IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	
Zohar III, Corp.,[1]	)	Case No. 18-10512 (KBO)
	)	
Debtor.	)	(Jointly Administered)
	)	
	)	
DAVID DUNN, AS LITIGATION TRUSTEE FOR ZOHAR LITIGATION TRUST-A,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. Proc. No. 20-50534 (KBO)
	)	
PATRIARCH PARTNERS, LLC; PATRIARCH PARTNERS VIII, LLC; PATRIARCH PARTNERS XIV, LLC; PATRIARCH PARTNERS XV, LLC; PHOENIX VIII, LLC; OCTALUNA LLC; OCTALUNA II LLC; OCTALUNA III LLC; ARK II CLO 2001-1, LIMITED; ARK INVