee filed a notice of service and publication notice of the Motion to Extend Deadlines pursuant to the Notice and Service Procedures Order, indicating service was made by mail on January 22, 2024 and publication notice was made thereafter. (ECF No. 2540.)

On February 5, 2024, objections to the Motion to Extend Deadlines were filed by Ms. Mei Guo ("Ms. Guo"); Mr. Defeng Cao ("Mr. Cao"); UBS AG ("UBS"); Taurus Fund LLC, Taurus Management LLC, and Mr. Scott Barnett (collectively, the "Taurus Parties") jointly; G Club Operations LLC ("G Club"); Rule of Law Foundation III, Inc. and Rule of Law Society IV, Inc. (collectively, the "ROL Parties") jointly; Mr. Chris Lee ("Mr. Lee") and Mr. Qidong Xia ("Mr. Xia") jointly; Greenwich Land, LLC and Ms. Hing Chi Ngok (collectively, the "Greenwich Parties") jointly; and GS Security Solutions, Inc. ("GS Security"). (ECF Nos. 2551, 2553, 2554, 2557, 2563, 2565, 2566, 2569, 2571.) That same date, February 5, 2024, DBS Bank filed a reservation of rights to object to any extension or tolling of the statute of limitations beyond what the Motion to Extend Deadlines seeks. (ECF No. 2556.) On February 7, 2024, objections were untimely filed by Ms. Yinying Wang ("Ms. Wang") and Sotheby's International Realty, Inc. ("Sotheby's"). (ECF Nos. 2582, 2584.) On February 8, 2024, Mr. Yongbing Zhang ("Mr. Zhang") untimely filed an objection to the Motion to Extend Deadlines. (ECF No. 2591.)

***2** On February 9, 2024, the Trustee filed an omnibus reply to the objections. (ECF No. 2620.) On February 12, 2024, the Trustee filed a list of witnesses and exhibits, which identified the Trustee as a witness and contained a list of pleadings and orders publicly filed in these jointly administered Chapter 11 cases and related adversary proceedings as exhibits. (ECF No. 2763.)

On February 13, 2024, a hearing was held on the Motion to Extend Deadlines. Prior to the hearing, UBS filed a notice of withdrawal of its objection to the Motion to Extend Deadlines, which withdrawal UBS repeated on the record. (ECF No. 2810.) During the hearing, Sotheby's also withdrew its objection to the Motion to Extend Deadlines on the record. DBS reiterated that it was not objecting to the Motion to Extend Deadlines but only reserving its rights regarding any future motion to extend or toll the statute of limitations. Ms. Guo, Mr. Cao, the Taurus Parties, G Club, the ROL Parties, Mr. Lee, Mr. Xia, the Greenwich Parties, GS Security, Ms. Wang, and Mr. Zhang (collectively, the "Objecting Parties") pressed their objections to the Motion to Extend Deadlines. [1]

The Trustee testified and was cross-examined by the Objecting Parties. The Trustee requested the Court take judicial notice of the record of these jointly administered Chapter 11 cases and related adversary proceedings. The Trustee and the Objecting Parties each presented their arguments. At the conclusion of the hearing, the Motion to Extend Deadlines was taken under advisement.

This matter is ripe for decision.

III. JURISDICTION

The United States District Court for the District of Connecticut has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b). This Court has authority to hear and determine this matter pursuant to 28 U.S.C. § 157(a) and the Order of Reference of the United States District Court for the District of Connecticut dated September 21, 1984. The instant matter is a statutorily core proceeding. 28 U.S.C. § 157(b)(2)(A).

Nevertheless, the Objecting Parties make two arguments against jurisdiction. First, the Objecting Parties argue that under *Stern v. Marshall*, 564 U.S. 462, 487–99 (2011), the Court lacks jurisdiction to determine this matter because avoidance actions are matters of private – not public – right and must, therefore, be determined by an Article III court unless the parties consent to another court's exercise of jurisdiction, *see Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 686 (2015) (holding that parties may consent to entry of a final order by bankruptcy courts notwithstanding the holding in *Stern*). Second, the Objecting Parties argue that there is no case or controversy because no party has asserted a statute of limitations defense in an avoidance action.

The Court concludes that its determination of the Motion to Extend Deadlines is not contrary to *Stern*. Determination of the Motion to Extend Deadlines does not require that this Court finally determine the merits of any avoidance action. Rather, it requires the Court to determine as a matter of equity whether the statute of limitations contained in sections 108(a), 546(a), and 549(d) of the Bankruptcy Code may be extended. These time limitations are contained in the Bankruptcy Code. Furthermore, they are solely applicable in bankruptcy cases and embody bankruptcy policy considerations; namely, how to balance the need of a bankruptcy trustee to determine and prosecute the estate's causes of actions and the mandate to ensure the just, speedy, and inexpensive determination of every case and proceeding. *Compare* 11 U.S.C. §§ 108(a), 546(a), 549(a) *with* Fed. R. Bankr. P. 1001. Therefore, this Court may determine the issues raised by the Motion to Extend Deadlines. *See Young v. United States*, 535 U.S. 43, 49–50 (2002) (unanimous) (holding equitable tolling is particularly available where Congress enacts provisions intended to be applied by bankruptcy courts, which are courts of equity).

***3** The Court also concludes that there is presently a case or controversy. There are jointly administered Chapter 11 cases pending. Hence, the time limits contained in sections 108(a), 546(a), and 549(d) of the Bankruptcy Code are in effect. The Trustee argues that (i) there are potential estate causes of action he is currently pursuing but cannot file before the two-year period expires while also meeting the standard of Fed. R. Civ. P. 11 and (ii) there are undoubtedly estate causes of action completely unknown to him, given his experience and knowledge of these cases to date. The Trustee seeks to extend these time limits to allow him to bring more actions without being time-barred.

Therefore, the Court determines it has jurisdiction over this matter. Moreover, venue in this District is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

IV. DISCUSSION

The Court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052 are set forth below.

A. Bankruptcy Rule 9006(b)

Rule 9006(b) provides that, generally, "when an act is required to be done at or within a specified period by these rules or by a notice given thereunder or by order of court, the court for cause shown may at any time in its discretion ... order the period enlarged if the request therefor is made before the expiration of the period originally prescribed or as extended by a previous order." Fed. R. Bankr. P. 9006(b).

The parties dispute whether Rule 9006(b) may be utilized to extend the deadlines set forth in sections 108(a), 546(a), and 549(d). The Trustee, relying on *IBT International, Inc. v. Northern (In re International Administrative Services, Inc.)*, 408 F.3d 689 (11th Cir. 2005), and its progeny, argues that it is within the Court's discretion to extend the deadlines. The Objecting Parties – particularly G Club – rely on 28 U.S.C. § 2075, *Joint Council Dining Car Employees Local 370 v. Delaware, Lackawanna & Western Railroad Company*, 157 F.2d 417 (2d Cir. 1946), *In re Walnut Hill*, No. 16-50960 (JJT), 2018 WL 2672242 (Bankr. D. Conn. June 1, 2018) (Tancredi, J.), and *In re Damach Inc.*, 235 B.R. 727 (Bankr. D. Conn. 1999) (Krechevsky, J.), to argue that Rule 9006(b) may not extend the deadlines set forth in sections 108(a), 546(a), and 549(d).

The first question is whether 108(a), 546(a), and 549(d) contain statutes of limitation – subject to tolling, extension, equitable estoppel, and other principles of equity – or statutes of repose, which are not susceptible to equity. *Compare Young*, 535 U.S. at 49–50 (stating that provisions

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in the Bankruptcy Code are particularly susceptible to equity because they are drafted with the background understanding that bankruptcy courts are courts of equity) *with Arellano v. McDonough*, 598 U.S. 1, 12–13 (2023) (distinguishing the congressional intent behind 38 U.S.C. § 5110 from that behind 11 U.S.C. § 507 and, hence, arriving at different result than *Young*.) Here, as in *Young* and unlike in *Arellano*, sections 108(a), 546(a), and 549(d) have either no tolling provisions or tolling provisions that supplement rather than supplant traditional principles of equity. 11 U.S.C. §§ 108(a) (no tolling provision), 546(a) (potentially tolled by the first appointment of a trustee within the two-year period), 549(d) (no tolling provision); *compare Young*, 535 U.S. at 52–53 *with Arellano*, 598 U.S. at 12–14; *see IBT Int'l*, 408 F.3d at 699 (11th Cir. 2005); *Ernst & Young v. Matsumoto (In re United Ins. Mgmt., Inc.)*, 14 F.3d 1380, 1385 (9th Cir. 1994); *see also* 2 COLLIER ON BANKRUPTCY ¶ 108.2[1] (16th ed. 2023) (stating 11 U.S.C. § 108(a) does not apply to statutes of repose, only statutes of limitations) (collecting cases); 5 COLLIER ON BANKRUPTCY ¶ 546.02[4] (stating 11 U.S.C. § 546 is not jurisdictional) (collecting cases); *but see Martin v. First Nat'l Bank of Louisville (In re Butcher)*, 829 F.2d 596 (6th Cir. 1987). The Court agrees with the majority position that sections 108(a), 546(a), and 549(d) are subject to extension under principles of equity and disagrees with *Butcher*, upon which the Objecting Parties rely. *Compare* H.R. Rep. No. 103-835, at 49–50 (1994) *with Butcher*, 829 F.2d at 599–600.

***4** The next question is whether Rule 9006(b) provides a mechanism for such equitable extension. While the Court recognizes and respects the prior decisions in this District by the Honorable James J. Tancredi in *Walnut Hill* and the Honorable Robert L. Krechevsky in *Damach*, and the reliance by the Objecting Parties upon those decisions, there is no binding precedent on this issue from the United States Supreme Court, the United States Court of Appeals for the Second Circuit, or the United States District Court for the District of Connecticut. The only United States Court of Appeals to opine on the issue is the United States Court of Appeals for the Eleventh Circuit. In *IBT International*, the Eleventh Circuit held that a bankruptcy court has the discretion under Rule 9006(b) to enlarge the period of time to bring avoidance actions set forth in section 546(a), notwithstanding the omission of "statute" from the text of Rule 9006(b), because Rule 9006(b) governs the filing of adversary proceedings pursuant to Rules 7001 and 7003. 408 F.3d at 699.

The Objecting Parties argue that the Eleventh Circuit's analysis is flawed because it ignores the Rules Enabling Act and would be in defiance of the separation of powers. The Court disagrees. The basis of their argument is the language: "Such rules shall not abridge, enlarge, or modify any substantive right." 28 U.S.C. § 2075. Limitation periods are not, generally, substantive. *Young*, 535 at 49. As discussed above, this Court – and the majority of courts to consider the issue – concludes that sections 108(a), 546(a), and 549(d) present statutes of limitation, subject to principles of equity – which the Eleventh Circuit *does* address regarding section 546(a). *IBT Int'l*, 408 F.3d at 699. That is, they are not substantive. *See Young*, 535 at 49. For these reasons, the Court respectfully disagrees with the portion of *Walnut Hill* addressing Rule 9006(b) and concludes that the Rules Enabling Act does not preclude Rule 9006(b) from providing a mechanism for extending the statutes of limitation set forth in sections 108(a), 546(a), and 549(d). *Damach*, upon which *Walnut Hill* relies, was decided pre-*Young* and dealt with a motion to accept or reject a lease under section 365(d)(4) where a lessor's *substantive* contractual rights were involved – not, as here, on a motion to extend deadlines, or in *Young*, which dealt with equitable tolling, a non-substantive statute of limitations. 235 B.R. at 729–30, 731–32.

Citing the Second Circuit's decision in *Dining Car*, the Objecting Parties also argue by analogy that because Rule 6 cannot be used to modify statutes of limitation in non-bankruptcy civil litigation, Rule 9006(b) cannot be used here. The analogy, however, fails because of key differences between bankruptcy proceedings and other civil actions. *Dining Car* considered, and rejected, the argument that Rule 6(a)'s proscribed methodology for computation of time applied to limitation periods existing independent of the filed civil action. 157 F.2d at 420. The limitation periods set forth by sections 108(a), 546(a), and 549(d) are all dependent on a bankruptcy case existing. Unless an order for relief enters in a bankruptcy case, which orders have been entered in each of these jointly administered Chapter 11 cases, these sections have no effect. 11 U.S.C. §§ 108(a), 546(a), 549(d). Similarly, adversary proceedings depend upon a related bankruptcy case existing. *Dining Car* recognized Rule 6(a)'s applicability to statutes that govern procedure of a civil action after it has been filed. The Trustee here asks the Court to extend statutes of limitations that only come into effect after a bankruptcy case has been filed. 11 U.S.C. §§ 108(a), 546(a), 549(d). *Butcher*, relied upon by the Objecting Parties, disregards the obvious difference between adversary proceedings commenced in a

bankruptcy case and traditional civil actions. 829 F.2d at 599–600.

The Court concludes for these reasons that Rule 9006(b) could provide a mechanism to extend the statutes of limitation set forth by sections 108(a), 546(a), and 549(d). The next question is whether it does. In light of (i) the general exhortation of Rule 1001 that "[t]hese rules shall be construed, administered, and employed by the court and the parties to secure the just, speedy, and inexpensive determination of every case and proceeding"; (ii) the Eleventh's Circuit's ruling in *IBT International* and its rationale based on the applicability of Rule 9006(b) in adversary proceedings and its determination that section 546(a) is a statute of limitations "subject to waiver, tolling, and equitable estoppel", *see* Fed. R. Bankr. P. 7001, 7003; *IBT Int'l*, 408 F.3d at 699; (iii) the lack of any controlling precedent in this Circuit; and (iv) the reasons discussed above as to why the Court is not persuaded by the Objecting Parties' arguments based on the Rules Enabling Act and *Dining Car*, the Court concludes that it may extend the statutes of limitation set forth by sections 108(a), 546(a), and 549(d) pursuant to Rule 9006(b) despite Rule 9006(b) not including "statute" in its language. *IBT Int'l*, 408 F.3d at 698–99; *In re Fundamental Long Term Care, Inc.*, 501 B.R. 784, 787–791 (Bankr. M.D. Fla. 2013); *Marsh v. Levy (In re Martin Levy of Berlin D.M.D., P.C.)*, 416 B.R. 1, 8 (Bankr. D. Mass. 2009); *Frentz v. Stites & Harbinson (In re ThermoView Indus., Inc.)*, 381 B.R. 225, 227 (Bankr. W.D. Ky. 2008); *but see In re Cramer*, 636 B.R. 830, 833 (Bankr. C.D. Cal. 2022); *In re Randolph Hosp., Inc.*, No. 20-10247 (LMJ), 2022 WL 19298765, at *1 (Bankr. M.D.N.C. April 25, 2022); *Walnut Hill*, 2018 WL 2672242, at *2.

***5** The remaining issue, therefore, is whether there is "cause," on the facts and circumstances before the Court to extend the statutes of limitation in sections 108(a), 546(a), and 549(d). Fed. R. Bankr. P. 9006(b). The Court determines that on the very specific and extraordinary facts and circumstances of these jointly administered Chapter 11 cases, cause exists to extend the statutes of limitation in sections 108(a), 546(a), and 549(d).

Regardless of the Objecting Parties' arguments that they have individually caused no harm to the Trustee's investigation, as courts have observed, albeit in the context of equitable tolling, the equities to consider in determining whether to extend or toll a statute of limitations in a bankruptcy proceeding often involve whether the debtor failed to cooperate with the bankruptcy trustee or indeed sought to impede the trustee's investigation and liquidation of assets for the benefit of creditors. *Gladstone v. U.S. Bancorp*, 811 F.3d 1133, 1143 (9th Cir. 2016) (citing *Olsen v. Zerbetz (In re Olsen)*, 36 F.3d 71, 72–73 (9th Cir. 1994) and holding that concealment by the debtor rather than the defendant could support equitable tolling). As the United States Bankruptcy Court for the District of Minnesota stated:

> A bankruptcy case presents a rather different slant on equitable tolling. In the typical situation, it is the debtor's conduct rather than the defendant's conduct which invokes equitable tolling. In some senses, this is unfair to the defendant. On the other hand, unlike the usual civil case where a plaintiff at least has the advantage of being a party to the underlying transaction, a bankruptcy trustee must rely almost entirely on a third party (the debtor) to provide the information necessary to uncover avoidable transfers.

Moratzka v. Pomaville (In re Pomaville), 190 B.R. 632, 637 (Bankr. D. Minn. 1995) (denying summary judgment because there remained a genuine issue of material fact as to whether the statute of limitations could be equitably tolled).

As observed in *Pomaville*, fairness to defendants is the animating concern among courts that decline to extend statutes of limitation under Rule 9006(b). In *Cramer*, the United States Bankruptcy Court for the Central District of California was primarily concerned with the lack of notice to the potential defendants. 636 B.R. at 832. *Randolph Hospital* shared this concern. 2022 WL 19298765, at *1. Here, however, there has been extensive notice of the Motion to Extend Deadlines via traditional service where possible, alternative service where possible, and publication notice, in English and Mandarin Chinese, in substantially the form approved by the Court pursuant to the Notice and Service Procedures Order. *See Cramer*, 636 B.R. at 832 nn. 1, 2 (distinguishing cases where defendants had notice of the motion seeking an extension of time). Nevertheless, in light of this concern, the Court will not determine the issue of waiver of a statute of limitations defense at this time, but rather will

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reserve that issue for determination when and if it is raised in an adversary proceeding. As such, the Court finds it difficult for any party to argue that their substantive rights have been impacted by this decision.

Regarding the counterbalance noted in *Pomaville*, in these jointly administered Chapter 11 cases, the Trustee received no books and records from the Individual Debtor and no cooperation from the Individual Debtor. The Individual Debtor filed incomplete or inaccurate schedules and statement of affairs and did not comply with his duties under the Bankruptcy Code. 11 U.S.C. § 521. The Individual Debtor affirmatively disclaimed and qualified the sworn information in his schedules and statements of affairs by filing "Global Notes", which are not official forms and not in compliance with the Individual Debtor's duties under section 521. (ECF Nos. 77–78.) Arguably, the failure of the Individual Debtor to comply with his duties could result in a finding that the statutes of limitation contained in sections 108(a), 546(a), and 549(d) have not even begun to run.

***6** Instead of receiving compliance and cooperation from the Individual Debtor, the Trustee has faced ceaseless recalcitrance, obstruction, and flagrant disregard of court orders by the Individual Debtor, his family members, his associates and employees, and entities the Trustee alleges he controls since the Trustee's appointment. (*See, e.g.*, ECF Nos. 913, 1046, 1303, 1345, 1362, 1397, 1453, 1521, 1537, 1546, 1709, 1805, 1892, 1896, 2009, 2035, 2036, 2080, 2093, 2342, 2396; *Pac. All. Asia Opportunity Fund L.P. v. Kwok (In re Kwok)*, No. 22-50073 (JAM), Adv. P. No. 22-05032 (JAM) (Bankr. D. Conn. Jan. 13, 2023), ECF No. 133; *Despins ex rel. Kwok v. Mei Guo (In re Kwok)*, No. 22-50073 (JAM), Adv. P. No. 23-05008 (JAM) (Bankr. D. Conn. Oct. 18, 2023), ECF No. 32; *Guo*, No. 22-50073 (JAM), Adv. P. No. 23-05008 (JAM) (Bankr. D. Conn. Nov. 7, 2023), ECF No. 46.) Ultimately, the Court has entered at least eight orders holding the Individual Debtor, his daughter, Ms. Guo, and entities allegedly controlled by the Individual Debtor in contempt for failure to turn over assets and discovery abuse. (ECF Nos. 1372, 1537, 1709, 1892, 1896, 2009, 2035, 2093.) To date, each contemnor remains in contempt of court. The severity of nonperformance of statutory duties, *see* 11 U.S.C. §§ 521(a)(3), (4), and noncompliance with this Court's orders in these jointly administered Chapter 11 cases, is extraordinary.

Faced with these circumstances, the Trustee has had to seek extensive and ongoing third party discovery in addition to his efforts to obtain discovery from the Individual Debtor, his family, his associates, and entities he allegedly controls. (ECF Nos. 636–38, 839, 1116, 1259, 1592, 1789, 2079, 2249, 2304, 2308, 2434, 2508, 2514.) The Court has granted all fifteen of the Trustee's motions for Rule 2004 examinations, authorizing the examination of hundreds of entities. (ECF Nos. 756–58, 866, 1184, 1339, 1646, 1891, 2210, 2281, 2393, 2394, 2474, 2534, 2537.) The Court credits the Trustee's testimony that attempting to piece together the Individual Debtor's financial affairs from cold bank records and other documents evidencing a massive web of entities, bank accounts, and money transfers across multiple countries, continents, and jurisdictions is a time-consuming and difficult endeavor over an ever-increasing data set of unknown ultimate dimensions. This testimony is particularly credible because the Trustee is operating without the Individual Debtor's statutorily required cooperation. Moreover, the Trustee's investigation has been and continues to be impeded by the active obstruction of the Individual Debtor, his family members, associates, employees, followers, and associated entities. The "puzzle" the Trustee is faced with in these jointly administered Chapter 11 cases is particularly severe and the facts of these cases are similar to the facts of *IBT International*, which also involved allegations of a complex asset diversion plan, where there was a "jigsaw puzzle of transfers." 408 F.3d at 702.

The Objecting Parties argue that, nevertheless, the Trustee has been less than diligent in his attempts to understand the bankruptcy estate's potential causes of action. Counsel for the Individual Debtor, who also signed the objection submitted by the Individual Debtor's daughter, Ms. Guo, has previously testified that, contrary to Ms. Guo's present argument, the Trustee was too forceful in his statutory investigative duties, *see* 11 U.S.C. § 1106:

> Q. You testified, Mr. Kindseth, that prior to the meeting, you had urged the Trustee strenuously to quote, unquote, stand down. Is that right?
>
> A. Probably 50 times. Yes.
>
> Q. And --
>
> A. Gradually, too. Just to be clear. It wasn't just, do nothing. It's, can you please just stand down some to give us some space to let the settlement come together. Yes.
>
> Q. What you meant by that was stand down on the investigation, correct?

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> A. Stand down on the perpetual bombs, you know, attacks, 50 2004 exams, expedited hearings, just this perpetual attack, 12, 14 lawyers at Paul Hastings going all, you know, full board [sic]. I said, can you just reign [sic] it in a little bit to give us some time to breathe and work out a settlement.

***7** (Dec. 12, 2022 Hr'g Tr. at *894:2–18, *Pac. All. Asia Opportunity Fund*, No. 22-50073 (JAM), Adv. P. No. 22-05032 (JAM) (Bankr. D. Conn. Dec. 15, 2022), ECF No. 111.)

Indeed, the Individual Debtor's position in fall of 2022 was that the Trustee was proceeding too rapidly with his investigation. Prior to Attorney Kindseth's testimony, his colleague, also appearing on behalf of the Individual Debtor, repeatedly objected to the Trustee's urgent pursuit of his investigation. The exchange below during a hearing held on October 13, 2022, on the Trustee's Motion for Entry of Order Authorizing Compliance with Rule 2004 Subpoenas and Enforcing Consent Order Regarding Control of Attorney-Client Privilege and Work Product Protection is illustrative:

> Mr. Henzy: Next week I'm going to be fully engulfed in potentially reviewing documents which actually I wanted to ask Your Honor a question about. But I'm not sure, Your Honor, what the hurry is. But I'm not sure what the hurry –
>
> Mr. Despins: Your Honor, the hurry is that we're supposed to have control of these entities. We're being deprived of control -- of access to privilege in relation -- for to those entities because that's the same counsel representing Mr. Kwok and those two entities. And so to say there's no rush, I don't know what to say about that. It's been ten -- we're not rushing, meaning we've asked for this for a while now. And if we are correct that he owns it, the rush is that he's just disregarding this case completely. So I don't know what to say about the issue of no rush.

(Oct. 13, 2022 Hr'g Tr. at 106:8–23, ECF No. 1020; *see also* Sept. 27, 2022 Status Conference Tr. at 23:1–20, ECF No. 936.)

In a case with more than 2900 docket entries and more than 250 associated adversary proceedings, where the Trustee has, by counsel to the Individual Debtor's own admission and in this Court's own observation, aggressively pursued discovery relating to the Individual Debtor's financial affairs and recovery of assets, the Court concludes that the Trustee has shown more than reasonable diligence in his efforts. That not every lead has borne fruit, that not every stone has been unturned, that not every action has been successful, does not diminish the fact that the Trustee has been more than reasonably diligent.

The facts and circumstances of the present case are wholly unlike the facts Judge Tancredi faced in *Walnut Hill*. In *Walnut Hill*, the Chapter 7 trustee had the entire two-year time period set forth in sections 108(a) and 546(a) to fulfill his investigative duties and bring causes of action. Here, the Trustee was appointed five months into the case – which means he had nineteen months to perform his investigation in the Individual Debtor's Chapter 11 case. (ECF No. 514.) Furthermore, in *Walnut Hill*, the Chapter 7 trustee filed her first motion for Rule 2004 examination eleven months after the petition was filed. (*In re Walnut Hill*, No. 16-20960 (JJT) (Bankr. D. Conn. May 31, 2017), ECF No. 78.) In this case, the Trustee filed his first motion to conduct a Rule 2004 motion less than a month after the approval of his appointment and continues to vigorously seek discovery as part of his ongoing investigation. (ECF No. 636.)

***8** Nevertheless, the Objecting Parties also argue against the Trustee's diligence on the basis of the Trustee's testimony that hiring a forensic accountant had to wait until the estate had funding. In particular, the Objecting Parties focus on the Trustee's testimony that even if a forensic accountant was willing to work on a contingency basis, they would have demanded to be treated *pari passu* with the Trustee and his lawyers. However, the Objecting Parties ignore that the necessity of forensic accountant has been caused by the Individual Debtor's failure to cooperate with the Trustee and the discovery abuses in these jointly administered Chapter 11 cases. They also ignore that administrative insolvency – which is when *pari passu* treatment of administrative claims would pose a concern to the Trustee's counsel – would be to the detriment of the Individual Debtor's unsecured creditors, to whom the Trustee is a fiduciary. The Court is not persuaded by the Objecting Parties' focus on this testimony to support their claims that the Trustee's investigation has lacked diligence.

For these reasons, the Court concludes that there is cause to extend the statute of limitations set forth by sections 108(a), 546(a), and 549(d) pursuant to Rule 9006(b). Therefore, the Motion to Extend Deadlines is granted to the extent set forth below.

B. Equitable Tolling

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Statutes of limitations in the Bankruptcy Code are drafted with implied awareness of general principles of equity, including equitable tolling – particularly because bankruptcy courts are courts of equity. *Young*, 535 U.S. at 49–50. "Generally, a litigant seeking equitable tolling bears the burden of establishing two elements: (1) that he has been pursuing his rights diligently, and (2) that some extraordinary circumstance stood in his way." *Pace v. DiGuglielmo*, 544 U.S. 408, 418 (2005) (citing *Irwin v. Dep't of Veteran Affs.*, 498 U.S. 89, 96 (1990)); *see Castillo ex rel. A.Q.C. v. United States*, 656 F.3d 135, 144 (2d Cir. 2011) (quoting *Pace*). Equitable tolling is not to be confused with fraudulent concealment by the defendant: the United States Court of Appeals for the Second Circuit has "held explicitly that the application of the doctrine of equitable tolling is not limited to [cases with fraudulent concealment]." *Donely ex rel. Valdez v. United States*, 518 F.3d 173, 183 (2d Cir. 2008) (collecting cases). Indeed, equitable tolling does not require any wrongdoing by a defendant. *Donely*, 518 F.3d at 182–83; *Canales v. Sullivan*, 936 F.2d 755, 758, *on reh'g* 947 F.2d 45, 758 (2d Cir. 1991); *Fundamental Long Term Care*, 501 B.R. at 791; *Fam. Golf Ctrs., Inc. v. Acushnet Co. (In re Randall's Island Fam. Golf Ctrs., Inc.)*, 288 B.R. 701, 705–06 (Bankr. S.D.N.Y. 2003). Moreover, insofar as misconduct is alleged, in bankruptcy proceedings it is often the debtor's rather than the defendant's conduct that is relevant. *Gladstone*, 811 F.3d at 1143; *Pomaville*, 190 B.R. at 637.

The Objecting Parties dispute whether the Trustee may properly seek equitable tolling now or must instead assert equitable tolling when and if a defendant in an adversary proceeding asserts a defense that the Trustee's complaint is time-barred. The Objecting Parties – particularly the Taurus Parties and the Greenwich Parties – argue that equitable tolling is not yet ripe and that the proper consideration is instead, as discussed above, whether the statute of limitations can be extended. The Trustee argues that equitable tolling can be considered prospectively.

The Court agrees with the Objecting Parties. As Judge Tancredi observed in *Walnut Hill*, in *IBT International*, the Eleventh Circuit only considered equitable tolling in the context of a motion to dismiss raising a statute of limitations defense to a complaint in an adversary proceeding. 408 F.3d at 700–03. While it is not entirely clear from the decision itself, a review of the pleadings before the Eleventh Circuit supports the conclusion that the Eleventh Circuit found that the bankruptcy court's orders extending the statute of limitation were within its discretion pursuant to Rule 9006(b) and that, in any event, equitable tolling would apply to defeat the statute of limitation defense. *Id.* at 695–703; *see Fundamental Long Term Care*, 501 B.R. at 789 ("It seems to the Court that the appropriate standard would be the "for cause" analysis under Rule 9006. The Trustee here seeks an enlargement of time before the period has expired (equitable tolling presumably comes into play after the limitations period has expired). And that was the analysis the Eleventh Circuit initially applied in *In re International Administrative Services*, before turning to the equitable tolling analysis in an abundance of caution.").

***9** Therefore, the Court denies the Motion to Extend Deadlines insofar as it seeks an order equitably tolling the statutes of limitations set forth by sections 108(a), 546(a), and 549(d), without prejudice to the Trustee raising equitable tolling or other equitable arguments in response to a defense that an adversary proceeding commenced by the Trustee is time-barred.

V. CONCLUSION AND ORDER

Therefore, having reviewed and considered the arguments of the Trustee and the Objecting Parties during the hearing and raised in their briefs, the caselaw cited during the hearing and in the briefs, and the equities, the Court grants in part the Trustee's Motion to Extend Deadlines based upon good cause having been shown. Accordingly, it is hereby

ORDERED: Pursuant Fed. R. Bankr. P. 9006(b), the Motion to Extend Deadlines is **GRANTED IN PART** as set forth herein; and it is further

ORDERED: The time limitations set forth in 11 U.S.C. 108, 546, and 549 for the Trustee to commence avoidance actions are extended through and including August 15, 2024 (such extension, the "Ordered Extension"), which date may be further extended upon notice and a hearing; and it is further

ORDERED: Notwithstanding anything in this Order to the contrary, pursuant to the agreement of the parties, this Order and the Ordered Extension herein shall not apply to (i) UBS AG; and (ii) Sotheby's International Realty, Inc., Sotheby's International Realty Affiliates LLC, Sotheby's International Realty Referral Company LLC, Sotheby's International Realty Referral Company Inc., Martha Turner Sotheby's International Realty Referral Company LLC, Martha Turner Properties, LP, MTPGP, LLC, Anywhere Advisors LLC, Anywhere Real Estate Services Group LLC, Anywhere Real Estate Group LLC, Anywhere Intermediate Holdings LLC, and Anywhere Real Estate Inc.; and it is further

ORDERED: The Motion to Extend Deadlines is **DENIED IN PART** with respect to the request for prospective equitable tolling, without prejudice to the Trustee raising equitable tolling or other equitable arguments in response to a defense that an adversary proceeding commenced by the Trustee is time-barred; and it is further

ORDERED: The terms and conditions of this Order shall be immediately effective and enforceable upon its entry; and it is further

ORDERED: The Court shall retain jurisdiction with respect to all matters arising from or related to the interpretation or implementation of this Order.

All Citations

Not Reported in B.R. Rptr., 2024 WL 666646

Footnotes

1 The Objecting Parties, for the most part, join in each other's arguments. Hence, the Court will refer to them in the collective throughout the discussion below.

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United States Bankruptcy Court, W.D. North Carolina.

IN RE: MARTINEZ QUALITY
PAINTING & DRYWALL, INC., Debtor.
In re: Martinez Quality Painting
& Drywall, Inc., Plaintiff,
v.
Newco Capital Group VI, LLC, Defendant.

Case No. 22-30357
|
Adv. Proc. No. 24-03039
|
March 14, 2025

Attorneys and Law Firms

John C. Woodman, Essex Richards, Charlotte, NC, for Plaintiff.

Joseph Z. Frost, Buckmiller & Frost, PLLC, Raleigh, NC, for Defendant.

ORDER AND OPINION ON MOTION TO DISMISS

Ashley Austin Edwards, United States Bankruptcy Judge

***1 THIS MATTER** is before the Court upon the *Motion to Dismiss Complaint* (the "Motion"), which was filed by Newco Capital Group VI, LLC (the "Defendant") on October 25, 2024. [D.I. 7]. Following a hearing on the Motion, the Court took the matter under advisement and now renders this order and opinion.

BACKGROUND

I. Complaint [1]

Martinez Quality Painting & Drywall, Inc. (the "Plaintiff") filed the complaint that initiated this adversary proceeding on July 31, 2024 (the "Complaint"). [D.I . 1]. The Plaintiff "operated a commercial drywall and painting contractor completing projects in the southeast United States." The Defendant is a merchant cash advance ("MCA") lender that is incorporated in Delaware with a principal place of business in New York, New York. This adversary proceeding arises out of two MCA agreements between the Plaintiff and the Defendant (collectively, the "Parties").

On July 23, 2021, the Parties entered into a Revenue Purchase Agreement that provided for a "Purchase Price" of $250,000 to be paid by the Defendant in exchange for "Receivables Purchased" of $347,500 to be provided by the Plaintiff (the "First MCA Agreement"). In connection with the First MCA Agreement, among other ancillary agreements, the Plaintiff executed an ACH authorization, and the Plaintiff's insider executed a personal guaranty. In accordance with the terms of the First MCA Agreement, the Defendant received "at least $347,500" total in the form of daily withdrawals of $2,483 from the Plaintiff's bank account until the Receivables Purchased plus fees were recouped (collectively, the "First MCA Transfer"). The First MCA Agreement provides that the Defendant purchased 15% of the Plaintiff's receivables, but Plaintiff contends that the Defendant did not limit its sweep of the Plaintiff's bank account to actual receivables.

On November 4, 2021, the Parties entered into a second Revenue Purchase Agreement that provided for a "Purchase Price" of $325,000 to be paid by the Defendant in exchange for "Receivables Purchased" of $451,750 to be provided by the Plaintiff (the "Second MCA Agreement," and, together with the First MCA Agreement, the "MCA Agreements"). In connection with the Second MCA Agreement, among other ancillary agreements, the Plaintiff executed an ACH authorization, and the Plaintiff's insider executed a personal guaranty. In accordance with the terms of the Second MCA Agreement, the Defendant received "at least $451,750" in the form of daily withdrawals of $3,226 from the Plaintiff's bank account until the Receivables Purchased plus fees were recouped (collectively, the "Second MCA Transfer," and, collectively with the First MCA Transfer, the "Transfers"). The Second MCA Agreement provides that the Defendant purchased 15% of the Plaintiff's receivables, but the Defendant did not limit its sweep of the Plaintiff's bank account to actual receivables.

***2** In total, the Plaintiff paid $799,250 to the Defendant pursuant to the MCA Agreements, while the Defendant paid $575,000 to the Plaintiff. The difference between these two amounts is $224,250 (the "Excess Amount"). The Plaintiff made the last payment to the Defendant under the MCA Agreements on April 13, 2022. Plaintiff contends in the Complaint that the Defendant (a) received significantly more money than the amount that it gave to the Plaintiff under the MCA Agreements; (b) failed to complete an accounting or

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due diligence or take steps to verify that the funds it swept were receivables under the MCA Agreements; (c) received payments to which the Defendant had no right under the MCA Agreements; (d) intentionally disregarded the reality of the Debtor's finances, which, if considered, would have impaired the Defendant's ability to recoup the funds it "loaned" to the Plaintiff; (e) knew or should have known that the Plaintiff was in financial distress; (f) did not conduct an investigation of the Plaintiff's supposed accounts debtors; and (g) was a Net Winner, as defined in the Plaintiff's confirmed Chapter 11 plan, [#22-30357, D.I. 141], meaning the Defendant received more value than it extended to the Plaintiff.

According to the Complaint, the MCA Agreements were disguised loan agreements that caused the Defendant to bear little to no risk of loss and gave the Defendant significant recourse rights against the Plaintiff and its principal. The Complaint provides that the MCA Agreements (1) are governed by New York law; (2) charged an annual rate of interest of 40% in violation of several usury laws, including New York Penal Law § 190.409 and New York General Obligations Law § 5-511; and (3) are void *ab initio* for violating these usury laws, meaning that the recovery of principal and interest by the Defendant under the MCA Agreements is prohibited. For these reasons, the Complaint brings claims under the Bankruptcy Code and the North Carolina General Statutes to (1) avoid the Transfers as actually and constructively fraudulent transfers and (2) recover the $799,250 allegedly paid by the Plaintiff to the Defendant.

II. Motion to Dismiss

On October 25, 2024, the Defendant filed the Motion arguing that the Complaint should be dismissed pursuant to rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure. The Defendant filed a brief in support of the Motion on November 13, 2024 (the "Supporting Brief"). [D.I. 10]. The Defendant primarily argues that the MCA Agreements (1) are not loans; (2) if considered to be loans, are not criminally usurious loans because the Plaintiff received reasonably equivalent value; and (3) are exempt from North Carolina usury law, which the Defendant asserts is the appropriate state law to apply when analyzing the MCA Agreements.

On January 21, 2025, the Plaintiff filed a brief in opposition to the Motion, arguing primarily that (a) the MCA Agreements and the Transfers can be avoided as constructively fraudulent transfers; (b) the Court has subject matter jurisdiction over the claims raised in the Complaint; (c) the MCA Agreements are governed by New York law, not North Carolina law, due to the choice of law provisions in the MCA Agreements; and (d) the choice of law provisions should be enforced because the Defendant prepared the MCA Agreements, which include the Defendant's logo on the top of each of the MCA Agreements (the "Opposing Brief"). [D.I. 14].

On January 27, 2025, the Defendant filed a reply in support of the Motion primarily arguing that the Plaintiff is precluded and prohibited from invoking New York's Criminal Usury Statute (defined below) to argue that the MCA Agreements and Transfers are usurious, regardless of the characterization of the MCA Agreements and Transfers, even if New York law applied (the "Reply"). [D.I. 16]. The Reply cited a recent decision from the United States Bankruptcy Court for the Eastern District of North Carolina: *Azalea Gynecology, P.A. v. GFE NY, LLC (In re Azalea Gynecology)*, No. 24-00109-5-PWM (Bankr. E.D.N.C. Dec. 6, 2024). That decision was entered on December 6, 2024—just over a month after the Motion was filed and prior to the Hearing (defined below).

On January 28, 2025, the Court conducted a hearing on the Motion (the "Hearing"). John C. Woodman appeared on behalf of the Plaintiff. Joseph Z. Frost appeared on behalf of the Defendant. The Court permitted the Plaintiff to file a sur-reply by February 7, 2025, which deadline was subsequently extended by mutual consent of the Parties. On February 19, 2025, the Plaintiff filed the *Sur-Reply in Opposition to [the] Motion to Dismiss* (the "Sur-Reply"). [D.I. 18]. This Motion is now ripe for adjudication.

DISCUSSION

III. Motion to Dismiss for Lack of Subject Matter Jurisdiction

***3** The Defendant moved to dismiss the Complaint for lack of subject matter jurisdiction pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure, made applicable to this adversary proceeding by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure (the "Rule 12(b)(1) Motion"). The Fourth Circuit has articulated the following standard when evaluating motions under Rule 12(b)(1):

> [A] defendant may challenge subject matter jurisdiction in one of two ways. First, the defendant may contend that a complaint simply fails to allege facts upon which subject matter jurisdiction can be based. When a defendant makes a facial challenge to subject matter jurisdiction, the plaintiff,

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> in effect, is afforded the same procedural protection as he would receive under a Rule 12(b)(6) consideration. In that situation, the facts alleged in the complaint are taken as true, and the motion must be denied if the complaint alleges sufficient facts to invoke subject matter jurisdiction.
>
> In the alternative, the defendant can contend ... that the jurisdictional allegations of the complaint are not true. The plaintiff in this latter situation is afforded less procedural protection: If the defendant challenges the factual predicate of subject matter jurisdiction, a trial court may then go beyond the allegations of the complaint *and in an evidentiary hearing* determine if there are facts to support the jurisdictional allegations, without converting the motion to a summary judgment proceeding. In that situation, the presumption of truthfulness normally accorded a complaint's allegations does not apply, and the district court is entitled to decide disputed issues of fact with respect to subject matter jurisdiction.

Kerns v. United States, 585 F.3d 187, 192 (4th Cir. 2009) (citations omitted).

In this case, the Defendant did not explain in the Motion, Supporting Brief, Reply, or at the Hearing, how or why this Court lacks subject matter jurisdiction over this adversary proceeding or the Complaint other than by restating the relevant legal standard. The Defendant also did not clarify whether it made a facial challenge to subject matter jurisdiction or whether it challenged the factual predicate of subject matter jurisdiction. The Plaintiff argues that this Court has subject matter jurisdiction over the claims raised in the Complaint under 28 U.S.C. §§ 157 and 1334, the Amended Standing Order of Reference issued by the United States District Court for the Western District of North Carolina (the "Amended Reference Order"), [2] and Article 13 of the Chapter 11 plan that was confirmed in the underlying bankruptcy case.

The Court will treat the Rule 12(b)(1) Motion as a facial challenge to subject matter jurisdiction because the Defendant has not specifically challenged the factual predicate of subject matter jurisdiction as set forth in the Complaint. The Court finds that the Complaint alleges sufficient facts to invoke subject matter jurisdiction. For these reasons, the Rule 12(b)(1) Motion shall be denied.

IV. Motion to Dismiss for Failure to State a Claim

***4** The Defendant also moved to dismiss the Complaint for failure to state a claim upon which relief may be granted pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, made applicable to this adversary proceeding by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure. "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (citation omitted); *see also E. I. du Pont de Nemours & Co. v. Kolon Indus.*, 637 F.3d 435, 440 (4th Cir. 2011) (citation omitted) (noting that a court ruling on a Rule 12(b)(6) motion should "draw all reasonable inferences in favor of the plaintiff"). "The plausibility standard is not akin to a probability requirement, but it asks for more than a sheer possibility that a defendant has acted unlawfully." *Id.* (citation omitted). "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* (citation omitted). Plaintiffs "must plausibly allege facts that, if proven, would be sufficient to establish each element of the claim." *Harvey v. Cable News Network, Inc.*, 48 F.4th 257, 268–69 (4th Cir. 2022).

Although this Court is required to "take all of the factual allegations in the complaint as true," the Court is "not bound to accept as true a legal conclusion couched as a factual allegation." *Iqbal*, 556 U.S. at 678 (citation omitted). Ultimately, the Defendant bears the burden to prove that the Plaintiff has failed to state a claim upon which relief can be granted. *Moore v. Berry (In re Moore)*, Nos. 20-31195-KLP, 21-03041-KLP, 2022 WL 839702, at *2 (Bankr. E.D. Va. Mar. 21, 2022) (citing *Emerald Capital Advisors Corp. v. Bayerische Moteren Werke Aktiengesellschaft (In re Fah Liquidating Corp.)*, 572 B.R. 117, 122 (Bankr. D. Del. 2017)); *Richland-Lexington Airport Dist. v. Atlas Props.*, 854 F. Supp. 400, 407 (D.S.C. 1994) (citing *Kehr Packages v. Fidelcor, Inc.*, 926 F.2d 1406, 1408 (3d Cir. 1991)).

The Complaint contains six separate claims for relief. After considering which state law governs the MCA Agreements, the Court will address each claim in turn.

A. Controlling Law

As a preliminary matter, the Court is asked to determine whether to apply New York or North Carolina law in its consideration of the claims for relief raised in the Complaint. The Parties appear to agree that (1) the MCA Agreements each contain a choice of law provision that selects New

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York law as the governing law for the MCA Agreements and (2) the result would be different depending on whether New York law or North Carolina law applies. The Defendant argues that the Court should not apply the choice of law provision because "[c]ontractual choice-of-law provisions are not sufficient to avoid application of North Carolina usury law, codified in Chapter 24 of the North Carolina General Statutes, to any loans or extensions of credit made to borrowers residing within the State of North Carolina." By acknowledging that (1) the Plaintiff allegedly operates in North Carolina and (2) North Carolina's usury laws do not apply to corporations in certain contexts, *see* N.C. Gen. Stat. § 24-9(a)(3), the Defendant argues that the MCA Agreements should be "exempt and excluded from any usury and interest rate limitations and requirements." The Defendant also argues that North Carolina law should be applied because "[t]he public policy of the State of North Carolina, codified in N.C. Gen. Stat. § 24-2.1 and applying to loans and extensions of credit to borrowers residing in the State of North Carolina, would override the contractual choice-of-law provisions in the MCA Agreement."

When considering a motion to dismiss, many courts are reluctant to engage in a choice of law analysis given the potentially fact-intensive inquiry. *See, e.g., Banner Life Ins. Co. v. Bonney*, No. 2:11cv198, 2011 WL 6002609, at *5 (E.D. Va. Nov. 29, 2011) (declining to engage in choice of law analysis at motion to dismiss stage) *and Graboff v. Collern Firm*, No. 10-1710, 2010 WL 4456923, at *8 (E.D. Pa. Nov. 5, 2010) ("[A] choice of law analysis is premature [when considering a Rule 12(b)(6) motion] because the record lacks necessary facts for the Court to conduct the fact-intensive, context-specific analysis required by [state] law."). For this reason, it is often necessary to defer whether to enforce a contractual choice of law provision to a later stage in the proceeding. *See N. Am. Tech. Servs. v. V.J. Techs., Inc.*, Civil Action No. 10 CV 1384 (AWT), 2011 WL 4538069, at *2 (D. Conn. Sep. 29, 2011) (quoting *Graboff*, 2010 WL 4456923, at *8). If a court defers the choice of law analysis to a later proceeding, the court may apply the choice of law as alleged in the Complaint under the Rule 12(b)(6) standard. *See, e.g., Snyder v. Farnam Cos.*, 792 F. Supp. 2d 712, 721 (D.N.J. 2011) (citation omitted) (declining to engage in choice of law analysis when considering Rule12(b)(6) motion to dismiss and applying New Jersey law as alleged in the complaint).

***5** A "bankruptcy court applies the choice of law rules of the state in which it sits." *Hovis v. Gen. Dynamics Corp. (In re Marine Energy Sys. Corp.)*, 299 F. App'x 222, 227 (4th Cir. 2008) (quoting *Amtech Lighting Servs. v. Payless Cashways, Inc. (In re Payless Cashways)*, 203 F.3d 1081, 1084 (8th Cir. 2000)). This Court sits in the Western District of North Carolina and applies North Carolina's choice of law rules. "As a general rule, North Carolina courts will give a contractual choice of law provision effect unless [a][1] the chosen state has no substantial connection to the transaction and [2] there is no other reasonable basis for the parties' choice, or [b] the law of the chosen state violates a fundamental public policy of North Carolina." *Vizant Techs., LLC v. YRC Worldwide, Inc.*, 373 N.C. 549, 556 (2020) (citation omitted) (adopting the analysis set forth in the Restatement (Second) of Conflict of Laws § 187(2) (1971)).

As alleged in the Complaint, Paragraph 4.5 of each MCA Agreement provides that the

> Agreement, Security Agreement and Guaranty, Guaranty of Performance, and any and all addendums, attachments, exhibits, and other documents relating to this Agreement in any way, *shall be governed by and construed in accordance with the laws of the state of New York, without regards to any applicable principals of conflicts of law*. Any suit, action or proceeding arising hereunder or the interpretation performance or breach hereof shall, if NCG so elects, be instituted in any court sitting in New York (the "Acceptable Forums"). All Parties to this Agreement, including but not limited to, Merchant, Guarantor(s), Corporate Guarantor(s) Merchant and Guarantor(s) that the Acceptable Forums are convenient to it and submit to the Jurisdiction of the Acceptable Forums and waives any and all objections to jurisdiction or venue. Should such proceeding be initiated in any other forum, Merchant and Guarantor(s) waives any right to oppose any motion or application made by NCG to transfer such proceeding to an Acceptable Forum.

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MCA Agreements, ¶ 4.5 (emphasis added). While this paragraph appears in the middle of the MCA Agreements, a nearly identical provision appears again at the end of both MCA Agreements.

Still, applying the exceptions set forth in *Vizant Technologies* to the use of the contractual choice of law provision in this case would require a factually intensive inquiry. For example, the first exception under the *Vizant Technologies* standard, regarding whether a "substantial connection" exists, may require considering "if the contract is made in the state attempting to exercise jurisdiction." *See Liberty Fin. Co. v. N. Augusta Comput. Store, Inc.*, 100 N.C. App. 279, 285 (1990) (citation omitted); *Tom Togs, Inc. v. Ben Elias Indus. Corp.*, 318 N.C. 361, 365 (1986) ("[A] contract is made in the place where the last act necessary to make it binding occurred." (citation omitted)). The second exception requires considering whether there is a reasonable basis for parties' choice of law in the agreement, which could be true if a contract party's principal place of business is within the chosen state. *See IPayment, Inc. v. Grainger*, 257 N.C. App. 307, 312 (2017). The last exception under *Vizant Technologies* requires considering whether the choice of law provision violates North Carolina's fundamental public policy, such as by violating a statute. *See Troublefield v. Automoney, Inc.*, 284 N.C. App. 494, 506–07 (2022) (quoting *Glover v. Rowan Mut. Fire Ins. Co.*, 228 N.C. 195, 198 (1947)); *see also Torres v. McClain*, 140 N.C. App. 238, 243 (2000) (quoting *Boudreau v. Baughman*, 322 N.C. 331, 340 (1988)) ("The courts of North Carolina have been reluctant to find that the law of another state violates [their] public policy absent a showing that the law violates 'some prevalent conception of good morals or fundamental principle of natural justice or involve injustice to the people of the forum state.' "); N.C. Gen. Stat. § 24.1(g) (emphasis added) ("It is the paramount public policy of North Carolina to *protect* North Carolina resident borrowers through the application of North Carolina interest laws.").

***6** As this line of cases makes evident, the inquiry into whether to apply the choice of law provision contained in the MCA Agreements is particularly fact intensive and context specific. Given the multi-factor *Vizant Technologies* test that is used by courts in North Carolina, this Court cannot meaningfully engage in the choice of law analysis without the benefit of discovery. Therefore, the Court declines to engage in the choice of law inquiry until after a factual record is developed. For purposes of this Motion, the Court will accept the allegations set forth in the Complaint as true when considering which state's law to apply.

B. <u>First and Third Claims for Relief</u>

The first claim for relief in the Complaint is titled "Avoidance of Constructively Fraudulent Transfers – 11 U.S.C. § 548(a)(1)(B)," and the third claim for relief is titled "Obligations Incurred Under the MCA Agreements – 11 U.S.C. § 548(a)(1)(B)." Both claims are based on alleged "constructively fraudulent transfers." "Section 548 [of the Bankruptcy Code] defines a constructively fraudulent transfer ... as one where (1) the debtor was insolvent, and (2) the debtor received 'less than a reasonably equivalent value in exchange.' " *French v. Liebmann (In re French)*, 440 F.3d 145, 150 (4th Cir. 2006) (quoting 11 U.S.C. § 548(a)(1)(B)).[3] The trustee or debtor-in-possession may avoid a constructively fraudulent transfer "that was made or incurred on or within 2 years before the date of the filing of the petition." 11 U.S.C. § 548(a)(1).

Here, the Complaint alleges that (1) the Transfers made under the MCA Agreements occurred within two years before the date the Debtor filed the bankruptcy petition on August 1, 2022 (the "<u>Petition Date</u>"); and (2) the "Debtor was insolvent or became insolvent as a result of each [t]ransfer," which is a requirement for a claim pursuant to section 548 of the Bankruptcy Code. At this motion to dismiss stage and for purposes of the section 548 analysis, the Court takes as true both the two-year time frame of the Transfers and the insolvency of the Plaintiff at the time of the Transfers.

Thus, the only outstanding element for a claim under section 548, is whether the Plaintiff received less than a reasonably equivalent value in exchange for the Transfers. The Defendant argues that the Plaintiff has failed to plead this element because the MCA Agreements are not criminally usurious loans and, therefore, are enforceable contracts that are not void *ab initio*. Even if the Court were to find the MCA Agreements and Transfers thereunder are loans, the Defendant argues that North Carolina law applies and that North Carolina law does not prohibit such transactions because North Carolina usury laws do not apply to agreements between corporations. As a preliminary matter, the Complaint alleges that the MCA Agreements and Transfers thereunder constitute loans rather than sales, so the Court will treat them as loans for purposes of this analysis.

1. <u>Usury under New York Penal Law</u>

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***7** The Defendant is correct that, given the facts in this case, attempting to avoid the MCA Agreements through the Criminal Usury Statute (defined below) is not an appropriate basis to argue a lack of reasonably equivalent value. Under section 190.40 of the New York Penal Law (the "Criminal Usury Statute"), a corporation may only invoke criminal usury as an affirmative defense to the enforcement of a usurious contract and may not seek affirmative relief under that statute. *See Azalea Gynecology, P.A. v. GFE NY, LLC (In re Azalea Gynecology)*, No. 24-00109-5-PWM, slip op. at 7 (Bankr. E.D.N.C. Dec. 6, 2024); *Haymount Urgent Care PC v. GoFund Advance, LLC*, 609 F. Supp. 3d 237, 254 (S.D.N.Y. 2022) (citing *Paycation Travel, Inc. v. Glob. Merch. Cash, Inc.*, 192 A.D.3d 1040, 1041 (N.Y. App. Div. 2021)).

Corporations may only use the Criminal Usury Statute as a shield, not as a sword. *See Azalea Gynecology*, No. 24-00109-5-PWM, slip op. at 7. The *Azalea Gynecology* court considered whether to apply the Criminal Usury Statute in the analysis of reasonably equivalent value under section 548 of the Bankruptcy Code. In *Azalea Gynecology*, prior to a plan of reorganization being confirmed in that case, the Chapter 11 debtor initiated an adversary proceeding against an MCA lender seeking a declaratory judgment finding that the MCA agreement between the two was criminally usurious and void *ab initio* under New York's Criminal Usury Statute because the 54.75% effective interest rate under the agreement exceeded the 25% interest rate permitted by the Criminal Usury Statute. *Id.* at 5–6. The defendant in *Azaela Gynecology* filed a motion to dismiss, arguing that, "first, North Carolina law, not New York law, controls, rendering the interest rates non-usurious; and second, even if New York law controls, [the plaintiff] may not assert an *affirmative claim* for criminal usury." *Id.* at 2 (emphasis added). Instead, the defendant argued "that usury may only be asserted as a *defense* under New York Law." *Id.* at 7 (emphasis added).

The *Azalea Gynecology* court did not reach the question of whether to apply North Carolina or New York law because it found that (1) the complaint failed under New York law, which was the state law that the complaint sought to apply; and (2) the claims rested upon an "affirmative determination" that the MCA agreement was void under the Criminal Usury Statute, rather than using such statute as an affirmative "defense." *See id.* at 2, 6, 8. Because there was no "basis upon which [the plaintiff] could assert criminal usury defensively," the court found that the claims failed as a matter of law and had to be dismissed. *See id.* at 8. The *Azalea Gynecology* court noted that the defendant had not filed a proof of claim, but if it had, "the result might be different." *Id.* at 8, 8 n.1.

The facts in this case are similar to those in *Azalea Gynecology*. In the case at hand, (a) the Defendant did not file a proof of claim; (b) the Defendant did not participate in or engage in other offensive gestures against the Plaintiff in the underlying bankruptcy case; and (c) the requirements under the MCA Agreements were fully satisfied, meaning the Defendant was not a creditor at the time of the Plaintiff's bankruptcy case.[4] Given these specific facts, the Plaintiff has no basis to use the Criminal Usury Statute as an affirmative defense, and the Complaint improperly invokes the Criminal Usury Statute to obtain affirmative relief against the Defendant—specifically, to have the MCA Agreements deemed void *ab initio* and to recover the Transfers. Because, as in *Azalea Gynecology,* the Plaintiff seeks to use the Criminal Usury Statute as a sword rather than as a shield, the references to the Criminal Usury Statute are improper and cannot be used to argue that the MCA Agreements were void and therefore that the Debtor received less than a reasonably equivalent value in exchange for the Transfers.[5]

2. Usury under New York General Obligations Law

***8** However, the Defendant ignores a key allegation in paragraph 66 of the Complaint: that the MCA Agreements are void *ab initio* under New York General Obligations Law § 5-511. That law provides that, with certain exceptions, "[a]ll bonds, bills, notes, assurances, conveyances, *all other contracts* or securities whatsoever, except bottomry and respondentia bonds and contracts, and all deposits of goods or other things whatsoever, whereupon or whereby there shall be reserved or taken, or secured or agreed to be reserved or taken, any greater sum, or greater value, for the loan or forbearance of any money, goods or other things in action, than is prescribed in section 5-501, *shall be void* ...." N.Y. Gen. Oblig. Law § 5-511(1) (emphasis added). In this case, the Complaint and Sur-Reply explicitly raise section 5-511 of the New York General Obligations Law as a basis for determining that there was no reasonably equivalent value exchanged under the MCA Agreements.

While corporations may not "interpose the defense of [civil] usury in any action," N.Y. Gen. Oblig. Law § 5-521(1), "[t]he legislature provided no exceptions to the voiding of usurious loans if the borrower is a corporation." *Adar Bays, LLC v. GeneSYS ID, Inc.*, 37 N.Y.3d 320, 333 (2021); *see Crystal Springs Cap., Inc. v. Big Thicket Coin, LLC*, 220 A.D.3d

745, 746 (N.Y. App. Div. 2023) (citing *Adar Bays, LLC*, 37 N.Y.3d at 332); *Welz v. Brown*, 228 A.D.3d 416, 417 (N.Y. App. Div. 2024) (citing *Adar Bays, LLC*, 37 N.Y.3d at 324) (holding that a usurious loan is "void and unenforceable" "at its inception"). Taking the facts as true and construing reasonable inferences in favor of the Plaintiff, it is plausible that the Plaintiff may show (1) a lack of reasonably equivalent value under New York law and, consequently, (2) that the Transfers or portions thereof were constructively fraudulent transfers under section 548(a)(1)(B) of the Bankruptcy Code.

Therefore, as to the first and third claims for relief in the Complaint, the motion to dismiss under Rule 12(b)(6) is granted without leave to amend as it relates to the Criminal Usury Statute and denied as to the remainder of the first and third claims for relief. For clarity, the Plaintiff may not use the Criminal Usury Statute to argue that the MCA Agreements or Transfers are void, but the Plaintiff may argue that there is a lack of reasonably equivalent value on another basis set forth in the Complaint, including under section 5-511 of the New York General Obligations Law.

3. <u>Recovery of Constructively Fraudulent Transfer</u>

While the Complaint alleges sufficient facts to plausibly state a constructively fraudulent transfer claim under section 548 of the Bankruptcy Code, the Court does not decide at this stage the amount, if any, of any avoided transfers that may be *recovered*. Still, it is appropriate and necessary under the motion to dismiss standard for the Court to determine if the facts, taken as true, would be sufficient to establish each element under section 548—specifically, a lack of reasonably equivalent value. Fourth Circuit precedent provides specific guidance on how to determine the amounts of constructively fraudulent transfers that may be recovered under section 548.

"[R]easonably equivalent value is not susceptible to simple formation .... The focus is on the consideration received by the debtor, not on the value given by the transferee." *Harman v. First Am. Bank of Md. (In re Jeffrey Bigelow Design Grp.)*, 956 F.2d 479, 484 (4th Cir. 1992) (citing Jack F. Williams, *Revisiting the Proper Limits of Fraudulent Transfer Law*, 8 Bankr. Dev. J. 55, 80 (1991)). "This is reflective of the fact that constructively fraudulent transfer law is essentially concerned with preserving a debtor's net worth." *McCarthy v. 88 La Gorce, LLC (In re El-Atari)*, Nos. 09-14950-BFK, 11-01404, 2012 WL 404947, at *2 (Bankr. E.D. Va. Feb. 8, 2012). It is well established Fourth Circuit law under section 548 that the analysis for reasonably equivalent value requires considering the *net* benefit to the debtor and not simply the amount the debtor transferred to a certain party. *See Harman*, 956 F.2d at 485; *Field v. United States (In re Abatement Env't Res., Inc.)*, 102 F. App'x 272 (4th Cir. 2004)) (citing *Harman*, 956 F.2d at 485); *Bledsoe v. DeVos (In re Ferris)*, No. 18-04942-5-SWH, 2020 WL 3884735, at *3 (Bankr. E.D.N.C. July 9, 2020) (citing *Harman*, 956 F.2d at 484); *Terry Props., LLC v. Farm Credit of the Virginia, ACA (In re Terry Props., LLC)*, No. 16-71449, 2017 WL 507277, at *5 (Bankr. W.D. Va. Feb. 3, 2017), *aff'd*, No. 16-71449, 2017 WL 3736772 (W.D. Va. Aug. 30, 2017) (citing *Harman*, 956 F.2d at 485).

***9** Following the Fourth Circuit analysis, this Court has set forth a two-part test to assess reasonably equivalent value under section 548: "(1) Did the debtor receive value, and (2) was the payment reasonably equivalent to the value extended?" *Smith v. DiSeveria (In re BK Racing, LLC)*, 2024 WL 1060972, at *16 (Bankr. W.D.N.C. Mar. 11, 2024) (citing *Cohen v. Un-Ltd. Holdings (In re Nelco, Ltd.)*, 264 B.R. 790, 813 (Bankr. E.D. Va. 1999). In the *BK Racing* case, there were no written loan documents between the debtor and the defendants, and the trustee contended that certain payments to the defendants were returns on equity, whereas the defendants argued that the payments were repayments of short-term informal loans. *Id.* at *17. The Court determined that the transfers were made in repayment of short-term loans and were "substantially equivalent to the amount of the Transfers," which therefore constituted "reasonably equivalent value" under section 548. *Id.* at *20.

Critically, for the analysis of reasonably equivalent value under section 548, the specific form of the transactions is superfluous; the Court need only look at the substance of the transactions. 5 Collier on Bankruptcy ¶ 548.03[6] (Matthew Bender & Co., eds., 16th ed. 2022); *accord Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 793 (7th Cir. 2009) (quoting Douglas G. Baird, *Elements of Bankruptcy* 153–54 (4th ed. 2006)) ("Fraudulent conveyance doctrine is a flexible principle that looks to substance, rather than form, and protects creditors from any transactions the debtor engages in that have the effect of impairing their rights ...."). In the case at hand, taking the factual allegations in the Complaint as true, the Debtor paid to the Defendant the Transfers in the total amount of $799,250. Even construing reasonable inferences in favor of the Debtor, the Complaint asserts that the Debtor received value from the Defendant in at least the amount of $575,000, as the combined "Purchase Price" under the MCA Agreements.

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"In analyzing fraudulent conveyances, ... the test is whether, as a result of the transaction[s], the debtor's estate was unfairly diminished." *Field*, 102 F. App'x at 279 (quoting Gerrard Glenn, *Fraudulent Conveyances and Preferences* § 275 (rev. ed. 1940)); *see* *Harman*, 956 F.2d 479 at 484. The Fourth Circuit in *Harman* provided that the bankruptcy estate, including unsecured creditors, would be paid twice if a bankruptcy court allowed a debtor to (1) receive the benefit of funds from a defendant for which the transfers sought to repay and then (2) recover the same amount of funds from an avoidable transfer action. 956 F.2d at 485 ("Otherwise, the creditors would receive not only the benefit of the money received from the draws on the lines of credit, but also the windfall of avoided transfers designed to repay the draws.").

It is imperative that the "focus is on the *net effect* of the transfers on the debtor's estate, [meaning] the funds available to the unsecured creditors." *Harman*, 956 F.2d 479 at 484 (emphasis added). "As long as the unsecured creditors are no worse off because the debtor, and consequently the estate, has received an amount reasonably equivalent to what it paid, no fraudulent transfer has occurred." *Id.*; *see* *In re Johnson Bros. Truckers Inc.*, 9 Fed. App'x 156, 165 (4th Cir. 2001). Although "[r]easonably equivalent value is not susceptible to simple formulation," *Harman*, 956 F.2d at 484, "[t]he essential examination is a comparison of 'what went out' with 'what was received.' " *Altman v. Underwood (In re Underwood)*, 22 Fla. L. Weekly Fed. B 202 (Bankr. M.D. Fla. 2009) (citation omitted). Therefore, at a minimum, Fourth Circuit precedent precludes the recovery of any value exceeding what the Plaintiff has already received from the Defendant under the MCA Agreements.

***10** Under the MCA Agreements, the Defendant may have (1) purchased the "Purchase Receivables" or (2) had a valid contract with a fully secured interest in the receivables. In either situation, unsecured creditors would not be worse off. Additionally, pursuant to the Complaint, the Debtor received $250,000 on July 23, 2021, and then received $325,000 on November 4, 2021, from the Defendant. The Debtor relied on the $575,000 in funds to continue to operate and later filed for bankruptcy relief on the Petition Date. *See* *Miller vs. First Bank*, 206 N.C. App 166, 178–79 (2010) (applying *Harman* and determining that the benefit of using loan proceeds over time can support a finding of reasonably equivalent value, even if the amounts transferred between entities for a loan were not equal). The benefit to the Plaintiff of using these funds over time *may* show that there was reasonably equivalent value; or, at least, that may provide a partial justification for reducing the recovery to an amount less than the Excess Amount in an action under section 548.

Certain portions of the Transfers may exceed the appropriate market terms for this type of transaction, and therefore avoidable under section 548, which is a concept that the Court is familiar with. This Court previously determined, after extensive discovery, that when employees were substantially overpaid for work, the amount of the overpayment was an avoidable transfer and that "market value is an extremely important factor used in the assessment." *Ballantyne Brands, LLC v. Wiesehan, Jr. (In re Ballantyne Brands, LLC)*, 656 B.R. 117 (Bankr. W.D.N.C. 2023) (citing *Cooper v. Ashley Commc'ns., Inc. (In re Morris Commc'ns NC, Inc.)*, 914 F.2d 458, 466 (4th Cir. 1990)). The factual inquiry into reasonably equivalent value requires more than simple math and the debtor does not need to collect dollar for dollar equivalent to have received reasonably equivalent value. *See* *Miller*, 206 N.C. App 166 (citing *Butler Aviation Int'l, Inc. v. Whyte (In re Fairchild Aircraft Corp.)*, 6 F.3d 1119, 1125–26 (5th Cir. 1993)).

In summary, although certain transactions may give reasonably equivalent value as a matter of law, reasonable equivalence generally is a matter of fact. *See* *Ingalls v. Erlewine (In re Erlewine)*, 349 F.3d 205, 209 (5th Cir. 2003). This fact intensive inquiry often cannot be decided at the motion to dismiss stage based upon the pleadings. *See* *Kirschner v. Large S'holders (In re Tribune Co. Fraudulent Conveyance Litig.)*, 10 F.4th 147, 174 (2d Cir. 2021) (citing *A Andrew Velez Constr., Inc. v. Consol. Edison Co. of N.Y., Inc. (In re Andrew Velez Constr., Inc.)*, 373 B.R. 262, 271 (Bankr. S.D.N.Y. 2007) (declining to dismiss constructive fraudulent transfer claim given the complexities of the factual background in analyzing the "reasonably equivalent value"). In the case at hand, the Plaintiff has pled sufficient facts to raise a plausible claim under section 548 of the Bankruptcy Code to avoid some portion of the Transfers under the reasonably equivalent value standards, given the legal limitations cited herein. Fourth Circuit precedent demonstrates that the Excess Amount may be the maximum possible amount recovered under section 548, and any such recovery may be further reduced after considering the other factors discussed herein.

C. <u>Second Claim for Relief</u>

The second claim for relief in the Complaint is titled "Avoidance of Constructively Fraudulent Transfers – N.C. Gen. Stat. § 39-23.1 *et seq*." This claim fails because it

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is brought under North Carolina law, which the Complaint specifically alleges does not govern the MCA Agreements. The Complaint provides no plausible basis to allow this claim to proceed under North Carolina law. Instead, the Complaint alleges that New York law governs the MCA Agreements, and the Plaintiff has consistently argued the same point throughout this proceeding. Therefore, the motion to dismiss the second claim for relief under Rule 12(b)(6) is granted with leave to amend.

D. Fourth Claim for Relief

***11** The fourth claim for relief is titled "Avoidance of Fraudulent Transfers – 11 USC [sic] § 548(a)(1)(A) Actual Fraud." That statute authorizes the trustee to

> avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted.

11 U.S.C. § 548(a)(1)(A). The Complaint does not allege sufficient facts to support a claim that transfers were made, or that obligations were incurred, under the MCA Agreements by the Plaintiff (the Debtor in this case) with the actual intent to hinder, delay, or defraud another entity. In situations where a Debtor has "asked for, received, and then repaid" amounts, even under a verbal loan agreement, this Court has refused to find that the transfers were done "with an intention to hinder, delay and defraud its creditors." *See Smith v. DiSeveria (In re BK Racing, LLC)*, No. 18-30241, 2024 WL 1060972, at *20 (Bankr. W.D.N.C. Mar. 11, 2024). Because the Complaint alleges that this very conduct occurred between the Parties, there is no plausible basis to find that the Defendant is liable under section 548(a)(1)(A). Therefore, the motion to dismiss the fourth claim for relief under Rule 12(b)(6) is granted without leave to amend.

E. Fifth Claim for Relief

The fifth claim for relief is titled "Recovery of Transfers under 11 U.S.C. § 550." As is noted above, section 548(a)(1)(B) of the Bankruptcy Codes authorizes a trustee to avoid constructively fraudulent transfers. Section 550 of the Bankruptcy Code authorizes a trustee to recover property or the value of property if a transfer of such property was avoided. *See* Collier on Bankruptcy ¶ 550.01 (16th ed. 2024). The Defendant did not argue that this claim for relief should be dismissed, although the Court recognizes that there is a "stray" reference to section 547 of the Bankruptcy Code in this section of the Complaint. That Bankruptcy Code section, titled "Preferences," "is not concerned with fraudulent transfers" but instead "permits a trustee to avoid certain prebankruptcy transfers as 'preferences.' " *See* Collier on Bankruptcy ¶ 547.01. The Complaint does not allege sufficient facts to plausibly show that there were any preferential transfers that may be avoided.

At the Hearing, the Plaintiff conceded that it did not feel comfortable alleging that the Defendant was an insider and could not allege that the Transfers occurred within 90 days of the Petition Date. At least one of these facts would have been required to show that any of the Transfers were preferential under section 547 of the Bankruptcy Code. Therefore, the motion to dismiss the fifth claim for relief under Rule 12(b)(6) is granted without leave to amend as it relates to section 547 of the Bankruptcy Code and denied as to the remainder of the fifth claim for relief.

F. Sixth Claim for Relief

***12** The sixth claim for relief in the Complaint is titled "Reconciliation and Accounting / Turnover of Property of Estate under 11 U.S.C. § 542." Section 542 of the Bankruptcy Code provides,

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that

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> the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a). This statute "invokes the court's most basic equitable powers to gather and manage property of the estate." *Braunstein v. McCabe*, 571 F.3d 108, 122 (1st Cir. 2009). Again, the Defendant did not argue that this claim for relief should be dismissed and has failed to meet its burden under the Federal Rule of Civil Procedure 12(b)(6). Therefore, the motion to dismiss the sixth claim for relief under Rule 12(b)(6) is denied.

CONCLUSION

For the reasons stated in this opinion, the Court **ORDERS** as follows:

1. The Motion is **GRANTED** without leave to amend as it relates to (a) the Criminal Usury Statute under the first and third claims for relief, (b) the fourth claim for relief, and (c) the fifth claim for relief as it relates to section 547 of the Bankruptcy Code;
2. The Motion is **GRANTED** with leave to amend as it relates to the second claim for relief; and
3. The Motion is **DENIED** as it relates to (a) the Rule 12(b)(1) Motion, (b) the remainder of the first and third claims for relief, (c) the remainder of the fifth claim for relief, and (d) the sixth claim for relief.

IT IS SO ORDERED.

This Order has been signed electronically. The Judge's signature and Court's seal appear at the top of this order.

All Citations

Slip Copy, 2025 WL 828882

Footnotes

1 This "Complaint" section of the opinion recites the allegations set forth in the Complaint. These recitals do not constitute findings of fact or legal conclusions by the Court. Instead, the Court finds generally that these allegations are contained in the Complaint.

2 The Plaintiff, in the Opposing Brief, references the General Order of Reference that was entered on July 30, 1984. However, the current standing order of reference that applies to this Court is the Amended Reference Order, which was entered on April 14, 2014.

3 In addition to being insolvent, section 548 allows the Debtor to plead in the alternative that the Debtor "(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business." 11 U.S.C. § 548(a)(1)(B)(ii). Here, the Debtor also pled elements (II) and (III).

4 There was no need for the Defendant to file a proof of claim or to otherwise engage in the case offensively since the Defendant had been paid in full under the MCA Agreements.

5 As was noted in *Azalea Gynecology*, the Court may have reached a different conclusion if the Defendant had filed a proof of claim or taken other affirmative action against the Plaintiff in this case. *See Azalea Gynecology,*

P.A. v. GFE NY, LLC (In re Azalea Gynecology), No. 24-00109-5-PWM, slip op. at 8 n.1 (Bankr. E.D.N.C. Dec. 6, 2024).

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United States Bankruptcy Court, E.D. North Carolina.

IN RE: WILLIAMS LAND CLEARING, GRADING, AND TIMBER LOGGER, LLC, Debtor.
Williams Land Clearing, Grading, and Timber Logger, LLC, Plaintiff,
v.
Apex Funding Source LLC and Yehuda Klein a/k/a Jay Klein, Defendants.
Commercial Funding, Inc., Intervenor Plaintiff,
v.
Williams Land Clearing, Grading, and Timber Logger, LLC, Apex Funding Source LLC, and Yehuda Klein a/k/a Jay Klein, Intervenor Defendants.

Case No. 22-02094-5-PWM
|
Adversary Proceeding No. 23-00024-5-PWM
|
Signed May 16, 2025

Attorneys and Law Firms

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ORDER ALLOWING IN PART AND DENYING IN PART MOTIONS FOR SUMMARY JUDGMENT

Pamela W. McAfee, United States Bankruptcy Judge

***1** The matters before the court are the motions for partial summary judgment filed by the Intervenor Plaintiff, Commercial Funding, Inc. (CFI), D.E. 91, and the motions for summary judgment filed by the Defendants and Intervenor Defendants, Apex Funding Source LLC (Apex) and Yehuda Klein a/k/a Jay Klein, D.E. 99 and 95, respectively. The motions were fully briefed and a hearing was conducted in Raleigh, North Carolina on March 18, 2025. At the hearing, the court indicated that summary judgment would be granted in favor of Mr. Klein on all claims asserted against him in the Amended Complaint and the Intervenor Complaint, that summary judgment would be granted in favor of Apex on the tortious interference with contract claim asserted in the Intervenor Complaint, and that the remaining claims would be taken under advisement.

After full consideration, and for the reasons set forth below, the court holds as follows:

Mr. Klein's motions for summary judgment on all claims in the Amended Complaint and the Intervenor Complaint are ALLOWED;

Apex's motion for summary judgment on Williams Land's claim to avoid fraudulent transfers pursuant to 11 U.S.C. § 548 is ALLOWED;

Apex's motion for summary judgment on Williams Land's objection to its claim is DENIED;

Apex's motion for summary judgment on Williams Land's claim for unfair and deceptive trade practices pursuant to chapter 75 of the North Carolina General Statutes is DENIED IN PART and ALLOWED IN PART;

Apex's motion for summary judgment on Williams Land's claim to avoid preferential payments pursuant to 11 U.S.C. § 547 is DENIED and summary judgment will be entered in favor of Williams Land on this claim;

Apex's motion for summary judgment on Williams Land's claim to recover avoided transfers pursuant to 11 U.S.C. § 550 is DENIED and summary judgment will be entered in favor of Williams Land on this claim;

Apex's motion for summary judgment on Williams Land's claim for equitable subordination is DENIED;

CFI's motion for summary judgment seeking a declaratory judgment that any transfers should be avoided for its benefit and not the benefit of the estate is DENIED, and summary judgment will be entered in favor of Williams Land on this claim;

CFI's motion for summary judgment on its claim for conversion against Apex is DENIED, and Apex's motion for summary judgment on CFI's claim for conversion against it is ALLOWED; and

Apex's motion for summary judgment on CFI's claim for tortious interference with contract is ALLOWED.

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PROCEDURAL HISTORY

Williams Land Clearing, Grading, and Timber Logger, LLC (Williams Land) filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code on September 16, 2022. Its liquidating chapter 11 plan was confirmed on October 30, 2023. Williams Land filed the complaint in this adversary proceeding on April 26, 2023, asserting the following claims against Apex and Mr. Klein: Avoidance of Fraudulent Transfers of Receivables pursuant to 11 U.S.C. § 548 (both Defendants); Objection to Claim (Apex); Unfair and Deceptive Trade Practices pursuant to chapter 75 of the North Carolina General Statutes (Apex); in the alternative, Avoidance of Preference Payments pursuant to 11 U.S.C. § 547 (both Defendants); and, Recovery of Avoided Transfers pursuant to 11 U.S.C. § 550 (both Defendants). Apex and Mr. Klein filed a motion to dismiss the complaint pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure, made applicable in this adversary proceeding by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, on June 26, 2023, D.E. 9. On July 21, 2023, Williams Land filed an Amended Complaint, D.E. 14, asserting the same claims as the original complaint and adding a claim for equitable subordination. Apex and Mr. Klein filed a motion to dismiss the Amended Complaint on August 28, 2023, D.E. 24.

***2** The court conducted a hearing on the motion to dismiss the Amended Complaint on December 14, 2023, and denied the motion by written order on February 8, 2024, D.E. 62. Apex and Mr. Klein filed an interlocutory appeal and motion for leave to appeal that order, which was denied by the United States District Court for the Eastern District of North Carolina on August 5, 2024, D.E. 87.

In the interim, on July 7, 2023, CFI filed its Motion to Intervene, D.E. 11, asserting that as the senior secured creditor, it was entitled to payment of any funds recovered in the adversary proceeding, and also advancing claims against Apex and Mr. Klein for conversion of its collateral and tortious interference with contract. Williams Land filed a limited response, D.E. 15, not opposing the Motion to Intervene but reserving the right to oppose CFI's claim for direct payment of any proceeds of the litigation. Apex and Mr. Klein opposed the Motion to Intervene, D.E. 18. After a hearing conducted on September 19, 2023, the court directed CFI to supplement its Motion to Intervene with a proposed pleading, and invited Apex and Mr. Klein to submit a further response thereafter. D.E. 30. CFI supplemented its Motion to Intervene on September 27, 2023, D.E. 34, and Apex and Mr. Klein filed no further response. The court allowed the Motion to Intervene by order dated November 15, 2023, DE. 39.

CFI filed its Intervenor Complaint on November 28, 2023, D.E. 42, and Apex and Mr. Klein filed a motion to dismiss the Intervenor Complaint pursuant to Rules 12(b)(1) and 12(b)(6) on January 23, 2024, D.E. 60. The court denied the motion to dismiss the Intervenor Complaint on March 22, 2024, D.E. 73. In that order, the court found that it has constitutional authority to enter a final order and judgment on all the claims in the Amended Complaint and the Intervenor Complaint. *Id.* On April 4, 2024, the court issued an order directing the parties to proceed with pretrial scheduling and discovery pending the district court's consideration of the motion for leave to appeal the order denying the motion to dismiss the Amended Complaint, D.E. 75.

On December 17, 2024, CFI filed its motion for partial summary judgment on its claim for declaratory judgment that any recovery by Williams Land on its avoidance action should be for the benefit of CFI, and not the estate as a whole, and on its claim for conversion against Apex and Mr. Klein. On December 20, 2024, Apex and Mr. Klein filed motions for summary judgment on all claims in the Amended Complaint and the Intervenor Complaint. After a number of extensions of time to respond were allowed, the motions were fully briefed as of February 7, 2025, and a hearing was conducted on March 18, 2025.

In the briefing, CFI conceded that it did not have evidentiary support for its intervenor claims for tortious interference with contract against either Apex or Mr. Klein. At the hearing, CFI conceded that it also did not have evidentiary support for its claim for conversion against Mr. Klein. CFI further clarified at the hearing that its claim for declaratory judgment is not based on a right to litigation proceeds recovered by Williams Land on its chapter 5 claims against Apex due to CFI's security interest in those proceeds (as it had briefed), but instead that this claim is based entirely on CFI's conversion claim against Apex.[1] Also at the hearing, Williams Land conceded that it had no evidentiary support for any of its claims against Mr. Klein.

JURISDICTION

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***3** This bankruptcy court has jurisdiction over the parties and the subject matter of this proceeding pursuant to 28 U.S.C. § 1334. This is a statutorily core proceeding under 28 U.S.C. § 157(b)(1) that this court is authorized to hear and determine. The United States District Court for the Eastern District of North Carolina has referred this case and this proceeding to this court under 28 U.S.C. § 157(a) by its General Order of Reference entered on August 3, 1984. This proceeding is constitutionally core, and this court may enter final orders herein. [2] Venue is proper pursuant to 28 U.S.C. §§ 1408 and 1409.

STANDARD FOR SUMMARY JUDGMENT

Summary judgment "is proper 'if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.' " *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). In evaluating a summary judgment motion, a court "must consider whether a reasonable jury could find favor in the non-moving party, taking all inferences to be drawn from the underlying facts in the light most favorable to the non-movant." *In re Apex Express Corp.*, 190 F.3d 624, 633 (4th Cir. 1999). The party seeking summary judgment shoulders the initial burden of demonstrating to the court that there is no genuine issue of material fact. *Celotex*, 477 U.S. at 323, 106 S.Ct. 2548. Once the movant has made this threshold demonstration, the non-moving party, to survive the motion for summary judgment, may not rest on the allegations averred in his pleadings. *Id.* at 324, 106 S.Ct. 2548. Rather, the non-moving party must demonstrate the existence of specific, material facts that give rise to a genuine issue. *Id.* Under this standard, the existence of a mere scintilla of evidence in support of the non-movant's position is insufficient to withstand the summary judgment motion. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Likewise, conclusory allegations or denials, without more, are insufficient to preclude granting the summary judgment motion. *Id.* at 248, 106 S.Ct. 2505.

Because CFI, Apex, and Mr. Klein have each filed motions for summary judgment, the burden to come forward to show there is a genuine issue of material fact varies with each motion. Fed. R. Civ. P. 56(c)(1).

UNDISPUTED FACTS

On July 12, 2021, Williams Land entered into an agreement with CFI pursuant to which CFI purchased certain of Williams Land's future accounts receivable, and Williams Land granted CFI a security interest in all of its assets, including its accounts receivable. [3] *See* Claim No. 69-1 and exhibits thereto. On June 22, 2021, CFI filed a UCC-1 financing statement with the North Carolina Secretary of State, thereby perfecting CFI's security interest in Williams Land's assets including its accounts receivable. *Id.* at Ex. 5. CFI filed a proof of claim in the amount of $770,976.84, asserting that its claim is fully secured. Claim No. 69-1.

On March 8, 2022, Williams Land entered into a Standard Merchant Cash Advance Agreement (MCA Agreement) with Apex, pursuant to which Apex purported to purchase $337,500 of Williams Land's future receivables for a cash payment to Williams Land in the amount of $250,000. [4] *See* Summ. J. Ex. 1, D.E. 97-1 at 1. On the same day, Apex filed a UCC-1 financing statement with the North Carolina Secretary of State, perfecting its asserted security interest in all of Williams Land's assets, including accounts receivable. Summ. J. Ex. 2, D.E. 97-1 at 1 at 21. As between CFI and Apex, CFI holds the first priority security interest in Williams Land's receivables. Neither Apex nor its attorney, Mr. Klein, conducted a UCC search to determine whether there were any senior liens against Williams Land's receivables, but Apex instead relied upon the representation of Williams Land contained within the MCA Agreement that no prior lien existed. Accordingly, Apex asserts, and CFI does not dispute, that Apex did not have actual knowledge of the CFI security interest.

***4** Pursuant to the terms of the MCA Agreement, Williams Land made eight weekly payments to Apex in the amount of $18,750 through May 4, 2022. *See* D.E. 14, Ex. C. After Williams Land defaulted on its contractual payments, on May 10, 2022, Apex through its counsel Mr. Klein filed a lawsuit in the Supreme Court of the State of New York to collect $187,500 remaining due under the MCA Agreement, plus $75,000 in contractual costs and $2,500 in default account fees. On July 11, 2022, Williams Land and Apex signed a Stipulation of Settlement in which the parties agreed that Williams Land would pay Apex the sum of $165,000 through monthly payments of $19,285.71, with one payment of $30,000 to be paid by wire transfer or check "on behalf of" Williams Land. Summ. J. Ex. 5, D.E. 97-1 at 44. Williams

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Land defaulted on the terms of the Stipulation of Settlement, after which a judgment was entered in favor of Apex in the amount of $138,577.17. Summ. J. Ex. 7, D.E. 97-1 at 49. The request for entry of judgment acknowledges receipt of $30,159.42 pursuant to the Stipulation of Settlement. Summ. J. Ex. 6, D.E. 97-1 at 48.

Meanwhile, between June 9, 2022, and October 6, 2022, Williams Land became entitled to $133,878.38 in payments from its customer, Domtar Corporation. On May 9, 2022, Mr. Klein, as attorney for Apex, sent a letter to Domtar asserting Apex's lien in the Domtar accounts payable and demanding that Domtar make payments directly to Apex. In response to this letter, Domtar paid Apex (through its attorney) the sums of $48,782.06 on June 9, 2022, and $30,159.42 on July 14, 2022, for a total of $78,941.48.[5] Although CFI asserts that it held the senior secured lien on the Domtar receivable, it does not contend that the Domtar receivable was one that it had purchased under its agreement with Williams Land. CFI also concedes that it had not taken steps to enforce its lien on the Domtar receivable.

In total, Apex received the sum of $228,941.48 from either Williams Land or its customers pursuant to the MCA Agreement. Apex filed a proof of claim asserting a fully secured balance due in the amount of $120,652.07. Claim No. 64-1. The attachments supporting the proof of claim include the MCA Agreement, the guarantee of performance executed by Williams Land's principal, and the UCC Financing Statement, but not the judgment or other documents related to the collection action. *See id.*

CONTENTIONS

Based on these facts, Williams Land contends that the MCA Agreement is not a true sale, but instead is a usurious loan that is void under New York law. If the agreement is void, Williams Land contends that as a matter of law it received no reasonably equivalent value for the payments made to Apex, rendering those payments avoidable under § 548 of the Bankruptcy Code. Williams Land further contends that the $30,159.42 payment Apex received from Domtar is an avoidable preference under § 547 of the Bankruptcy Code. Williams Land's claim for unfair and deceptive trade practices is also grounded in part on its claim that the MCA Agreement is, in reality, a usurious loan. Apex, on the other hand, contends that the MCA Agreement is a true sale and that all of Williams Land's claims fail as a matter of law because they are dependent upon the recharacterization of the agreement as a loan.

Also relying on the undisputed facts, CFI contends Apex converted its collateral by directing Domtar to pay to Apex monies owed to Williams Land in contravention of CFI's senior lien on receivables. Apex, on the other hand, contends that the undisputed facts defeat any claim for conversion; specifically, that it did not know that CFI asserted a security interest in the Domtar receivable and that CFI made no demand for the return of its collateral.

DISCUSSION

APEX'S MOTION FOR SUMMARY JUDGMENT ON WILLIAMS LAND'S CLAIMS

As noted above, Williams Land's Amended Complaint asserts claims that require a preliminary determination of whether the MCA Agreement is a sale or loan under New York law, which applies by virtue of a choice of law provision within the agreement.[6] According to Williams Land, if the MCA Agreement is a loan, it is criminally usurious under New York law and, by operation of statute, void. Williams Land's claims for avoidable transfers and unfair and deceptive trade practices and its objection to Apex's claim are dependent on and arise from an ultimate conclusion that the MCA Agreement is void.

***5** Apex, on the other hand, contends that usury laws are inapplicable because the MCA Agreement is a true sale and not a loan. *See LG Funding, LLC v. United Senior Props. of Olathe, LLC*, 181 A.D.3d 664, 122 N.Y.S.3d 309, 312 (2020) ("The rudimentary element of usury is the existence of a loan or forbearance of money, and where there is no loan, there can be no usury, however unconscionable the contract may be."). For the same reason, Apex maintains that the payments received from Domtar are not avoidable preferences or constructively fraudulent transfers as a matter of law because Williams Land had no interest in the property transferred by Domtar – the account was already owned by Apex. Apex also contends that even if the court construes the agreement to be a loan, New York's criminal usury statutes may not be used affirmatively by a plaintiff to void an agreement, but may only be used defensively where a lender seeks to collect on the loan.

Accordingly, the threshold issues for the court before considering the delineated claims are whether the MCA

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Agreement is a loan or a sale, and, if it is a loan, whether and how the New York usury laws apply.

The Nature of the MCA Agreement

While the determination of whether an agreement is a sale or is a loan is typically a factually-intensive one, *see Cap Call, LLC v. Foster (In re Shoot the Moon, LLC)*, 635 B.R. 797, 820 (Bankr. D. Mont. 2021), the parties here provided no forecast of evidence as to the course of dealing between the parties other than the MCA Agreement itself and the payment history. Thus, the court must construe the agreement based solely on its language to determine whether it constitutes a loan or a sale under New York law.

The MCA Agreement does contain language designed to reflect the intent of the parties for the transaction to be a sale of receivables. For example, the summary of the transaction lists a "purchase price" and "receivables purchased amount." *See* Summ. J. Ex. 1, D.E. 97-1 at 1. Paragraph 1 of the Terms and Conditions is entitled "Sale of Future Receipts" and provides that Williams Land sells, assigns, and transfers to Apex "all of [Williams Land]'s future accounts ... from contract rights, and other obligations arising from or relating to the payment of monies" from Williams Land's customers for payment for Williams Land's services. *Id.* Paragraph 15 of the Terms and Conditions provides that the purchase price is "in exchange for the Receivables Purchased Amount" and "is not intended to be, nor shall it be construed as a loan[.]" *Id.* at 4.

Under New York law, however, the question of whether an agreement constitutes a loan is governed by its substance, not its form. *Fleetwood Servs., LLC v. Richmond Cap. Grp. LLC*, No. 22-1885-CV, 2023 WL 3882697, at *2 (2d Cir. June 8, 2023); *see also Adar Bays, LLC v. GeneSYS ID, Inc.*, 37 N.Y.3d 320, 179 N.E.3d 612, 621–22 (2021). Courts generally evaluate three factors to determine whether a transaction is a loan under New York law: (1) whether there is a reconciliation provision in the agreement; (2) whether the agreement has a finite term; and (3) whether there is any recourse should the merchant declare bankruptcy. *LG Funding, LLC*, 122 N.Y.S.3d at 312. These considerations take into account the totality of the circumstances, and "a court need not find the presence of all three factors in concluding that a transaction is a loan." *Fleetwood Servs., LLC v. Ram Cap. Funding, LLC*, No. 20-CV-5120 (LJL), 2022 WL 1997207, at *9 (S.D.N.Y. June 6, 2022).

Other courts consider additional factors that inform the analysis of the primary three factors. For example, the bankruptcy court in *Shoot the Moon* identified these considerations:

(1) whether the buyer has a right of recourse against the seller;

(2) whether the seller continues to service the accounts and commingles receipts with its operating funds;

***6** (3) whether there was an independent investigation by the buyer of the account debtor;

(4) whether the seller has a right to excess collections;

(5) whether the seller retains an option to repurchase accounts;

(6) whether the buyer can unilaterally alter the pricing terms;

(7) whether the seller has the absolute power to alter or compromise the terms of the underlying asset; and

(8) the language of the agreement and the conduct of the parties.

635 B.R. at 813. While the *Shoot the Moon* court was applying Montana law, the evaluative factors appear to overlap.

At its core, the analysis looks to which party bears the risk of non-payment on the accounts that the "buyer" purports to purchase. *See id.* at 819. ("[A] consideration that overlays and unites the factors is how the parties allocated *risk*."). Professor Kara Bruce of the University of North Carolina School of Law has written extensively on the risk allocation issue, and, in collecting recent cases, has the following observations:

> When weighing whether a transaction styled as a sale is a true sale, the core of the inquiry is to assess which party —buyer or seller—holds the risks, benefits, obligations, and other attributes we typically associate with ownership. When an item of property is sold, the buyer takes on the upside and downside risk of that item's future performance. With a secured loan, in contrast, the lender's entitlement to payment is not dependent on the performance or value of the underlying collateral. Further, in a typical sale transaction, the buyer controls the asset and must take on the obligations associated with ownership, such as servicing accounts.
>
> ***

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> It is thus important to approach a true-sale analysis by remembering that "the substance of MCA transactions may belie the contracts' careful descriptions of risk allocation." Courts must look beyond the contract's window-dressing to evaluate the true commercial nature of these transactions. The ultimate question, again, is whether the buyer has acquired the risks and rewards of the purchased receivables (in line with a true sale) or has instead contracted for a repayment that does not vary based on the performance of the assets (in line with a secured loan).

Kara J. Bruce, Revenue-Based Finance in Bankruptcy and Beyond, 45 No. 4 Bankruptcy Law Letter NL 1 at 6 (April 2025) (citations omitted). The court finds her discussion to be persuasive, and with these concepts in mind, has considered the three factors as supplemented by the considerations identified in *Shoot the Moon* to evaluate the allocation of risk. Because the court finds the "recourse in bankruptcy" factor to be the best indicator that the risk of nonpayment is not truly shifted to Apex through the MCA Agreement, the bulk of the following discussion is devoted to that factor.

Factors I and II: Reconciliation and Finite Term

While there is a reconciliation provision in the MCA Agreement, Summ. J. Ex. 1, D.E. 97-1 at 2, ¶ 4, there are no facts before the court to establish whether there is a true opportunity to adjust payments. Further, invocation of the reconciliation provision does not change the amount ultimately owed, but only the amount of the payment to be made in a particular week. Similarly, while there is no stated "finite" term, the term is easily calculated based on simple math – weekly payments of $18,750 until the amount of $337,500 is received, *see id.* at 1, which results in a term of 18 weeks. Absent invocation of the reconciliation provision, the term is readily discernable. *See, e.g., AKF, Inc. v. Haven Transp. Bus. Sols., Inc.*, No. 1:22-cv-269 (MAD/CFH), 2024 WL 2941746, at *7 (N.D.N.Y. June 11, 2024) and cases cited therein. Without additional context including course of dealing, however, the court finds that neither of these factors is dispositive of the characterization as either a sale or a loan.

Factor III: Recourse in Bankruptcy

***7** Many courts find "recourse in bankruptcy" where the agreement provides that default remedies are triggered by the merchant's bankruptcy, thereby accelerating any unpaid purchased amount. *See, e.g., Fleetwood Servs.*, 2022 WL 1997207, at *9; *LG Funding, LLC*, 122 N.Y.S.3d at 313 . Apex denies that it has recourse in Williams Land's bankruptcy because bankruptcy is not a delineated event of default within the MCA Agreement. It is true that bankruptcy itself does not trigger a default under the Apex MCA Agreement, but that does not end the inquiry, because a number of other defaults occur by necessity when a bankruptcy is filed (for example, changing the depository account into which receivables are paid by the opening of a DIP account), which, by the terms of the MCA Agreement, do result in acceleration of all amounts due. Summ. J. Ex. 1, D.E. 97-1 at 4-5, ¶ 17.

More importantly, in this court's view, the often-used "bankruptcy as an event of default" analysis conflates the question of whether Apex's remedies are triggered by a bankruptcy filing with the question of whether Apex has the ability to collect – *i.e.*, *recourse* – notwithstanding Williams Land's bankruptcy. To phrase it differently, the question is whether Apex has a means to recover payment if Williams Land stops operating and no longer generates the future receivables that Apex purports to have purchased. If Apex truly bore the risk and had no recourse in bankruptcy, it would have no ability to recover once the payment stream to Williams Land stopped.

Here, Apex's own actions suggest that it believes it has recourse against both Williams Land and its guarantor: Apex filed a secured proof of claim in the Williams Land chapter 11 case for the full amount it contends is due, including fees and costs, Claim No. 64-1. Courts consider the filing of a proof of claim to be relevant to this factor. *See, e.g., JCS Hospitality LLC v. LG Funding LLC (In re JCS Hospitality)*, Adv. Pro. No. 24-00034-5-PWM (Bankr. E.D.N.C. Sept. 16, 2004) (Slip Op., D.E. 18 at 8) (finding that the filing of a secured proof of claim indicates that an MCA lender believes it has recourse to recover defaulted amounts in the bankruptcy case); *AKF*, 2024 WL 2941746, at *7 ("Despite the[ ] assertions in the Agreement of being left without recourse in the event of a bankruptcy, it seems virtually certain that FundKite would be able to file a claim in any bankruptcy proceeding, as a secured creditor, for any remainder of the [amount] owed."). Through its proof of claim, Apex asserts that it has a blanket lien on assets (which is a separate question from whether the lien is supported by collateral), and that it has a claim for the total balance due (which is a separate question from whether there will be a distribution on the claim). As evidence of additional means of collection, Apex also pursued recovery against

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the principal's guaranty through its collection litigation. *See* Summ. J. Exs. 3-7, D.E. 97-1 at 21-51.

The blanket lien on assets, the filed proof of claim, and the guaranty allow Apex, in some way, to collect on its debt from Williams Land even if the debtor stops generating receivables. Those remedies are evidence of recourse in the event of bankruptcy. With no recourse, there would be no source of payment once purchased future accounts were no longer being generated. Instead, Apex has multiple alternate methods to recover on its claim even where there are no new receivables, making it readily apparent to the court that Apex has burdened itself with very little risk through the MCA Agreement, if Apex has taken on any risk at all. Because the risk of nonpayment by a customer is not shifted to Apex, the court concludes as a matter of law that the MCA Agreement is a loan, and not a true sale.

Other Provisions Informing the Analysis

***8** While the court finds that Apex's recourse in bankruptcy is sufficient to conclude that the risk of loss remains with Williams Land under the MCA Agreement and that the agreement is a loan, the MCA Agreement also contains additional indicia (as identified in *Shoot the Moon*) that the risk of loss remains with Williams Land. Specifically, Apex's lien extends beyond the assets that it purported to purchase to also include all accounts and inventory and all proceeds; Apex obtained (and pursued) a personal guaranty of Williams Land's principal; and the default provisions, found at Summ. J. Ex. 1, D.E. 97-1 at 4-5, ¶ 17, include "aggressive loan-like remedies that [spring] into effect if the merchant default[s]," *Haymount Urgent Care PC v. GoFund Advance, LLC,* 609 F. Supp. 3d 237, 249 (S.D.N.Y. 2022), such as acceleration of amounts due, an assignment of lease, power of attorney, and additional costs of collection and attorney's fees. In addition, there is no evidence that Apex took over servicing the accounts or that Williams Land segregated the funds, and there is no evidence that Apex investigated the customers to determine the collectability of the purchased accounts.

Indeed, to the last point, Apex did not purport to purchase specific accounts. Instead, its agreement purports to purchase "all" accounts "until the amount [of $337,500] has been delivered" by Williams Land to Apex, with 13% of all receivables to be delivered weekly until the amount is paid in full. In this way, Apex is purchasing whichever accounts pay first – again, taking only the minor risk that *none* of Williams Land's customers will pay, rather than taking the risk that specific accounts will not be paid. This is consistent with a scenario described by Professor Bruce:

> The funder takes an interest in an unspecified share of receivables, which means, quite simply, the funder always gets the good ones. The funder draws its payment from whatever money the debtor has available, which include accounts that have been paid, funds from other MCA companies, and any other monies that happen to be in the debtor's deposit account. In this way, the MCA funder's recovery is in no way tied to the performance of any individual account. If 20% of the accounts go uncollected, or 50%, or 70%, the funder's ultimate recovery remains payable from the first dollars received by the merchant. A reconciliation of the MCA, if available, could adjust the *timeframe* for repayment, but would not alter the principal amount owing.

Bruce, Revenue-Based, 45 No. 4 Bankruptcy Law Letter NL 1 at 7 (citations omitted). Based on this analysis, and considering the MCA Agreement as a whole, the court finds that Apex's many sources of recourse and other indicia of its lack of risk lead to only one conclusion: that the MCA Agreement is a loan, and not a sale, as a matter of law.

The MCA Agreement is Void as Usurious under New York Law

Having determined that the MCA Agreement is a loan and not a true sale, the court turns to whether New York's usury statutes apply and, if so, the consequences of those statutes. Under New York law, an interest rate of more than 25% per annum is usurious. Here, a calculation of the effective rate of interest based on the funds advanced and the contractual term of repayment of 18 weeks results in an annual simple interest rate of 101.1%. D.E. 14 at ¶ 46. Accordingly, the terms of the MCA Agreement bring it within the New York usury statutes.

New York law also specifies the consequences of usury. Pursuant to New York Penal Law § 190.40, "[a] person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period." N.Y. Penal Law § 190.40. Separately, New York's General Obligations Law § 5-511(1) provides for the voidability of those contracts. *Adar Bays,* 157 N.Y.S.3d 800, 179 N.E.3d at 621. Construing both statutes, New York's highest court has held that, where a loan is found to be criminally usurious, the proper remedy is to render the agreement void *ab initio*. *Id.,* 157 N.Y.S.3d 800, 179 N.E.3d at 615-20 (providing a detailed discussion of the history of New York's criminal usury laws and the extension of those laws to voiding usurious contracts involving corporate borrowers).

***9** Apex maintains that Williams Land may not bring an affirmative action for criminal usury, and as a general matter, this court agrees. Likewise, New York courts have held that the general prohibition on corporations asserting (noncriminal) usury as a defense should also be read to prohibit corporations from bringing affirmative claims alleging criminal usury. *Haymount Urgent Care PC v. GoFund Advance, LLC*, 635 F. Supp. 3d 238, 242–43 (S.D.N.Y. 2022) (citing *Intima-Eighteen, Inc. v. A.H. Schreiber Co.*, 568 N.Y.S.2d 802, 172 A.D. 2d 456, 457–58 (N.Y. App. Div. 1991)). However, a corporation may assert *criminal* usury as a defense, and use of that defense is broad; General Obligations Law § 5-521(3) provides that corporations may interpose the defense of criminal usury in "*any* action." *Haymount Urgent Care PC*, 635 F. Supp. 3d at 244 (emphasis in original).

"[A]ssertion of criminal usury, to the extent the Debtor utilizes such assertion as a defense to repayment of Defendant's claim, is procedurally proper under applicable New York law." *In re GMI Grp., Inc.*, 606 B.R. 467, 483 (Bankr. N.D. Ga. 2019). Here, Apex filed a proof of claim, and the Amended Complaint includes an objection to claim as part of the relief sought. It is this important difference that distinguishes this case from this court's decision in *Azalea Gyn., P.A. v. Mint Funding Inc. (In re Azalea Gyn., P.A.)*, Adv. Pro. No. 24-00107-5-PWM (Bankr. E.D.N.C. Dec. 6, 2024) (Slip Op., D.E. 10 at 8), in which the plaintiff/debtor could not assert usury laws as an affirmative claim against an MCA creditor that had filed no claim in the bankruptcy case.

Here, using an annual simple interest calculation, the rate of interest under the MCA Agreement is 101.1%, exceeding the 25% threshold prescribed in New York Penal Law § 190.40. Pursuant to applicable New York statutory and case law, the MCA Agreement is criminally usurious. By application of General Obligations Law § 5-511(1), it is also void *ab initio*. The effect of this finding, however, must be assessed with respect to the specific claims for relief in the Amended Complaint, to which the court now turns. [7]

First Claim for Relief: Avoidance of Fraudulent Transfers under 11 U.S.C. § 548

As relevant here, § 548 of the Bankruptcy Code provides for the avoidance of constructively fraudulent transfers of an interest of the debtor in property where the debtor received less than reasonably equivalent value in exchange for the transfer and the debtor was insolvent. Williams Land seeks to avoid all of the payments made to Apex by it or by Domtar, contending that because the MCA Agreement is void, Williams Land did not receive reasonably equivalent value for the payments. Apex, on the other hand, contends that the claim fails as a matter of law because no interest of the debtor was transferred: because the MCA Agreement is a sale and not a loan, Williams Land did not have an interest in the funds paid to Apex.

The court turns first to Apex's argument. Because the court has found as a matter of law that the MCA Agreement is a loan, Williams Land did have an interest in the funds transferred both by Williams Land and by Domtar, and Apex's "no transferred interest" argument in defense of the § 548 claim necessarily fails.

However, although the court has also found the MCA Agreement to be void under New York law, this determination alone does not answer the question of whether reasonably equivalent value was received by Williams Land for the payments it or Domtar made to Apex. Reasonably equivalent value is based on the actual value given and received, not necessarily the value(s) contemplated by the contract. There is no dispute that Apex did advance funds in the amount of $245,000 to Williams Land, and that advance constitutes value. It is also undisputed that the payments made by or on behalf of Williams Land *to* Apex total less than the $245,000 advanced to Williams Land *by* Apex. [8] Accordingly, the court concludes as a matter of law that Williams Land did receive reasonably equivalent value for the funds transferred by or

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on behalf of Williams Land. Apex's motion for summary judgment on this claim will be ALLOWED.

Fifth and Sixth Claims for Relief: Avoidance of Preference under 11 U.S.C. § 547 and Recovery of Avoided Transfers under 11 U.S.C. § 550

***10** Pursuant to § 547 of the Bankruptcy Code, a debtor in possession may avoid a transfer made within 90 days of the petition date on account of an antecedent debt that enables a creditor to receive more than it would have received in a chapter 7 case had the transfer not been made. It is undisputed that on or about July 14, 2022, within the 90 days preceding the filing of Williams Land's bankruptcy petition, Apex received the amount of $30,159.42 from Domtar to be applied to the Williams Land obligation. Based on its assertion that the MCA Agreement is a true sale, Apex disputes both that the funds were property of Williams Land and that there was an antecedent debt.

The court has concluded that the MCA Agreement was a loan and not a sale, effectively determining the elements of antecedent debt and transfer of an interest of the debtor in property as a matter of law. Because Apex is under or unsecured, that payment allowed Apex to receive more than it would have received in a chapter 7 liquidation. Consequently, the elements of a preference have been established through the undisputed facts and this court's prior conclusions of law, and summary judgment is appropriate unless a defense under § 547(c) applies.

As noted above, Williams Land and Apex entered a Stipulation of Settlement on July 11, 2022, which contemplated a payment of $30,000 to be made to Apex "on behalf of" Williams Land. Summary Judgment Ex. 5, D.E. 97-1 at 44. There is no dispute that the $30,159.42 payment made by Domtar to Apex is the payment contemplated in the Stipulation of Settlement. Apex contends that because the parties agreed this payment would be made, their agreement is sufficient to characterize the payment as having been made in the ordinary course of business under § 547(c)(2).

To establish ordinary course for purposes of § 547(c)(2), Apex is required to show that the transfer was "made in the ordinary course of business or financial affairs of the debtor and the transferee; or made according to ordinary business terms." 11 U.S.C. § 547(c)(2). The record before the court shows that the ordinary course of business between Williams Land and Apex consisted of weekly payments in the amount of $18,750.[9] In light of that established pattern, the payment of $30,159.42 was a unique, one-time event made after collection litigation was pursued, the parties reached a settlement, and Apex sent a UCC demand letter to Domtar. This was well outside the ordinary course of dealings between Williams Land and Apex. In addition, there is nothing before the court to establish that this payment could fall within ordinary business terms in the industry.

Because there are no material issues of disputed fact, the court concludes as a matter of law that the transfer made by Domtar on July 11, 2022 in the amount of $30,159.42 is avoidable under § 547. The motion for summary judgment by Apex on this claim will be DENIED, and summary judgment will be entered in favor of Williams Land. Similarly, Williams Land is entitled to recover the avoided transfer in the amount of $30,159.42 for the benefit of the estate pursuant to § 550. The motion for summary judgment by Apex on the § 550 claim will be DENIED, and summary judgment will be entered in favor of Williams Land.

Fourth Claim for Relief: Unfair and Deceptive Trade Practices

***11** The Amended Complaint asserts that Apex holds itself out as an alternative funding source that personalizes solutions to a specific business's individual needs, preying on small, insolvent businesses and issuing disguised loans that are criminally usurious. D.E. 14 at 10-11, ¶¶ 78-82. The Amended Complaint also asserts that Apex's lending practices were unethical and predatory, and further that Apex falsely recorded payments made on or behalf of Williams Land, artificially inflating the amount still owed by Williams Land and asserted in the proof of claim. *Id.* at 11, ¶¶ 88-90. Williams Land contends that these are unfair and deceptive acts in or affecting commerce that entitle it to treble damages and attorney's fees[10] under chapter 75 of the North Carolina General Statutes, the Unfair or Deceptive Trade Practices Act (UDTPA). That act prohibits "unfair or deceptive acts or practices in or affecting commerce," N.C. Gen. Stat. § 75-1.1(a), with "commerce" defined to include "all business activities, however denominated, but does not include professional services rendered by a member of a learned profession." N.C. Gen. Stat. § 75-1.1(b). Case law informs that the factfinder (typically a jury) finds the "facts," then the court decides as a matter of law whether the facts found by the jury satisfy the conduct standard under the statute. *See, e.g.*, *Hardy v. Toler*, 288 N.C. 303, 310, 218 S.E.2d 342 (1975) (establishing these roles for the jury and

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for the court in § 75-1.1 cases). In the summary judgment context, the court must consider whether the undisputed facts constitute unfair or deceptive acts in or affecting commerce.

In its motion for summary judgment, Apex makes two legal arguments. The first is that the filing of an allegedly incorrect proof of claim is not an act in or affecting commerce, rendering the UDTPA inapplicable. Apex is correct that the act of filing a proof of claim is not "in or affecting commerce." *Winter v. Suddenlink (In re Winter)*, Adv. Pro. No. 15-00013-5-DMW, 2015 WL 5063953, at *3, 2015 Bankr. LEXIS 2839, at *8–9 (Bankr. E.D.N.C. Aug. 26, 2015). Accordingly, the court determines as a matter of law that Williams Land cannot prevail on its UDTPA claim for the "act" of filing an inaccurate proof of claim. However, the allegation that the proof of claim itself is unfair or deceptive is only one of the bases on which Williams Land seeks to recover under the UDTPA, so this holding does not resolve the entire claim for relief.

Apex's second legal argument is that any claim related to the terms of the MCA Agreement was released in the Stipulation of Settlement. The court previously considered and rejected this contention. In its order denying the motion to dismiss the amended complaint, the court noted that

> under New York law as cited by WLC, a 'settlement agreement purporting to compromise and release a borrower's usury claim is void and unenforceable if the original usurious obligation transcends into the parties' subsequent agreement. *Adar Bays, LLC v. 5Barz Int'l, Inc.* [2018 WL 3962831, at *7], 2018 U.S. Dist. LEXIS 139843, at *16 (S.D.N.Y. August 16, 2018) (citation omitted). Accordingly, the claim objection and other claims based on the allegation of usury have not been waived.

D.E. 62 at 15-16. The Stipulation of Settlement provided a compromised repayment schedule for Williams Land to satisfy the obligation established through the MCA Agreement, and thus the original usurious obligation transcended into the Stipulation of Settlement. The crux of the UDTPA claim is that the MCA Agreement was marketed as an individualized solution to Williams Land's financing needs, purported to be a sale, and was, in fact, a usurious loan. Thus, the UDTPA claim is largely based on the allegation of usury, and the court concludes that the UDTPA claim was not released by the Stipulation of Settlement.

***12** On substantive review of that claim, Apex did not present the court with a threshold demonstration that there is no genuine issue of material fact on this claim sufficient to shift the burden to Williams Land. Instead, the only "facts" provided by Apex are a self-serving statement that it does not prey on small and insolvent businesses, Decl. of Apex Funding Source, LLC, Summary Judgment Ex. 8, D.E. 97-2 at ¶ 6, and its Declaration and discovery responses that address the alleged failure to properly apply all payments received from Domtar to the Williams Land account. *See, e.g.* Decl. of Apex Funding Source, LLC, Summary Judgment Ex. 8, D.E. 97-2 at ¶¶ 66, 67, 71, 73; Apex Response to CFI's Interrogatories, Summary Judgment Ex. 10, D.E. 97-4 at 14-15, Int. No. 7. There is no evidence in the record (undisputed or otherwise) as to how Williams Land came to enter the MCA Agreement with Apex or what representations were made and by whom at the time the agreement was entered, other than the representations contained in the agreement itself.

Accordingly, the court finds that Williams Land cannot prevail on its UDTPA claim for the "act" of filing an inaccurate proof of claim and Apex's motion summary judgment will be ALLOWED IN PART. With respect to all other allegations of unfair or deceptive acts or practices, Apex has failed to demonstrate that there are no issues of material fact that would require judgment in its favor as a matter of law on the UDTPA claim, and Apex's motion for summary judgment is therefore DENIED IN PART. [11]

Second Claim for Relief: Objection to Claim

Apex moved for summary judgment on all claims in the Amended Complaint, but the motion does not specifically address the objection to claim other than to the extent that a finding in favor of Apex with respect to the characterization of the MCA Agreement would necessarily require a finding in its favor on the objection to claim. Based on the court's conclusion that the MCA Agreement is void as criminally usurious as well as its conclusion that Apex received an avoidable preference, the final amount of Apex's claim in the case will have to be determined at trial. Accordingly, Apex's motion for summary judgment on the objection to claim is DENIED.

Third Claim for Relief: Equitable Subordination

Just as the motion for summary judgment does not specifically address the objection to claim, it does not specifically address the claim for equitable subordination. Accordingly, the court finds that Apex has not shown that

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there are no disputed issues of material fact, and summary judgment is DENIED.

MOTIONS FOR SUMMARY JUDGMENT ON CFI'S CLAIMS IN THE INTERVENOR COMPLAINT

CFI's Claim for Declaratory Judgment that Transfers Recovered by Williams Land Remain Subject to CFI's Lien

CFI's Intervenor Complaint and brief in support of summary judgment sought a declaratory judgment that, because it held a senior lien on the funds transferred to Apex, any payments avoided by Williams Land remain subject to its lien and should be avoided for its benefit, not the benefit of the estate. Specifically, CFI maintained in its Intervenor Complaint and in its brief that Williams Land transferred property that was subject to CFI's properly-perfected security interest, and that because avoidance of the transfers does not operate to remove a properly perfected lien in the transferred funds, the funds remained subject to CFI's lien. *See* D.E. 92 at 12-13. Therefore, CFI maintained, its rights to the transferred funds are senior to the rights of Williams Land. *Id.*

At the hearing, CFI conceded that it did not have a perfected lien on the *proceeds* of accounts receivable; put another way, it did not have a lien on funds once an account was collected and in the hands of Williams Land. This would include any funds paid directly to Apex by Williams Land as well as the funds paid by Domtar to Apex. Thus, CFI concedes that it has no lien on any funds Williams Land might recover under the debtor's chapter 5 avoidance powers. Because the court has already concluded that Apex is entitled to summary judgment on the fraudulent transfer claims, there will be no recovery by Williams Land of any funds transferred directly by Williams Land to Apex, rendering this argument largely academic unless CFI has any claim to the proceeds of Williams Land's avoided preference.

***13** It is generally understood that recoveries of a postpetition avoidance action constitute postpetition property of the estate and are not subject to prepetition liens, "even if the recovered funds are traceable to prepetition collateral and the creditors would have an independent right of recovery against the avoidance defendants." *Hutson v. First-Citizens Bank & Tr. Co. (In re Nat'l Gas Distribs., LLC)*, Nos. 06-00166-8-ATS, S-06-00031-8-AP, 2007 Bankr. LEXIS 4703 at *22 (Bankr. E.D.N.C. July 24, 2007); *see also* 5 Collier on Bankruptcy P 552.02 (16th 2025) ("On the whole, therefore, the more persuasively reasoned opinions do not permit secured creditors to share in recoveries obtained by bankruptcy trustees or estate representatives pursuant to the avoiding powers, even where such creditors may have independent, traceable rights to those funds."). CFI conceded this at the hearing and stated that it does not contend it has a lien on any avoidance recovery.

Instead, CFI revised its argument to contend that its entitlement to the proceeds of this litigation is limited to the payments received by Apex from Domtar – a right that arises because "as soon as that receivable was paid out by Domtar to Apex, it gave [CFI] a cognizable cause of action against Apex for conversion." March 18, 2025 Hearing audio at 42:40. At the same time, CFI argued that Apex could be subject to double liability: first to the debtor for avoided payments, and secondly to CFI for converted funds. From this, it appears to the court that CFI has recognized that it has no claim to any proceeds Williams Land may recover pursuant to Williams Land's avoidance actions. Instead, CFI simply has direct claims against Apex that involve the same sums and that may or may not be impacted by Williams Land's independent chapter 5 actions. Accordingly, the court denies CFI's motion for summary judgment on its declaratory judgment claim, and will enter summary judgment in favor of Williams Land on this claim.

Cross-motions on CFI's Claim for Conversion

CFI contends that Apex converted CFI's collateral when Apex received funds from Domtar pursuant to the UCC letter Apex sent demanding that Domtar remit moneys owed to Williams Land to Apex. To be clear, CFI does not contend that it owned the Domtar receivable pursuant to its factoring arrangement, but only that it held a higher priority security interest in the Domtar receivable. Apex, on the other hand, maintains that CFI has not satisfied any of the required elements of conversion under New York law, all of which must be shown: specifically, CFI has not demonstrated that it had a present right to possession of the Domtar payments, that CFI made a demand for return of the collateral, that Apex had actual knowledge of CFI's interest, or that the funds were designated for a specific purpose and used for an unauthorized purpose. *See* D.E. 101 at 7-10.

The parties agree that New York law governs this claim. *See* D.E. 92 at 6-8; D.E 101 at 5-6. Under New York law, conversion is "any unauthorized exercise of dominion or control over property by one who is not the owner of the property which interferes with and is in defiance of a superior possessory right of another in the property." *Meese v. Miller,*

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79 A.D.2d 237, 436 N.Y.S.2d 496, 500 (4th Dep't 1981). New York courts have recognized a cognizable claim for conversion by a secured creditor against another secured creditor. *In re A.N. Frieda Diamonds, Inc.*, 616 B.R. 295, 317 (Bankr. S.D.N.Y. 2020), *aff'd*, 633 B.R. 190 (S.D.N.Y. 2021) ("The disposition by a junior creditor of collateral in which another creditor has a valid and perfected lien constitutes conversion of the senior creditor's interests in the collateral."); *HSCM Bermuda Fund Ltd. v. Newco Cap. Grp. VI LLC*, 619 F. Supp. 3d 434, 442 (S.D.N.Y. 2022) (plaintiffs plausibly stated a claim for conversion by alleging that defendant interfered with their property interest in borrower's assets by asking borrower's vendors to pay defendant in derogation of plaintiffs' rights); *Bank of India v. Weg & Myers, P.C.*, 257 A.D.2d 183, 185–86, 691 N.Y.S.2d 439 (N.Y. App. Div. 1999) (bank awarded summary judgment against law firm for conversion where proceeds of collateral insurance policy were applied to legal fees and paid to debtor despite knowledge of bank's interest in and entitlement to proceeds).

***14** Apex contends that it had no knowledge of CFI's senior security interest, and CFI agrees that the undisputed facts demonstrate that Apex did not search the public record to discover CFI's perfected lien. However, Apex is deemed to have constructive knowledge of what is on the public record. *See* *A.N. Frieda Diamonds,* 616 B.R. at 310–13 (citing additional authorities). In *A.N. Frieda Diamonds*, the defendants maintained that they were not actually aware of the creditor bank's perfected security interests; the court acknowledged this, but held that "even if that had been the case it was only because, by their own admission, they never bothered to check to see if a UCC financing statement was on file. ... [T]he filed financing statement is deemed under New York law to constitute valid notice to other creditors." *Id.* at 313. " 'Notice filings' would be meaningless if a creditor ... could defeat the perfected rights of a senior creditor just by refusing to investigate and thereby deliberately avoiding actual knowledge of a senior secured claim that is readily ascertainable." *Id.* at 314. The same is true here.

Having found that Apex took possession of the Domtar payments with constructive knowledge of CFI's senior lien on all accounts, the court turns to whether CFI had a present right to possession of the funds at issue. In the cases cited above in which a New York court found conversion of a senior lender's collateral by a junior lienholder, the court either noted as undisputed or found as a fact that the debtor was in default to the senior secured creditor, giving that creditor a right to possession of the collateral. In this case, there is no evidence that CFI had declared a default, and CFI admitted at the hearing that it had taken no action to assert its right to the accounts. Accordingly, there is no evidence that CFI had a present right to possession of the Domtar accounts at the time that those funds were paid to Apex.

It is also undisputed that CFI made no demand for return of the collateral. Where the original possession of another's property is lawful, "a conversion does not occur until the defendant refuses to return the property after demand or until he sooner disposes of the property." *Schwartz v. Cap. Liquidators, Inc.*, 984 F.2d 53, 54 (2d Cir. 1993) (quoting *Johnson v. Gumer*, 94 A.D.2d 955, 464 N.Y.S.2d 318, 319 (4th Dep't 1983)); *see also* *Schloss v. Danka Bus. Sys. PLC*, No. 99 CIV. 0817 (DC), 2000 WL 282791, at *7 (S.D.N.Y. Mar. 16, 2000), *aff'd*, 234 F.3d 1263 (2d Cir. 2000). There is nothing inherently unlawful about a junior lienholder taking possession of its collateral; a junior lienholder would simply do so subject to a senior lienholder's rights. For conversion to occur where possession is lawful, Apex either had to refuse to return the funds after demand by CFI for those funds, or dispose of the funds without notice to CFI. CFI presented no evidence to establish that demand was made, and slim argument that this element is not required. Indeed, the cases cited above for the proposition that the senior lender had to have declared a default also included a clear demand and refusal to return the collateral or, in the case of *A.N. Frieda Diamonds*, disposal of the tangible collateral.

Finally, to establish a claim for conversion where the property in question is money, the funds must have designated for a specific purpose and used for an unauthorized purpose. In *Manufacturers Hanover Tr. Co. v. Chem. Bank*, 160 A.D.2d 113, 559 N.Y.S.2d 704 (1990), the plaintiff wired funds to the defendant to be credited to a specific account; when the defendant applied the funds to a different account and refused a demand for their return, it was liable for conversion. "An action will lie for the conversion of money where there is a specific, identifiable fund and an obligation to return or otherwise treat in a particular manner the specific fund in question." *Id.* at 113, 559 N.Y.S.2d 704; *see also* *E. Schodack Fire Co. v. Milkewicz*, 140 A.D.3d 1255, 1256, 34 N.Y.S.3d 640 (2016) (holding that "[w]here the property alleged to have been converted is money, 'it must be specifically identifiable and be subject to an obligation to be returned or to be otherwise treated in a particular manner' ") (quoting *Salatino v. Salatino*, 64 A.D.3d 923, 925, 881 N.Y.S.2d 721 (2009) (internal quotation marks omitted)). Here, there is no evidence that the Domtar funds were designated for a specific

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purpose and used for an unauthorized purpose. The Domtar account had not been purchased by CFI, it was simply one of many accounts on which CFI held a lien that otherwise was used for operation of Williams Land's business. CFI admitted at the hearing that if Domtar had paid Williams Land on its account and then Williams Land, in turn, paid Apex, CFI would have no claim against Apex. It is difficult to see how CFI should be in a *better* position as a result of the direct payment from Domtar to Apex than it would have been in had Domtar paid Williams Land first.

***15** In sum, the court finds that CFI did not establish the elements of conversion for either of the payments from Domtar to Apex [12] because, even with Apex's deemed constructive knowledge of CFI's superior lien, CFI failed to establish three elements of a conversion claim: that CFI had a right to possession, that the funds were designated for a specific purpose and used for an unauthorized purpose, and that CFI made a demand to Apex for the return of the funds. Accordingly, Apex's motion for summary judgment on CFI's claim for conversion is ALLOWED, and CFI's motion for summary judgment is DENIED.

CFI's Claim for Tortious Interference

In its brief and at the hearing, CFI conceded that it does not have evidence to support its claim for tortious interference. Accordingly, and as announced at the hearing, summary judgment will be entered in favor of Apex on the tortious interference claim.

MR. KLEIN'S MOTION FOR SUMMARY JUDGMENT ON ALL CLAIMS

Finally, and as noted above, at the hearing, Williams Land and CFI conceded that there is no evidentiary support for any of the claims asserted against Mr. Klein in the Williams Land Amended Complaint or in the Intervenor Complaint. Accordingly, summary judgment will be entered in favor of Mr. Klein on all claims.

CONCLUSION

Based on the foregoing,

Mr. Klein's motions for summary judgment on all claims in the Amended Complaint and the Intervenor Complaint are ALLOWED and Mr. Klein is dismissed as a party to this proceeding;

Apex's motion for summary judgment on Williams Land's first claim for relief, avoidance of fraudulent transfers pursuant to 11 U.S.C. § 548, is ALLOWED;

Apex's motion for summary judgment on Williams Land's second claim for relief, objection to claim, is DENIED;

Apex's motion for summary judgment on Williams Land's fourth claim for relief, unfair and deceptive trade practices pursuant to chapter 75 of the North Carolina General Statutes, is DENIED IN PART and ALLOWED IN PART;

Apex's motion for summary judgment on Williams Land's fifth claim for relief, avoidance of preferential payments in the amount of $30,159.42 pursuant to 11 U.S.C. § 547, is DENIED and summary judgment will be entered in favor of Williams Land on this claim;

Apex's motion for summary judgment on Williams Land's sixth claim for relief, recovery of avoided transfers pursuant to 11 U.S.C. § 550, is DENIED and summary judgment will be entered in favor of Williams Land on this claim in the amount of $30,159.42;

Apex's motion for summary judgment on Williams Land's third claim for relief, equitable subordination, is DENIED;

CFI's motion for summary judgment on its claim for declaratory judgment is DENIED, and summary judgment will be entered in favor of Williams Land on this claim;

CFI's motion for summary judgment on its claim for conversion against Apex is DENIED, and Apex's motion for summary judgment on CFI's claim for conversion against it is ALLOWED; and

***16** Apex's motion for summary judgment on CFI's claim for tortious interference with contract is ALLOWED.

The remaining issues, including Williams Land's objection to Apex's claim in the chapter 11 case, Williams Land's claim for unfair or deceptive trade practices, and Williams Land's claim for equitable subordination, will be set for trial. Appropriate judgments will be entered at the conclusion of all matters before the court.

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Footnotes

1 This claim and argument are addressed more fully below. However, CFI did suggest at the hearing that because its claim to the litigation proceeds is entirely due to its independent claim against Apex, then Apex could be subject to double payment – once to the debtor for its chapter 5 claims, and once to CFI for its conversion claim. It seems to the court, then, that CFI is not asserting any right to the debtor's litigation recovery, but instead simply contends that it has a separate claim against Apex for the same sums.

2 Apex challenged this court's jurisdiction in its motions to dismiss the Amended Complaint and the Intervenor Complaint, but it did not reassert those challenges in its motions for summary judgment.

3 There has been no challenge to the asserted nature of the CFI transaction as a true sale or traditional factor.

4 Although there is no disputed fact as to the terms and language of the MCA Agreement, there is significant dispute as to the legal interpretation of that agreement. Accordingly, any relevant language of the MCA Agreement is set forth in the discussion below.

5 The July 14, 2022 payment was also made with the agreement of Williams Land pursuant to the Stipulation of Settlement. For purposes of this decision, it is not necessary to determine whether the payment was also in response to the UCC letter.

6 In its motion to dismiss the Amended Complaint, Apex contended that if the agreement is construed as a loan, the choice of law provision in the MCA Agreement should be disregarded, maintaining that North Carolina requires application of North Carolina interest law to any North Carolina borrower. *See* D.E. 10. The court disagreed, D.E. 62, and Apex sought leave to appeal the court's interlocutory order denying Apex's motion to dismiss, D.E. 69, which the district court denied. D.E. 87. Apex has not reasserted the choice of law argument on summary judgment.

7 The claims are discussed in a different sequence than how they are set forth in the Amended Complaint.

8 The court expresses no opinion on whether a finding of criminal usury as a defense to a proof of claim also may be used as part of an affirmative § 548 claim to establish lack of reasonably equivalent value where the debtor has paid to the MCA entity more than the funds advanced, as those are not the facts before the court.

9 The court expresses no opinion of whether a similarly-situated creditor would prevail on an ordinary course defense for payments made under similar contract terms within the 90 days prior to filing; the court notes simply that the Domtar payment here was not consistent with the established pattern of payments between these parties.

10 § 75-16. Civil action by person injured; treble damages. If any person shall be injured or the business of any person, firm or corporation shall be broken up, destroyed or injured by reason of any act or thing done by any other person, firm or corporation in violation of the provisions of this Chapter, such person, firm or corporation so injured shall have a right of action on account of such injury done, and if damages are assessed in such case judgment shall be rendered in favor of the plaintiff and against the defendant for treble the amount fixed by the verdict.

§ 75-16.1. Attorney fee. In any suit instituted by a person who alleges that the defendant violated G.S. 75-1.1, the presiding judge may, in his discretion, allow a reasonable attorney fee to the duly licensed attorney representing the prevailing party, such attorney fee to be taxed as a part of the court costs and payable by the losing party, upon a finding by the presiding judge that: (1) The party charged with the violation has willfully engaged in the act or practice, and there was an unwarranted refusal by such party to fully resolve the matter

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which constitutes the basis of such suit; or (2) The party instituting the action knew, or should have known, the action was frivolous and malicious.

11 It is not clear to the court what damages may have been suffered by Williams Land as a result of the asserted unfair or deceptive acts; however, the court acknowledges that the measure of damages may differ from the evaluation of reasonably equivalent value for purposes of the § 548 claim.

12 Because the court finds that CFI has not established a claim for conversion for either payment, it need not consider whether the payment avoided by Williams Land as a preference could also be subject to a claim for conversion. The court has serious concerns about the viability of that claim as intruding on the rights conferred on a debtor in possession by the Bankruptcy Code, as well as subjecting a creditor to refunding the same sums twice with the ability to amend its claim to seek payment through the bankruptcy process only for the avoided preference payment. Indeed, the court has concerns about a secured creditor using a state law claim for conversion to assert rights to funds that the Bankruptcy Code allows a debtor to recover for the benefit of all creditors. But, that issue does not have to be resolved by the court today.

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
CEDAR RAPIDS DIVISION

KEYSTONE SAVINGS BANK, Appellant, vs. RENEE HANRAHAN, in her capacity as Chapter 7 Trustee, Appellee.	No. C24-104-LTS-MAR **MEMORANDUM OPINION AND ORDER ON BANKRUPTCY APPEAL**

I. INTRODUCTION

This case is before me on an appeal (Doc. 1) by secured creditor Keystone Savings Bank (KSB) from a September 10, 2024, decision of the United States Bankruptcy Court for the Northern District of Iowa (the Bankruptcy Court). KSB argues the Bankruptcy Court erred by denying KSB's motion to recognize lien and motion for summary judgment. Doc. 5. Appellee Renee Hanrahan, the Chapter 7 trustee, has filed a response (Doc. 6) and KSB has filed a reply (Doc. 7).

II. SUMMARY OF RELEVANT FACTS

As the Bankruptcy Court noted, there are no disputed issues of material fact. *In re BDC Group, Inc.,* Bankruptcy No. 23-00484, 2024 WL 4137984, at *1 (Bankr. N.D. Iowa 2024). The parties have not objected to the Bankruptcy Court's factual findings. As such, I will adopt the Bankruptcy Court's findings of fact, which state:

> The security agreements executed in favor of or held by KSB and related UCC financing statements identify "general intangibles" as collateral. KSB timely filed a proof of claim in BDC's bankruptcy case asserting its rights against all of its collateral.

Id.

III. DISCUSSION

A. Parties' Arguments

The sole issue in this case is whether KSB has a lien on Chapter 5 avoidance actions by debtor BDC, Inc. (BDC). KSB argues that a recent Eighth Circuit Court of Appeals opinion, *In re Simply Essentials, LLC,* 78 F.4th 1006 (8th Cir. 2023), necessitates a finding that KSB has a lien on BDC's Chapter 5 avoidance actions. Specifically, KSB argues that the Eighth Circuit's statement in *Simple Essentials* that "the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings" means that secured creditors can receive a debtor's interest in avoidance actions as collateral. *Simply Essentials,* 78 F. 4th at 1009; Doc. 5 at 6.

Hanrahan argues that *Simply Essentials* does not stand for the proposition that Chapter 5 avoidance actions may be subject to post-petition liens based on a debtor's pledge of "general intangibles" as collateral. Doc. 6 at 11. Hanrahan further argues that even if the court were to hold that the avoidance actions are subject to liens, the value of those liens is *de minimis* at best. *Id.* at 15.

B. The Bankruptcy Court Opinion

The Bankruptcy Court rejected KSB's argument that *Simply Essentials* changed longstanding law regarding liens on avoidance actions. The Bankruptcy Court began by summarizing cases holding that pre-petition liens do not attach to avoidance actions. *BDC Group,* 2024 WL 4137984, at *2. For example, one bankruptcy court stated, "a pre-petition lien does not attach to rights or actions by the trustee of a bankruptcy estate that did not exist prior to the bankruptcy filing." *In re Pierport Dev. & Realty,* 491 B.R. 544, 549 (Bankr. N.D. Ill. 2013) (citing *In re Tek-Aids Indus.,* 145 B.R. 253, 256 (Bankr. N.D. Ill. 1992)). The Bankruptcy Court then discussed case law holding that avoidance actions arise post-petition, and thus qualify as after-acquired property that cannot be encumbered by pre-petition liens. *BDC Group,* 2024 WL 4137984, at *2 (citing *Official Comm. of Unsecured Creditors v. UMB Bank* (*In re Residential Cap., LLC*), 497 B.R.

403, 414 (Bankr. S.D.N.Y. 2013); *In re Connolly Geaney Ablitt & Willard, P.C.,* 585 B.R. 644 (Bankr. D. Mass. 2018); *In re AMKO Fishing Co.,* No. 1:15-BK-00489, 2018 WL 3748820 (B.A.P. 9th Cir. Aug. 7, 2018); *In re Ludford Fruit Prod., Inc.,* 99 B.R. 18, 25 (Bankr. C.D. Cal. 1989)). The Bankruptcy Court then noted that the leading Bankruptcy treatise, *Collier on Bankruptcy,* states in relevant part:

> Once a bankruptcy case commences, however, because all recoveries under the avoiding powers are property of the estate, administered almost exclusively by the trustee for the benefit of the estate as a whole rather than for any creditor individually, it is difficult to see how such recoveries can be other than "after-acquired property" within the meaning of section 552(a), rather than proceeds of prepetition collateral under section 552(b)(1). This is true for fraudulent transfers as well as preferences, and no persuasive distinction seems possible along these lines. Prebankruptcy state law preferences exist, and may be asserted postbankruptcy under section 544(b) of the Bankruptcy Code. And the assertion by a trustee of state fraudulent transfer law under section 544(b) allows for an expanded recovery under the rule of *Moore v. Bay*, as well as section 550, underscoring the fact that the recoveries that are property of the estate under section 541(a)(3) are peculiarly postpetition in nature. Indeed, a creditor may not sue to recover a state law fraudulent transfer once a case in bankruptcy is commenced, because this would be taking a chose in action from the estate, thereby violating the automatic stay. On the whole, therefore, the more persuasively reasoned opinions do not permit secured creditors to share in recoveries obtained by bankruptcy trustees or estate representatives pursuant to the avoiding powers, even where such creditors may have independent, traceable rights to those funds.

5 *Collier on Bankruptcy* ¶ 552.02[5][d] (16th ed. 2020).

The Bankruptcy Court went on to discuss the myriad ways in which *Simply Essentials* failed to change anything about long-standing case law surrounding the effect of pre-petition liens on avoidance actions. It began by discussing the holding of *Simply Essentials*:

> The Eighth Circuit recognized in *Simply Essentials* that the "debtor in possession or the Trustee" is the party with the rights to the avoidance action—not Debtor. [*Simply Essentials,* 78 F.4th at 1009–10.] The Court recognized avoidance actions are allowed solely for the benefit of the estate

3

> and its creditors—not debtor or one of its creditors—and "belong to the estate". *Id.* The case did not purport to change this well-established law. KSB argues that because the Eighth Circuit noted (in one of its two alternative holdings on property of the estate) "that the debtor has an inchoate interest in avoidance actions prior to the commencement of the bankruptcy proceeding," this somehow necessarily changed the law and gives KSB a security interest in the trustee's actions that arise after the bankruptcy filing. KSB reads far too much into the Eighth Circuit's comment about "an inchoate interest" of the debtor.

BDC Group, 2024 WL 4137984, at *3. The Bankruptcy Court then explained that the Eighth Circuit had narrowly defined a debtor's inchoate interest in *Simply Essentials,* and this narrow definition did not allow for post-petition recovery on pre-petition liens on the debtor's inchoate interest in avoidance actions. *Id.*

Next, the Bankruptcy Court wrote that KSB's broad reading of a debtor's inchoate interest is in direct conflict with "fundamental bankruptcy principles." *Id.* at *4. For example, *Simply Essentials* reenforced the principle that Chapter 5 avoidance actions are placed under the control of the trustee or the debtor in possession (DIP). *Id.* The debtor's role in this scheme is the ability to file bankruptcy before the legal rights of avoidance actions come into existence. *Id.* The Bankruptcy Court noted that this right is narrow and not subject to a lien. *Id.* Even if this inchoate interest later becomes part of the estate as an avoidance action, another court noted that "there is no requirement that the debtor be able to transfer the interest, or that creditors be able to reach it, for the interest to be part of the estate[.]" *In re Jones,* 487 B.R. 224, 229 (Bankr. D. Ariz. 2012). Finally, as the Bankruptcy Court notes, the debtor has no ownership rights in avoidance actions, because avoidance actions "arise as a creditor's right outside bankruptcy, and in bankruptcy are only for the benefit of all creditors." *BDC Group,* 2024 WL 4137984, at *5.

The Bankruptcy Court then determined that KSB's arguments fundamentally undermine the holding of *Simply Essentials*. The court pointed out that KSB's arguments would fundamentally change existing law in which "(1) avoidance actions arise by statute

post-petition; (2) the trustee or DIP has the sole right to pursue avoidance actions, and (3) those avoidance actions can only be pursued for the benefit of all the estate's creditors, unless the Trustee or DIP sells them after filing." *Id.* at *6. *Simply Essentials* does not purport to overturn any of these established principles. Rather, *Simply Essentials* held that avoidance actions belong to the estate and that the trustee can thus sell them "for the benefit of the estate." *Simply Essentials,* 78 F. 4th at 1008. The Bankruptcy Court stated that KSB's theory would "effectively gut that result" because a "pre-petition creditor could lock [avoidance actions] up for its sole benefit." *BDC Group,* 2024 WL 4137984, at *6. Further, the Bankruptcy Court reiterated that KSB is not being deprived of collateral for which it bargained but instead is trying to impermissibly expand its collateral based on an overly broad reading of *Simply Essentials*. *Id.*

Next, the Bankruptcy Court noted that KSB ignored the other key holding of *Simply Essentials*, which is:

> [T]he avoidance actions clearly qualify as property of the estate under subsection (7) which includes "any interest in property that the estate acquires after the commencement of the case." The Bankruptcy Code makes these assets available to the estate after the commencement of the case.

Simply Essentials, 78 F.4th at 1009. Regarding this holding, the Bankruptcy Court stated:

> KSB's only arguable response to *Simply Essentials* section 541(a)(7) holding is that the "after-acquired" avoidance actions are "proceeds" of KSB's collateral interest in Debtors pre-petition inchoate right. This argument contradicts section 541(a)(7) and the *Simply Essentials* conclusion that avoidance actions arise and are acquired by the estate post-petition. There is no tie to a pre-petition right of Debtor because, under section 541(a)(7), the estate acquired the right post-filing when it came into being. This provides no basis for KSB's lien arguments.

BDC Group, 2024 WL 4137984, at *7. The Bankruptcy Court went on to note that extensive case law has rejected any notion that avoidance actions are proceeds of pre-petition collateral. *Id.*

The Bankruptcy Court concluded by noting that KSB's arguments undermine the holding of *Simply Essentials* in a different way, namely that *Simply Essentials* emphasized maximizing the value of the estate while KSB's arguments would lead to the opposite result and simply funnel what is available to the estate to a single creditor. *Id.* at *8.

C. Legal Standards

The Bankruptcy Court's findings of fact are reviewed for clear error while its conclusions of law are reviewed *de novo*. *Tri-State Financial, LLC v. First Dakota Nat'l Bank*, 538 F.3d 920, 923-24 (8th Cir. 2008). The district court may affirm, reverse or modify the Bankruptcy Court's ruling or remand the case for further proceedings. Fed. R. Bankr. P. 8013.

D. Analysis

After conducting a thorough, de novo review of the Bankruptcy Court's opinion and the underlying case law cited in that opinion, I find no error. While I agree with the entirety of the Bankruptcy Court's opinion, I will address three of KSB's arguments in more detail.

First, the thrust of KSB's argument continues to be that *Simply Essentials* overturned prior bankruptcy case law holding that avoidance actions are after-acquired property that cannot be encumbered by pre-petition liens. *BDC Group,* 2024 WL 4137984, at *2; Doc. 5 at 7 ("This issue is controlled by, and resolved by, a straightforward extension of *Simply Essentials's* reasoning and Uniform Commercial Code law."). I disagree. In *Simply Essentials*, the Eighth Circuit stated that "[t]he only issue on appeal is the legal question of whether avoidance actions can be sold as property of the estate." *Simply Essentials,* 78 F. 4th at 1008. While the court recognized that "the debtor has an inchoate interest in the avoidance actions prior to the commencement of the bankruptcy proceedings[,]" this reasoning applied to the sole issue on appeal: whether avoidance actions can be sold as property of the estate. *Id.* at 1009. The court

reasoned that avoidance actions are "brought for the benefit of the estate and therefore belong[] to the estate" and the sale of avoidance actions "is consistent with the congressional intent behind including a fiduciary duty to maximize the value of the estate." *Simply Essentials,* 78 F. 4th at 1008, 1009. KSB's argument – which is that a debtor's inchoate interest in avoidance actions can be encumbered with liens and accessed by KSB as proceeds of pre-petition collateral – would turn the reasoning of *Simply Essentials* on its head. Rather than remaining "consistent with the congressional intent behind including a fiduciary to maximize the value of the estate[,]" KSB's theory would allow a single creditor to diminish the estate at the expense of all other creditors. *Id.* at 1009.

KSB argues that because the debtor has an inchoate interest in avoidance actions, it necessarily follows that this interest may be encumbered with a lien that KSB may access as post-petition proceeds. *See* Doc. 5 at 11 ("The inchoate avoidance actions BDC had an interest in became estate property when BDC filed its bankruptcy petition … But BDC's act of commencing the bankruptcy case did not cause [KSB] to lose its security interest in the property. This is so because section 552(b)(1) preserved [KSB's] interest in its collateral and proceeds of its collateral.")). The Bankruptcy Court noted that such arguments "have been almost uniformly rejected by case law which KSB does not even acknowledge." *BDC Group,* 2024 WL 4137984, at *7. The Bankruptcy Court summarized this case law as follows:

> "Proceeds" only covers "property that is directly attributable to prepetition collateral, without addition of estate resources." *In re Residential Cap.,* 501 B.R. at 612. See also *In re Twin Pines, LLC,* 2021 WL 312674 at *18 (Bankr. D.N.M. Jan. 29, 2021) (same). The Courts have generally found this rule to stem from and be consistent with Supreme Court case law that prohibited "the creation of an enforceable lien upon a subject not existent when the bankruptcy became effective or even arising from, or connected with, preexisting property, but brought into being solely as the fruit of the subsequent labor of the bankrupt." *In re Barbara K Enterprises Inc.,* 2008 WL 24 39679 at *10 (Bankr. S.D.N.Y. 2008) (quoting *Local Loan Co. v. Hunt,* 292 U.S. 234, 243, 54 S. Ct. 695, 78 L. Ed. 1230 (1934) (emphasis

> added). Here, avoidance actions by the trustee or DIP did not exist at filing and, at a minimum, are the quintessential things that require the addition of estate resources to succeed and produce a recovery. In fact, *Simply Essentials* recognized this very point by noting that estates often do not have the resources to pursue those actions—and instead of letting them go with no recovery, Trustees can sell them to get a recovery.

Id.

On appeal, KSB argues that "the availability of avoidance actions has to do with the debtor's pre-bankruptcy past and commencement of the case, and nothing to do with the amount of investment an estate puts into them." Doc. 5 at 13. KSB acknowledges the contrary case law but argues that:

> [T]he availability of avoidance actions has to do with the debtor's pre-bankruptcy past and commencement of the case, and nothing to do with the amount of investment an estate puts into them. *In re Raynor,* 406 B.R. at 38. The decisions to transfer assets pre-bankruptcy and the "right to file for bankruptcy" belongs to the "debtor," not to the debtor's estate. *Simply Essentials,* 78 F.4th at 1009. Thus, avoidance actions do not depend upon estate resources. All it takes is a debtor filing a petition.

Id. Again, I disagree. The inchoate right in avoidance actions that a debtor possesses matures into the debtor's right to file for bankruptcy. After this point, avoidance actions "arise as a brand-new thing" which are "created postpetition in the trustee or a DIP, solely for one of them to pursue, and solely for the benefit of the estate." *BDC Group,* 2024 WL 4137984, at *7. As such, the Bankruptcy Court correctly concluded that avoidance actions "are the quintessential things that require the addition of estate resources to succeed and produce a recovery" and thus cannot be proceeds. *Id.*

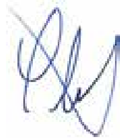
Finally, I must address KSB's argument that the Bankruptcy Court erred by analogizing a debtor's inchoate interest in avoidance actions to a spouse's inchoate dower interest. Doc. 5 at 14. KSB argues that "setting aside the public policy dower interests are intended to promote, there is nothing about the inchoate nature of the interest that prevents it from being assigned or used as collateral." *Id.* at 15. This misconstrues the Bankruptcy Court's argument. The Bankruptcy Court did not argue that the presence of

a spouse's unassignable inchoate dower interest stands for the proposition that an inchoate right can never be assigned. Rather, inchoate dower interests are merely an example of how inchoate interests are not *necessarily* assignable. Further, KSB's argument that dower interests are not transferable because of "unique public policy undergirding dower interests" actually supports the non-assignability of avoidance actions. *Id.* The *Simply Essentials* court recognized that its holding was "consistent with the congressional intent behind including a fiduciary duty to maximize the value of the estate." *Simply Essentials,* 78 F. 4th at 1010. The policy of allowing the maximization of the value of the estate supports, rather than undermines, a finding that an inchoate interest in avoidance actions cannot be encumbered for the post-petition benefit of a single creditor.

IV. CONCLUSION

For the reasons stated herein, KSB's appeal (Doc. 1) of the Bankruptcy Court's September 10, 2024, decision to deny the motion to recognize lien and motion for summary judgment is **denied** and the Bankruptcy Court's decision is **affirmed**.

IT IS SO ORDERED this 17th day of July, 2025.



Leonard T. Strand
United States District Judge

91 F.4th 376
United States Court of Appeals, Fifth Circuit.

In the MATTER OF SOUTH COAST SUPPLY COMPANY, Debtor,
Briar Capital Working Fund Capital, L.L.C., as assignee of South Coast Supply Company, Appellant,
v.
Robert W. Remmert, Appellee.

No. 22-20536
|
FILED January 22, 2024

Synopsis

Background: Chapter 11 debtor brought action against its former Chief Financial Officer (CFO), seeking to avoid and recover more than $300,000 of allegedly preferential transfers, and later, pursuant to debtor's modified plan of reorganization and the confirmation order, secured creditor was substituted as assignee of debtor in the preference action. Following withdrawal of the reference to the bankruptcy court and reassignment of the case, CFO moved to dismiss for lack of standing. The United States District Court for the Southern District of Texas, George C. Hanks, Jr., J., 2022 WL 4137840, granted motion. Secured creditor appealed.

Holdings: The Court of Appeals, Dennis, Circuit Judge, held that:

[1] addressing a novel issue for the circuit, preference claims arising under the Bankruptcy Code are property of the estate that may be sold, and

[2] one need not be a "representative of the estate" to pursue a validly purchased preference claim.

Reversed and remanded.

Procedural Posture(s): On Appeal; Motion to Dismiss for Lack of Standing.

West Headnotes (17)

[1] **Federal Courts** Jurisdiction

Court of Appeals reviews dismissal for lack of subject matter jurisdiction de novo, applying same standards as district court. Fed. R. Civ. P. 12(b)(1).

[2] **Federal Courts** Presumptions and burden of proof

Federal Courts Weight and sufficiency

Burden of proving subject matter jurisdiction lies with the party asserting jurisdiction, and it must be proved by a preponderance of the evidence.

[3] **Bankruptcy** Avoidance rights and limits thereon, in general

"Avoidance actions" are claims to avoid a transfer of property by the debtor that was made voidable by the Bankruptcy Code. 11 U.S.C.A. §§ 547, 548.

[4] **Bankruptcy** Preferences

Bankruptcy Fraudulent conveyances in general

Avoidance actions include claims to recover fraudulent transfers and certain preferential transfers made too close in time to the filing of bankruptcy. 11 U.S.C.A. §§ 547, 548.

[5] **Bankruptcy** Rights of Action; Contract Rights Generally

Preference claims arising under the Bankruptcy Code may be sold; pursuant to the Code's clear language, preference actions, as rights of action created by federal bankruptcy law to avoid transfers of property and thereby make additional property available to the estate, and which arise with the filing of the bankruptcy petition, fall within the Code's broad, general definition of "property of the estate," as well as under the subsection providing that property of the estate includes any interest in property that the estate acquires after commencement of the case, and interpreting the Code to allow the sale of preference actions does not undermine

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their purpose but, rather, is consistent with a bankruptcy trustee's duty to maximize the estate, and grants bankruptcy courts more flexibility in distributing assets, allowing for a more equitable distribution. 11 U.S.C.A. §§ 363(b), 541(a)(1), 541(a)(7), 547.

3 Cases that cite this headnote

[6] **Bankruptcy** Property of Estate in General

Bankruptcy Code's general definition of "property of the estate" must be read broadly. 11 U.S.C.A. § 541(a)(1).

[7] **Bankruptcy** Rights of Action; Contract Rights Generally

Preference action is property, as it is a right of action created by federal bankruptcy law to avoid a transfer of property. 11 U.S.C.A. §§ 541(a)(1), 547.

1 Case that cites this headnote

[8] **Bankruptcy** Preferences

Successful preference claim voids the allegedly preferential transfer and returns that property to the bankruptcy estate. 11 U.S.C.A. § 547.

[9] **Bankruptcy** Rights of Action; Contract Rights Generally

Claims to avoid allegedly preferential transfers arise with the filing of the bankruptcy petition, making them property that the debtor has an interest in as of the commencement of the case. 11 U.S.C.A. §§ 541(a)(1), 547.

[10] **Bankruptcy** Rights of Action; Contract Rights Generally

Preference actions qualify as "property of the estate" under the subsection of the Bankruptcy Code providing that property of the estate includes any interest in property that the estate acquires after commencement of the case. 11 U.S.C.A. §§ 541(a)(7), 547.

2 Cases that cite this headnote

[11] **Bankruptcy** Interest of debtor in general

Subsection of the Bankruptcy Code providing that property of the estate includes any interest in property that the estate acquires after commencement of the case must be read broadly. 11 U.S.C.A. § 541(a)(7).

2 Cases that cite this headnote

[12] **Courts** Particular questions or subject matter

While Bankruptcy Appellate Panel (BAP) decisions are not binding precedent, their rationale may be persuasive.

[13] **Bankruptcy** Equitable powers and principles

Equity is a general policy underlying the Bankruptcy Code.

[14] **Bankruptcy** Adequacy of price; appraisal

In approving the sale of preference claims, bankruptcy courts must ensure, on a case-by-case basis and in light of the factual circumstances, that fundamental bankruptcy policies of asset value maximization and equitable distribution are satisfied. 11 U.S.C.A. §§ 363(b), 547.

[15] **Bankruptcy** Trustee as representative of debtor or creditors

One need not be a "representative of the estate" to pursue a validly purchased preference claim. 11 U.S.C.A. § 547.

1 Case that cites this headnote

[16] **Bankruptcy** Sale or Assignment of Property

Bankruptcy The Plan

The Bankruptcy Code provides different mechanisms by which a debtor-in-possession

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may liquidate its assets, including through a Chapter 11 plan or though a sale of property of the estate. 11 U.S.C.A. §§ 363, 1123(b)(3).

[17] **Bankruptcy** Order of court and proceedings therefor in general

Bankruptcy Notice

There is no requirement in the section of the Bankruptcy Code governing use, sale, or lease of property that the purchaser of a piece of the estate's property also be a representative of the estate, only that the debtor-in-possession give notice and hold a hearing. 11 U.S.C.A. § 363.

***378** Appeal from the United States District Court for the Southern District of Texas, USDC No. 4:18-CV-2867, George C. Hanks, Jr., U.S. District Judge

Attorneys and Law Firms

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George William Vie, III, George W. Vie, III, P.C., Houston, TX, Robin Marie Ziek, Houston, TX, for Appellee.

Before Stewart, Dennis, and Wilson, Circuit Judges.

Opinion

James L. Dennis, Circuit Judge:

This appeal arises out of a Chapter 11 Bankruptcy petition and raises a res nova issue for our circuit. Because we find that preference claims arising under 11 U.S.C. § 547 may be sold, we REVERSE the district court's dismissal for lack of subject matter jurisdiction and REMAND for further proceedings.

I. BACKGROUND

South Coast Supply Company ("South Coast"), an industrial products distributor founded in 1972, began experiencing financial issues in 2016, which it later attributed to mismanagement. South Coast was forced to borrow $800,000 from Robert Remmert, its then-CFO, pursuant to a loan agreement. South Coast issued forty-seven checks pursuant to the terms of the loan agreement, totaling over $320,628.04, until Remmert resigned from South Coast. After his resignation, on October 17, 2017, Remmert sent a demand letter requesting $405,261.87 to satisfy the loan, less than the actual $578,199.04 left on the original loan. On October 20, 2017, South Coast filed a voluntary Chapter 11 petition for bankruptcy in the Southern District of Texas.

South Coast continued to operate its business as a debtor-in-possession, and the bankruptcy court appointed J. Patrick Magill as South Coast's Chief Restructuring Officer ("CRO"). At the time the CRO was ***379** appointed, Briar Capital Working Fund Capital, L.L.C. ("Briar Capital") was South Coast's sole secured lender and had filed proof of claim in the bankruptcy proceeding, thereby asserting a claim for $2,563,191.07. Briar Capital's proof of claim stated that it had a lien on property valued at $3,926,263.88.

Five months into the bankruptcy case, South Coast was not generating enough cash flow to remain liquid and cash-flow-positive. South Coast sought post-petition debtor-in-possession ("DIP") financing. It requested and received an order from the bankruptcy court authorizing it to obtain DIP financing from Solstice Capital, LLC ("Solstice"). The order specified that Briar Capital would have lien priority over Solstice as to property obtained by South Coast prior to the date on which Solstice advanced DIP financing to South Coast. Solstice, by contrast, would have lien priority over Briar Capital as to property obtained after that date. By doing so, the bankruptcy court found that Briar Capital's interests in its collateral were sufficiently protected. Additionally, Briar Capital received junior liens on all Solstice collateral. Around this time, South Coast also filed the instant lawsuit against Remmert attempting to "avoid" more than $300,000 of allegedly preferential transfers made to Remmert right before the bankruptcy proceedings were initiated under 11 U.S.C. § 547, and to recover, i.e., claw back, the value of the avoided transfers under 11 U.S.C. § 550.

After obtaining DIP financing, South Coast filed its first proposed Chapter 11 plan. The first plan proposed to sell all South Coast's "intangible assets," including intellectual property, to Solstice for $500,000. Solstice also agreed to pay up to $200,000 to satisfy claims entitled to administrative treatment under the Bankruptcy Code. Additionally, the first plan provided for the transfer of some of South Coast's property to Briar Capital to satisfy Briar Capital's claim but did not provide for any payment of Briar Capital's

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administrative expenses incurred in participating in the bankruptcy proceeding, which are traditionally prioritized and paid in full. The first plan also provided that unsecured creditors would receive $500,000 in cash.

Briar Capital objected to the first plan, asserting the plan did not offer it fair compensation. South Coast and Briar Capital settled their issues and agreed to a second, modified plan. The second plan provided that Briar Capital would abandon its security interest in $700,000 of sale proceeds that South Coast planned to distribute to other creditors and would also waive its claim to recover administrative expenses incurred in participating in the bankruptcy proceedings. In exchange, Briar Capital received South Coast's interest in this pending preference action against Remmert, which was seeking to avoid more than $300,000 of allegedly preferential transfers.

At the confirmation hearing of the second plan, the CRO testified about the value of the assets to be transferred to Briar Capital, stating that "it was very difficult to give a concrete valuation of any kind of inventory," that the estimate of the inventory transferred was "our best guess," and that he was uncertain and concerned about the real value of the collateral. The CRO also testified that the value of the accounts receivable transferred to Briar Capital was $400,000, but it was possible they could be worth less. The CRO specifically testified that because of South Coast's settlement with Briar Capital, the second proposed plan allowed the $700,000 of proceeds from the sale of South Coast's assets to be distributed to unsecured creditors and administrative claimants, rather than to Briar Capital, the secured creditor. Remmert ***380** objected on a limited basis, arguing that the plan should explicitly provide that only this one existing preference lawsuit would be assigned to Briar Capital. The bankruptcy court approved the plan over Remmert's objection, finding that the plan complied with the Bankruptcy Code, was proposed in good faith, and was not forbidden by law.

The order confirming the plan contained a paragraph titled "Assignment of Claims," which provided that "[a]s of the Effective Date of the Plan, [South Coast] and the bankruptcy estate assign and convey to Briar Capital and/or authorize to prosecute on their behalf" the preference action against Remmert attempting to avoid payments made prior to the filing of the bankruptcy petition. The plan itself specifically states that "[a]s of the Effective Date of the Plan, [South Coast] and the estate assign and convey to Briar Capital and/or authorizes Briar Capital to prosecute on their behalf all of [sic] their potential claims against Robert W. Remmert," including the currently pending preference lawsuit. The plan also provided that Briar Capital was permitted to keep any amount it recovered from Remmert, even if the recovery exceeded the amount it was owed to satisfy its debt, stating that "[a]ny and all recoveries and proceeds of such recoveries shall be solely the property of Briar Capital."

As a result of the plan's approval, Briar Capital was substituted as assignee of South Coast in this preference action against Remmert, leading to this instant suit. The parties litigated the case from January 2019 until August 2022. Eleven days before trial, Remmert filed a motion to dismiss under Rule 12(b)(1) of the Federal Rules of Civil Procedure, arguing that Briar Capital lacked standing to prosecute the preference action. The district court agreed, holding that since a successful recovery would not benefit South Coast's estate or its unsecured creditors, Briar Capital lacked standing to bring the preference claim against Remmert as a representative of the estate under 11 U.S.C. § 1123(b)(3)(B) of the Bankruptcy Code. Acknowledging the absence of caselaw from our circuit, the district court followed cases from bankruptcy courts ruling that outright sales of preference actions under 11 U.S.C. § 547 are impermissible. Therefore, the district court dismissed the suit for lack of subject matter jurisdiction. This timely appeal followed.

II. STANDARD OF REVIEW

[1] **[2]** We review a dismissal for lack of subject matter jurisdiction de novo, applying the same standards as the district court. *In re S. Recycling, LLC*, 982 F.3d 374, 379 (5th Cir. 2020); *Griener v. United States*, 900 F.3d 700, 703 (5th Cir. 2018). "The burden of proving subject matter jurisdiction lies with the party asserting jurisdiction, and it must be proved by a preponderance of the evidence." *In re S. Recycling, LLC*, 982 F.3d at 379 (citing *Ballew v. Cont'l Airlines, Inc.*, 668 F.3d 777, 781 (5th Cir. 2012) ("The plaintiff must prove by a preponderance of the evidence that the court has jurisdiction based on the complaint and evidence.")).

III. ANALYSIS

While Briar Capital raises several issues on appeal, this appeal turns on whether preference claims—a type of avoidance action—may validly be sold. [1]

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***381** *A. Preference Claims Arising Under 11 U.S.C. § 547 May Be Sold*

[3] [4] [5] Briar Capital argues the district court erred in finding that preference claims cannot be sold, and thus, that it did not have standing to bring this claim. The district court, relying on various bankruptcy court opinions in light of the "absence of explicit authorization from the Fifth Circuit for sales of 11 U.S.C. § 547 avoidance actions," found that Briar Capital did not have standing, and dismissed its claims for lack of subject matter jurisdiction. "Avoidance actions are claims to avoid a transfer of property by the debtor that was made voidable by the Bankruptcy Code. Avoidance actions include claims to recover fraudulent transfers and certain preferential transfers made too close in time to the filing of bankruptcy." *In re Simply Essentials, LLC*, 78 F.4th 1006, 1008 (8th Cir. 2023). At issue is whether a preference action, a specific type of avoidance action, may be sold. This question of whether preference claims may be sold is indeed a novel issue for this circuit. The Fifth Circuit has expressly reserved the question of whether a debtor-in-possession may sell the power to avoid preferences under 11 U.S.C. § 547. *In re Moore*, 608 F.3d 253, 261 (5th Cir. 2010) ("A split of authority exists as to whether the trustee may sell causes of action that arise from his avoidance powers."). We hold that 11 U.S.C. § 547 preference actions may be validly sold, and that Briar Capital has standing to bring this action for the following reasons.

* * *

As a general bankruptcy rule, a debtor-in-possession, "after notice and a hearing, may use, sell, or lease ... *property of the estate*." Title 11, United States Code, Section 363(b)(1) (emphasis added).[2] Property of the estate, in turn, is defined in 11 U.S.C. § 541. Briar Capital argues preference claims are property of the estate—and therefore can be sold by a debtor-in-possession under § 363(b)(1)—because they fall within the definitions of property of the estate listed in §§ 541(a)(1) and 541(a)(7). We address each subsection in turn.

Briar Capital first asserts that preference claims fall in the general, broad definition of property of the estate in § 541(a)(1) relying, in part, on the Supreme Court's broad reading of § 541(a)(1) in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983). Section 541(a)(1) defines "property of the estate" to include "all legal or equitable interests of the debtor in property as of the commencement of the case." In *Whiting Pools, Inc.*, the Court held that the reorganization estate included property of the debtor that had already been seized by a creditor before the debtor filed for reorganization. *Id.* at 205, 103 S.Ct. 2309. In interpreting "property of the estate," the Court stated that § 541(a)(1) "is intended to include in the estate any property made available to the estate by other provisions of the Bankruptcy Code." *Id.* The Court also looked to the congressional report on the Bankruptcy Code and stated that the "congressional goal of encouraging reorganizations and Congress' choice of methods to protect ***382** secured creditors suggest that Congress intended a broad range of property to be included in the estate." *Id.* at 204, 103 S.Ct. 2309. The Fifth Circuit has echoed this sentiment, asserting that "[t]he scope of property rights and interests included in a bankruptcy estate is very broad: The conditional, future, speculative, or equitable nature of an interest does not prevent it from being property of the bankruptcy estate." *In re Kemp*, 52 F.3d 546, 550 (5th Cir. 1995). Additionally, courts have generally noted that this broad definition includes causes of action. *In re Greenhaw Energy, Inc.*, 359 B.R. 636, 642 (Bankr. S.D. Tex. 2007) (citing *In re Equinox Oil Co.*, 300 F.3d 614, 618 (5th Cir. 2002) ("Section 541 is read broadly and is interpreted to 'include all kinds of property, including tangible or intangible property' [and] causes of action[.]")).

[6] [7] [8] [9] Reading § 541(a)(1) broadly, as we must, preference actions fall within its scope. A preference action is property, as it is a right of action created by federal bankruptcy law to avoid a transfer of property. *In re Moore*, 608 F.3d at 257–58 ("[T]he term 'all legal and equitable interests of the debtor in property' is all-encompassing and includes rights of action as bestowed by either federal or state law."). Preference actions are a mechanism in the Bankruptcy Code by which additional property is made available to the estate, fitting squarely within the *Whiting Pools* definition. A successful preference claim voids the allegedly preferential transfer and returns that property to the estate. *In re Tusa-Expo Holdings, Inc.*, 811 F.3d 786, 791–92 (5th Cir. 2016) ("If a trustee establishes each of the requirements of § 547(b), the transfer is a preference, which must be returned to the bankruptcy estate ..."). Additionally, claims to avoid allegedly preferential transfers arise with the filing of the bankruptcy petition, making them property that the debtor has an interest in as of the commencement of the case. *See In re Simply Essentials, LLC*, 78 F.4th 1006 (holding that avoidance actions are property of the estate under 11 U.S.C. § 541(a)(1) and (a)(7)). Thus, preference actions plainly fit

the statutory definition of "property of the estate" and may validly be sold under § 363(b).

[10] **[11]** Briar Capital also argues that preference actions generally may qualify as property of the estate under § 541(a)(7). Section 541(a)(7) provides that property of the estate includes "any interest in property that the estate acquires after the commencement of the estate." Briar Capital contends that "a right of action that accrues post-petition is estate property if it is created with or by property of the estate or related to or arises out of property that is already part of the estate." Similarly to Section 541(a)(1), the Fifth Circuit has held that "Congress enacted § 541(a)(7) to clarify its intention that § 541 be an all-embracing definition and to ensure that property interests created with or by property of the estate are themselves property of the estate." *In re TMT Procurement Corp.*, 764 F.3d 512, 525 (5th Cir. 2014). Preference actions clearly qualify as "property of the estate" under this section. *In re Simply Essentials, LLC*, 78 F.4th 1006 ("the avoidance actions clearly qualify as property of the estate under subsection (7)"). Keeping in mind our own precedent mandates a broad reading of § 541(a)(7), it is apparent that "[t]he Bankruptcy Code makes these assets available to the estate after the commencement of the case." *Id.* Thus, we also hold that the preference actions qualify as property of the estate under § 541(a)(7).

Beyond the clear statutory language, we find that our decision is bolstered by other courts across the country. We join the Eighth and Ninth Circuits in finding that ***383** preference claims are property of the estate that can be sold. *In re Simply Essentials, LLC*, 78 F.4th at 1011 ("Chapter 5 avoidance actions are property of the estate"); *In re Lahijani*, 325 B.R. 282, 288 (9th Cir. BAP 2005) ("While there is some disagreement among courts about the exercise by others of the trustee's bankruptcy-specific avoiding power causes of action, the Ninth Circuit permits such actions to be sold or transferred.") (first citing *In re P.R.T.C., Inc.*, 177 F.3d 774, 781 (9th Cir. 1999); and then citing *In re Prof'l Inv. Props. of Am.*, 955 F.2d 623, 625–26 (9th Cir. 1992)). In so deciding, the Eighth Circuit addressed Remmert's chief argument in this case—that the avoidance powers are unique powers belonging to the trustee and that should not have been sold to someone who would not exercise those powers for the benefits of all creditors. Specifically, the appellants in *In re Simply Essentials* argued that "allowing the sale of avoidance actions would violate the trustee's fiduciary duty or undermine the purpose of avoidance actions." *In re Simply Essentials, LLC*, 78 F.4th at 1010. In response, the court succinctly explained that the trustee's fiduciary duties require it to maximize the value of the estate, which may include and even require the sale of an avoidance action. *Id.* The court held that allowing the sale of avoidance actions "is consistent with the congressional intent behind including a fiduciary duty to maximize the value of the estate." *Id.*

[12] The Ninth Circuit has also found that all avoidance powers, including preference actions, may be sold. *In re P.R.T.C., Inc.*, 177 F.3d 774. A Bankruptcy Appeals Panel within the Ninth Circuit rejected the appellants' argument that the estate received no benefit where there was no specific portion of future recoveries reserved for the estate. *In re Lahijani*, 325 B.R. at 288 ("We reject appellants' argument that the avoiding power causes of action should not have been sold to one who would not exercise the powers for the benefit of all creditors."). [3] It decided that "[t]he benefit to the estate in such circumstances is the sale price, which might or might not include a portion of future recoveries for the estate." *Id.* at 287.

In rejecting these arguments, the courts took a broad view of what benefits the estate, which we adopt here. This logic of maximization of the estate applies even under circumstances like these, where a creditor is not pursuing the claim for the benefit of all creditors. In this case, Briar Capital waived the right to recover administrative expenses and its security interest in $700,000 of sales proceeds, in exchange for the right to pursue this preference claim. Although Briar Capital does not owe any percentage of the possible recovery in this case to the estate, its waiver of the right to collect administrative expenses and its release of its claim to $700,000 are concrete benefits to the estate. Interpreting the Bankruptcy Code to allow the sale of preference actions does not undermine the purpose of avoidance actions. Rather, it is consistent with the trustee's duty to maximize the estate.

[13] **[14]** Remmert also raises concerns about equity, a general policy underlying the Bankruptcy Code. Specifically, Remmert argues that since "Briar Capital would be pursuing claims only for itself" it "would be potentially allowed to recover more than rightfully due to it." We have already addressed this policy concern in a ***384** similar context [4] by reiterating that the sale of avoidance actions "will not necessarily undermine core bankruptcy principles. In approving such sales, bankruptcy courts must ensure that fundamental bankruptcy policies of asset value maximization and equitable distribution are satisfied. Bankruptcy courts must make those decisions on a case by case basis in light

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of the factual circumstances." *In re Moore*, 608 F.3d at 262 n.18; *see also In re Lahijani*, 325 B.R. at 288 ("The court's obligation in § 363(b) sales is to assure that optimal value is realized by the estate under the circumstances.").[5] Allowing the sale of preference actions will grant bankruptcy courts more flexibility in distributing assets, maximize the value of the bankruptcy estate, and in turn, allow for more equitable distribution of assets.

In fact, allowing for the sale of preference claims may be the most equitable option. For example, in some cases, the estate may not have sufficient funds to pursue preference actions. By assigning the actions to creditors who may be able to pursue the actions, the bankruptcy court and the debtor have more flexibility in distributing the remaining assets and can most effectively maximize the bankruptcy estate. *In re Simply Essentials, LLC*, 78 F.4th at 1010 ("When an estate cannot afford to pursue avoidance actions, the best way to maximize the value of the estate is to sell the actions."); *see also In re P.R.T.C.*, 177 F.3d at 777 (allowing the sale where the estate did not have the funds to pursue the avoidance claims, but believed they may be valuable). Maximization of the bankruptcy estate certainly benefits all creditors, as there are more assets to be distributed. Here, the estate received a benefit by Briar Capital's release of its claim to $700,000 as well as all administrative expenses, and the subsequent approval of the bankruptcy plan in exchange for the rights to the preference claim. We reject Remmert's blanket contention that allowing the sale of preference actions clashes with general principles of equity articulated in the Bankruptcy Code and instead find that bankruptcy courts are capable of determining what is the most equitable under the specific circumstances of each case, which may include selling preference claims. As Briar Capital validly purchased the claim outright, it has standing to pursue the lawsuit as purchaser of the claim.

B. One Need Not Be a Representative of the Estate to Pursue a Validly Purchased Preference Claim

[15] Though we find that avoidance actions are "property of the estate" which can be sold, Remmert still argues Briar Capital lacks standing to pursue such claims because it is not a "representative of the estate." The district court had two related findings. First, it found that under § 1123(b)(3)(B), a statute by which a third party may pursue a claim belonging to the estate, Briar Capital was not a representative of the estate and had no authority to pursue this claim under this particular provision of the Bankruptcy Code. Secondly, the district court found that preference claims could not be sold, and so Briar ***385** Capital did not have standing to pursue this claim as a purchaser. Thus, it concluded that Briar Capital did not have standing under either avenue. Because we find that preference claims can be sold, we hold that Briar Capital has standing to pursue this claim as a purchaser of the claim regardless of whether it is a "representative of the estate."

Remmert appears to argue that the "representative of the estate" issue is dispositive: Briar Capital is not a representative of the estate and thus, has no standing to bring the preference claim.[6] Remmert's view is that even if preference claims are found to be property of the estate which may be sold, since they are unique powers entrusted to the estate under the Bankruptcy Code, there ought to be an additional requirement on purchasers of these claims: that they must be representatives of the estate to have standing to pursue the claim. Briar Capital, contrastingly, argues that these issues are "exclusive and independent." We find that Briar Capital has the more compelling argument. Whether Briar Capital is a "representative of the estate" is irrelevant to this appeal.

[16] **[17]** This conclusion is supported by the plain text of the Bankruptcy Code. Title 11, United States Code, Section 1123(b)(3) states that a Chapter 11 bankruptcy plan *may* provide for the "settlement or adjustment of any claim or interest belonging to the debtor or the estate" or "the retention or enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose of any such claim." On the other hand, 11 U.S.C. § 363 provides that a debtor-in-possession "after notice and a hearing, may use, sell, or lease ... property of the estate." Remmert relies upon 11 U.S.C. § 1123(b)(3), arguing that Briar Capital's failure to meet the requirements of this section is fatal to its standing argument. This reliance is inapposite. The Bankruptcy Code provides different mechanisms by which a debtor-in-possession may liquidate its assets. There is no requirement in 11 U.S.C. § 363 that the purchaser of a piece of the estate's property also be a representative of the estate, only that the debtor-in-possession give notice and hold a hearing. These requirements were met in this case and the bankruptcy court found that the plan complied with the Bankruptcy Code, was proposed in good faith, and maximized the value of the estate. There is no additional requirement on the purchaser of a preference claim to qualify as a representative of the estate to have standing to pursue the validly purchased claim. In holding that preference claims may be sold, we also hold that

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the purchasers of preference claims have standing to pursue them.

IV. CONCLUSION

We hold that preference actions may be sold pursuant to 11 U.S.C. § 363(b)(1) because they are property of the estate under 11 U.S.C. §§ 541(a)(1) and (7). And, even if Briar Capital does not qualify as a representative of the estate, it has standing to pursue the preference claim as it validly purchased the claim outright. The district court therefore erred in finding that Briar Capital lacked standing to bring ***386** this claim. We REVERSE and REMAND for further proceedings.

All Citations

91 F.4th 376, 73 Bankr.Ct.Dec. 63

Footnotes

1 The parties also disagree about the applicability of res judicata or claim preclusion in this case. Briar Capital contends that the August 2018 order confirming the Chapter 11 reorganization plan should have preclusive effect. Remmert responds that this argument was not properly preserved for appeal. We do not address this issue as we decide this appeal on other grounds.

2 As the bankruptcy court did not appoint a trustee in this case, and South Coast continued to operate its business as a debtor-in-possession, the rights and powers referenced in this opinion are those of a debtor-in-possession. *See* 11 U.S.C. § 1107 ("[A] debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties ... of a trustee").

3 While Bankruptcy Appeals Panel decisions are not binding precedent, we find the rationale persuasive. *See* *In re Silverman*, 616 F.3d 1001, 1005 n.1 (9th Cir. 2010) (noting that while decisions from the Bankruptcy Appeals Panel are not binding, they are persuasive authority given their expertise in bankruptcy law).

4 While the *In re Moore* court did not address the sale of preference actions, the policy arguments underlying its holding apply with equal force in this case.

5 *In re Moore* cited this proposition—that allowing the sale of preference actions gives bankruptcy courts flexibility to maximize the value of the estate—favorably in dicta, stating that "[b]ankruptcy courts may determine, in any given situation, whether a sum-certain offer maximizes estate assets or whether, instead, an offer that includes a portion of future recoveries is more appropriate." *In re Moore*, 608 F.3d at 262 n.19 (citing *In re Lahijani*, 325 B.R. at 288).

6 While not explicit in Remmert's brief, at oral argument we asked Remmert "if this claim is property of the estate, and property can be sold or conveyed ... do they have to be a representative of the estate?" Remmert's counsel responded "they do." Remmert also stated in supplemental briefing to this Court that while one issue is whether avoidance actions are property which can be sold, a second issue is "when such a sale will confer standing because the purchaser's responsibilities qualify it as a 'representative of the estate.' "

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF DELAWARE

CRAIG T. GOLDBLATT
JUDGE

824 N. MARKET STREET
WILMINGTON, DELAWARE
(302) 252-3832

October 4, 2024

VIA CM/ECF

Re: *In re Pack Liquidating, LLC, et al.*, Case No. 22-10797

Official Committee of Unsecured Creditors of Pack Liquidating, LLC, et al., derivatively on behalf of the Debtors' estates v. Kepler Group, LLC, et al., Adv. Proc. No. 23-50536

Dear Counsel:

The debtors in this bankruptcy case operated an e-commerce business as third-party sellers of health, beauty, and other consumer products on online marketplaces.[1] The debtors filed their chapter 11 petitions in August 2022. The Committee filed this adversary proceeding seeking to avoid, as preferences and/or as fraudulent conveyances, $409,044.05 in payments that the debtors allegedly made to or for the benefit of the defendants in the 90 days before the bankruptcy filing.[2]

[1] Packable Holdings LLC and its affiliated debtors are referred to as the "debtors."

[2] The Official Committee of Unsecured Creditors, the plaintiff in this action, is referred to as the "Committee."

One of the defendants, Kepler, has moved to dismiss.[3] Kepler's principal argument is that $389,108.09 in payments are not recoverable as a matter of law because Kepler was not the "initial transferee," as defined by § 550 of the Bankruptcy Code, of the transfers in that amount. Instead, Kepler contends that it was a "mere conduit." Kepler also contends that the fraudulent conveyance claim fails because the complaint does not assert that the debtors received less than reasonably equivalent value in exchange for the transfers. Additionally, Kepler argues that the complaint fails to allege facts that would establish that the debtors were insolvent at the date of, or became insolvent as a result of, the transfers. Both the Committee and Amazon filed oppositions to Kepler's motion to dismiss, arguing that the affirmative defense of a mere conduit is premature at the pleading stage of this case.[4]

The Court concludes that the complaint, on its face, does not allege Kepler was a mere conduit. The Court will accordingly deny the motion to dismiss.

Factual and Procedural Background

Kepler is an e-marketing services provider that licenses and installs Amazon advertising platforms for its customers. The complaint alleges that Kepler purchased advertising campaigns from Amazon as an agent of the debtors. Amazon would bill Kepler each month for the services that Amazon provided to the debtors. Kepler, in turn, billed the debtors for the amount of Amazon's invoices, plus a fee for Kepler's

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[3] Defendant Kepler Group, LLC is referred to as "Kepler."

[4] *See* D.I. 31, 32, & 36.

services. The complaint further alleges that Kepler would then pay the Amazon invoices after it received payment from the debtors.

Jurisdiction

The Committee asserted claims to avoid and recover preferential transfers and fraudulent conveyances. These claims arise under the Bankruptcy Code (§§ 547, 548, and 550) and are thus within the district court's "arising under" jurisdiction as set out in 11 U.S.C. § 1334(b). These cases have been referred to this Court under 28 U.S.C. § 157(a) and the February 29, 2012 Standing Order of Reference of the United States District Court for the District of Delaware.

Analysis

At the motion to dismiss stage, the Court must determine whether the complaint's factual allegations, along with any attached exhibits, are sufficient to state the claims alleged. The Federal Rules of Civil Procedure require only a "short plain statement of the claim showing that the pleader is entitled to relief."[5] Rule 9 requires particularity when the plaintiff alleges fraud or mistake, but intent and knowledge may be alleged generally.[6] The purpose is to place defendants fairly on notice of the conduct alleged to give rise to the cause of action at issue.[7]

[5] Fed. R. Civ. P. 8(a)(2), made applicable by Fed. R. Bankr. P. 7008.

[6] Fed. R. Civ. P. 9(b), made applicable by Fed. R. Bankr. P. 7009.

[7] *In re Fruehauf Trailer Corp.*, 250 B.R. 168, 198 (D. Del. 2000).

The Third Circuit has set forth a two-step analysis to evaluate a motion to dismiss. *First*, courts should separate the factual and legal elements of a claim, accepting only the well-pled facts as true while disregarding any legal conclusions. And *second*, courts should determine whether the facts alleged, assuming them to be true, give rise to a plausible claim for relief.[8]

Generally, on a motion to dismiss, courts must limit their consideration to matters contained within the four corners of a complaint, including materials attached thereto.[9] There is, however, an exception that permits the consideration of a document that is either integral to or explicitly relied upon in the complaint.[10] In addition, those documents must be "undisputedly authentic" and attached as an exhibit to the motion to dismiss if the plaintiff's claims are based on that document.[11]

Kepler appended to its motion to dismiss a declaration signed by its counsel that purported to authenticate certain documents that were not attached to the complaint.[12] The Committee responds by objecting to that declaration, observing that it is not clear from the declaration that the declarant has personal knowledge of the

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[8] *Fowler v. UPMC Shadyside*, 578 F.3d 203, 210-211 (3d Cir. 2009) (giving effect to *Ashcroft v. Iqbal*, 556 U.S. 662 (2009) and *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007)).

[9] *See Pension Ben. Guar. Corp. v. White Consol. Indus.,* 998 F.2d 1192, 1196-97 (3d Cir. 1993). Note that under Federal Rule of Civil Procedure 10(c), a "copy of a written instrument that is an exhibit to a pleading is a part of the pleading for all purposes." Fed. R. Civ. P. 10(c).

[10] *See Angstadt v. Midd-West School Dist.,* 377 F.3d 338, 342 (3d Cir. 2004); *In re Start Man Furniture, LLC*, No. 22-50317, 2023 WL 2717662 (Bankr. D. Del. Mar. 30, 2023).

[11] *Pension Ben.,* 998 F. 2d at 1196.

[12] D.I. 22.

documents.[13] While the Committee's objection does not expressly challenge the authenticity of the documents, the point of the objection is that the attached documents themselves raise questions (including, perhaps, questions of authenticity) that the Committee has not had the opportunity to explore. The exception to the principle that a motion to dismiss should be premised on the allegations of the complaint and materials attached thereto, recognized in *White Consolidated Industries*, is a narrow one. Extraneous documents may be considered only when they are *indisputably* authentic. To find otherwise would risk bumping up against Rule 12(d), which provides that reliance on material outside the pleadings generally requires a court to treat the motion as one for summary judgment under Rule 56.[14] The Court will accordingly limit its consideration to the matters set forth in the complaint itself.

I. The complaint does not on its face plead facts that establish the affirmative defense of mere conduit.

Kepler argues that this complaint should be dismissed on the grounds that it is a mere conduit, not an initial transferee. As this Court addressed in *In re Art Institute of Philadelphia*, "a motion to dismiss measures the allegations set forth in the complaint against the elements of a plaintiff's *prima facie* case. The availability

[13] D.I. 32 at 6.

[14] Fed. R. Civ. P. 12(d). Note that in addition, Amazon contends in its opposition that the materials cited are not expressly relied on in the complaint. *See* D.I. 36 at 6-7.

of a potential affirmative defense is not generally cognizable on a motion to dismiss."[15] There is an exception, however, where the availability of the affirmative defense is apparent based on the plaintiff's own factual allegations.[16]

Section 550(a) enables the trustee to recover transfers avoided under §§ 547 and 548 from the initial transferee of such transfers, the entity for whose benefit such transfers were made, or any subsequent transferee.[17] A defense to such recovery is available, however, for "parties who act as a mere conduit in receiving a transfer solely for another and not for their own benefit."[18] A party that is a "mere conduit" is not a transferee from whom the trustee may recover transferred property under § 550.[19]

"To be a 'mere conduit,' a defendant must establish that it lacked dominion and control over the transfer because the payment simply passed through its hands and it had no power to redirect the funds to its own use."[20] "Where a transferee is 'not under any contractual or other obligation to use [transferred funds] for the benefit of [third parties,]' but rather, may use the funds freely, it is not a 'mere conduit.'"[21]

[15] No. 20-50627, 2022 WL 18401591, at *7 (Bankr. D. Del. Jan. 12, 2022).

[16] *See id.*

[17] 11 U.S.C. § 550(a)(1)-(2).

[18] *In re CVEO Corp.,* 327 B.R. 210, 216 (Bankr. D. Del. 2005).

[19] *In re FBI Wind Down, Inc.,* 614 B.R. 460, 500 (Bankr. D. Del. 2020).

[20] *In re Lenox Healthcare, Inc.,* 343 B.R. 96, 103 (Bankr. D. Del. 2006) (internal quotation and citations omitted).

[21] *Id.* at 104 (quoting *In re 360networks (USA) Inc.,* 338 B.R. 194, 202 (Bankr. S.D.N.Y. 2005)).

In examining whether a recipient of funds is a mere conduit, courts examine the sequence of payments between the debtor, defendant, and third-party. For example, "where the debtor reimburses the defendant for the defendant's advance payment to a third-party," but the "defendant is 'not under any obligation to use the transfers for the benefit of the claimants'" the defendant is the "owner" of the funds it receives, and thus is not a mere conduit.[22]

"Courts have made it clear that to be a conduit, one cannot be a creditor and receive a payment to satisfy a debt—this is the 'hallmark' of a preferential transfer."[23] And that principle "remains true even where a debtor imposes an obligation on the defendant to pass along funds to a third-party."[24] Instead, "a true conduit's obligation to the transferee would not arise until the transferor paid the conduit and the amount of the obligation would depend on the amount the transferor paid to the conduit."[25]

Kepler argues that the sequence of payments between itself, the debtors, and Amazon shows that it was a mere conduit of the funds. Kepler contends that unlike scenarios in which the debtor reimburses a defendant for an advanced payment, Kepler's obligation to pay Amazon did not arise unless and until the debtors paid Kepler the amounts owed to Amazon. Kepler further argues that its obligation to

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[22] *FBI Wind Down, Inc.,* 614 B.R. at 501 (quoting *Lenox Healthcare,* 343 B.R. at 104).

[23] *Lenox Healthcare,* 343 B.R. at 105 (citing *360networks*, 338 B.R. at 202).

[24] *FBI Wind Down, Inc.,* 614 B.R. at 501 (citing *In re Lambertson Truex, LLC*, 458 B.R. 155 (Bankr. D. Del. 2011)).

[25] *Lambertson*, 458 B.R. at 160 (citations omitted).

Amazon depended on the amount it received from the debtors. In support of those propositions, however, Kepler relies on the Amazon ad agreements and the advertising service agreement with the debtors, both of which were attached to the declarations.

In response to Kepler's motion to dismiss, the Committee contends that Kepler's status as a mere conduit requires a fact-intensive analysis regarding the extent of Kepler's dominion and control over the transfers. And that analysis includes an examination of the manner in which Kepler received and held the transfers, the bank accounts in which the funds were deposited, and Kepler's rights and uses of those accounts. The Committee argues that it is not obligated to disprove the affirmative defense of "mere conduit" at the pleadings stage of this litigation and that it has not yet had the opportunity to obtain the necessary discovery to address the defense. The Committee argues that even if the Court were to consider the exhibits attached to Kepler's declaration, those documents show that the payments came from a Kepler general operating account that commingled the transferred funds with non-debtor receipts.

Amazon's opposition to Kepler's motion to dismiss also asserts that the transferred funds were commingled in Kepler's bank account, illustrating its dominion and control over the transfers. Amazon argues that there is no evidence that Kepler used the same funds that it received from the debtors to pay Amazon because Kepler deposited the funds into a general operating account that it used to

pay Amazon. That bank account was allegedly controlled by Kepler and was in Kepler's own name. Amazon further contends that Kepler had both the discretion to decide how much to pay Amazon and when to pay Amazon. Both Amazon and the Committee point to caselaw that holds that a vendor is not a "mere conduit" where it accepts payments into its general operating account, thereby commingling the fund received with its other funds, even if the vendor transfers a portion of the funds to a third-party.

In *In re U.S. Interactive, Inc.,* the defendant was a travel agency that forwarded the debtors' transferred funds to hotels and airlines on behalf of the debtors.[26] The court held that the defendant retained dominion and control over the transferred funds because the money went into a general operating account from which a variety of parties could be paid.[27] The court reasoned that the defendant had "the power to decide who to pay with the funds received from the Debtors, including the Defendant's own creditors."[28] Because the defendant had the ability to decide who to pay, it was not a mere conduit.

Additionally, in *In re AES Thames,* the defendant argued it was acting as an agent and mere conduit when accepting payments from the debtor for third-parties.[29]

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[26] 321 B.R. 388, 396 (Bankr. D. Del. 2005).

[27] *Id.*

[28] *Id.*

[29] *In re AES Thames, LLC*, No. 13-50406-KJC, 2016 WL 11595116, at *5 (Bankr. D. Del. Oct. 28, 2016).

The court focused on the following facts in determining that the defendant exercised dominion and control over the transferred funds: (1) the defendant's "bank account was maintained solely in its name"; (2) it "deposited funds into its account from sources other than the Debtor"; and (3) the defendant had no obligation to "segregate funds, hold funds in escrow or hold funds in trust that it received from the Debtor for the benefit of any third parties."[30] There, the court found that the defendant was "free to do what it pleased with the proceeds" from the debtor, despite the fact that the defendant "chose to pay a portion of the proceeds to [third-parties]."[31]

Here, the complaint does not allege facts that would establish that Kepler was a mere conduit. And even if the Court were to consider the attached documents, those documents on their face establish only that Kepler's obligation to pay Amazon did not arise until the debtors paid Kepler amounts owed to Amazon. That is not by itself sufficient to establish the defense. Evidence may still be presented establishing that the transferred funds went to a general Kepler bank operating account where such funds were commingled with non-debtor funds. Under the case law, that would suggest that Kepler was not a mere conduit.

Accordingly, the Court is satisfied that this is not one of those cases in which the complaint itself operates to plead the plaintiff out of court by alleging facts that

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[30] *Id.*

[31] *Id.*

show the availability of an affirmative defense. The Court will deny the motion to dismiss.

II. The complaint adequately alleges, in the alternative to its preference claim, a claim for fraudulent conveyance under § 548.

Kepler argues that the fraudulent conveyance claim fails because the complaint does not assert that the debtors received less than reasonably equivalent value in exchange for the transfers. Kepler also contends that the complaint fails to show that the debtors were insolvent at the time of, or became insolvent as a result of, the transfers at issue. In response, the Committee argues that the complaint asserts the fraudulent conveyance claim as an alternative theory to the preference claim. The Committee contends that the fraudulent conveyance claim operates to preserve the Committee's ability to pursue a fraudulent conveyance theory if it were to turn out that, contrary to the allegations in their preference count, one or more transfers were not made on account of antecedent debt (since the satisfaction of a valid debt would constitute reasonably equivalent value).

The complaint does generally allege that the debtors were insolvent, had insufficient liquidity to funds their operations, and were incurring debts beyond their availability to pay at the time of the transfers. The complaint incorporates by reference the declaration of Brian Teets in support of the chapter 11 petitions and first day motions that sets forth such facts.[32]

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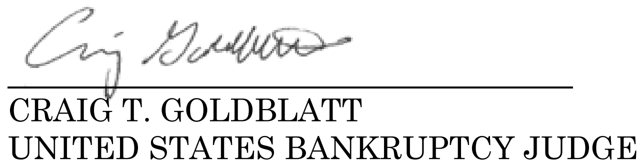
[32] Main Case D.I. 13.

Kepler is likely correct that a transaction cannot give rise to *both* claims for preference and constructive fraudulent conveyance. The element of a preference that the payment be in satisfaction of an antecedent debt would likely by itself establish reasonably equivalent value, and thus defeat a claim for constructive fraudulent conveyance. But the Committee is right that it is entitled to assert those claims in the alternative. The motion to dismiss the fraudulent conveyance claim will therefore also be denied.

Conclusion

For the reasons set forth above, the Court will deny Kepler's motion to dismiss. The Court will issue a separate order so providing.

Dated: October 4, 2024



CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

Faculty

Hon. Heather Z. Cooper is the Chief U.S. Bankruptcy Judge for the District of Vermont in Burlington. Prior to her appointment on March 14, 2022, she began her legal career as a briefing attorney to Justice David L. Richards of the Texas Court of Appeals, Second District. She then entered private practice with the firm of Dunn, Kacal, Adams, Pappas & Law, P.C. in Houston, followed by the firm of Murphy & King, P.C. in Boston. In 2004, Judge Cooper moved to Vermont and clerked for former Bankruptcy Judge Collen A. Brown (her predecessor). In 2006, Judge Cooper joined the firm of Facey Goss & McPhee P.C., a Vermont-based law firm, as an associate and then as a partner. Judge Cooper's practice focused on litigation with extensive and diverse bankruptcy law experience, with more than 20 years of experience in the financial and restructuring industry, representing individual and corporate debtors and creditors in loan workouts and restructurings, liquidations, foreclosures, litigation seizures and receiverships. During her partnership at Facey Goss & McPhee P.C., Judge Cooper served as managing partner and became certified in Consumer Bankruptcy Law by the American Board of Certification. She also served as the Bankruptcy Law Section Chair of the Vermont Bar Association from 2014-18 and on various task forces for the U.S. Bankruptcy Court for the District of Vermont since 2011. Judge Cooper is a member of the Texas, Massachusetts and Vermont Bar Associations, the Federal Bar Council, the National Conference of Bankruptcy Judges, ABI and the National Association of Bankruptcy Trustees. She serves as a member of the Human Resources Advisory Council of the Administrative Office of the U.S. Courts and various Second Circuit committees. Judge Cooper is a frequent lecturer at national conferences on bankruptcy-related issues. She received her B.A. from the University of Houston in 1993 and her J.D. *magna cum laude* from South Texas College of Law in 1998.

Hon. Clifton R. Jessup, Jr. is a U.S. Bankruptcy Judge for the Northern District of Alabama in Huntsville, appointed on March 2, 2015. He was formerly a principal shareholder in the Dallas office of Greenburg Traurig, LLP, where he concentrated his practice in business reorganization and bankruptcy. During his more than 35 years of bankruptcy-related practice before taking the bench, Judge Jessup represented secured creditors, unsecured creditors, committees, equity-holders, debtors and trustees in federal bankruptcy cases in more than 37 states and Puerto Rico. He also represented purchasers of assets in bankruptcy cases, and served as examiner and mediator in many cases. In 2001, Judge Jessup was selected as the liquidating trustee under the confirmed chapter 11 plan in the Baptist Foundation of Arizona, the largest nonprofit bankruptcy cases filed to date. The cases involved more than 13,000 investors and claims in excess of $600 million. In 2009, he represented the Opus West Corp. in a chapter 11 case involving more than 50 commercial real estate properties in California and Texas with claims in excess of $1.2 billion. Judge Jessup is a member of the Advisory Committee to ABI's Commission to Study the Reform of Chapter 11 and of the Texas State Bar. He received his J.D. in 1978 from the University of Michigan.

Alexa J. Kranzley is a partner with Sullivan & Cromwell LLP's Finance and Restructuring Group in New York. She represents companies and creditors in chapter 11 proceedings and out-of-court corporate and financial restructurings, as well as and private-equity and hedge funds in connection with distressed transactions and special-situation investments. Ms. Kranzley also has experience handling adversary proceedings, contested matters and both debtor and creditor representations in bankruptcy

proceedings. Ms. Kranzley's practice is international, and she has worked in collaboration with the firm's other offices on substantive matters involving restructurings in other jurisdictions. Ms. Kranzley was honored as a member of ABI's 2018 "40 Under 40" class and nominated and inducted in 2017 into the International Insolvency Institute's NextGen Leadership Program. She is also recognized by *IFLR1000* 2018 as a "Rising Star" and was named a 2021 "Outstanding Young Restructuring Lawyer" by *Turnarounds & Workouts*. Ms. Kranzley received her B.S. in 2005 from Cornell University and her J.D. in 2008 from Brooklyn Law School.

Lorenzo Marinuzzi is a partner with Morrison & Foerster in New York and global co-chair of its Business Restructuring & Insolvency Group. He represents debtors, creditors and creditors' committees in complex bankruptcy cases, workouts and litigation, and his cases have spanned the U.S. as well as countless industries, such as airline and cargo transportation, mortgage origination and servicing, retail, banking and finance, energy, oil and gas, and telecommunications. Mr. Marinuzzi has represented unsecured creditors' committees in numerous recent chapter 11 cases, including Windstream Holdings Inc., Cloud Peak Energy, Westmoreland Coal Co. Inc., The NORDAM Group Inc., Avaya Inc., Armstrong Energy Inc., 21st Century Oncology Holdings Inc., Peabody Energy Inc., Energy Future Holdings Corp. and UCI International Inc. He also recently represented Maxus Energy Corp. and HOVENSA LLC in their chapter 11 cases. Mr. Marinuzzi is listed as a leading lawyer in *Chambers USA* and has also been recommended by *The Legal 500 US*. He was also designated by *Turnarounds & Workouts* magazine as an Outstanding Restructuring Lawyer for his accomplishments in 2016 and 2017. Mr. Marinuzzi received his B.A. from Fordham University in 1993 and his J.D. from Fordham University School of Law in 1996, where he was a staff member of the *Fordham Urban Law Journal*.

Hon. Pamela W. McAfee is a U.S. Bankruptcy Judge for the Eastern District of North Carolina in Raleigh, appointed on Jan. 7, 2022. Prior to taking the bench, she was a creditors' rights attorney, commercial litigator and mediator for 13 nonconsecutive years and served as a law clerk or career law clerk for four bankruptcy judges over 14 nonconsecutive years. Judge McAfee has spoken and written on a variety of bankruptcy topics, served on the Local Rules Committee for the bankruptcy court and the Local Civil Rules Subcommittee for the district court, and was an adjunct professor of bankruptcy law and a moot court coach at Campbell Law School. In 2016, she was recognized by the North Carolina Bar Association with the Citizen Lawyer Award for her work with HopeLine, a suicide prevention hotline, and for her mentoring activities with law students and young lawyers. Judge McAfee received her undergraduate degree from the University of Pennsylvania and her J.D. with honors from the University of North Carolina School of Law.

Hon. Elizabeth S. Stong has served as a U.S. Bankruptcy Judge for the Eastern District of New York in Brooklyn since 2003. Prior to her appointment the bench, she was a litigation partner and associate at Willkie Farr & Gallagher in New York, an associate at Cravath, Swaine & Moore, and law clerk to Hon. A. David Mazzone, U.S. District Judge in the District of Massachusetts. Judge Stong is a member of the Council on Foreign Relations, the Council of the American Law Institute, and the boards of the National Conference of Bankruptcy Judges, the Practising Law Institute, the New York County Lawyers' Association and the New York Law Institute. She is a member of the Advisory Committee of Columbia University's Committee on Global Thought and the Advisory Board of P.R.I.M.E. Finance, an international dispute resolution and judicial training organization, as well as co-chair of the New York City Bar's Middle East-North Africa Law Committee. Judge Stong regularly serves as

a delegate to UNCITRAL's Working Groups on Arbitration and Conciliation and Insolvency, and is an elected member of the European Law Institute. She also chairs the ABA Standing Committee on Continuing Legal Education and holds leadership roles in the International Insolvency Institute, ABI and the ABA's Business Law Section, International Law Section and Judicial Division. In addition, she is an adjunct professor at Brooklyn Law School. Judge Stong has trained judges in more than 25 countries on five continents, including North, Central and West Africa, Central Europe, Central Asia, the Middle East, the Arabian Peninsula and South America, with the U.S. Commerce Department Commercial Law Development Program, the World Bank, INSOL and the ABA-Rule of Law Initiative, among other entities. She also has consulted with the Supreme Court of China and People's High Courts in Beijing and Guangzhou, the Uganda Registration Services Bureau, and recently has led judicial workshops and consultations in Bahrain, Kuwait, Kazakhstan, Nigeria and Brazil, among other venues. Judge Stong received the ABA International Law Section's Mayre Rasmussen Award for the Advancement of Women in International Law, the New York City Bar "Her Hero" Lifetime Achievement Award, the American Bar Foundation's Outstanding State Chair Award, the ABA Glass Cutter Award, the NYIC Honorable Burton R. Lifland Mentor of the Year Award, the NYIC Hon. Cecelia Goetz Award, the Association of Insolvency and Restructuring Advisors Judicial Service Award, the MFY Legal Services Scales of Justice Award, and the Brooklyn Bar Association's Freda Nisnewitz Award for *Pro Bono* Service, among others. She received her A.B. *magna cum laude* from Harvard University and her J.D. from Harvard Law School, where she received the Williston Prize, and she studied at the Université des Sciences Sociales in Toulouse, France, as a Rotary Foundation Graduate Fellow.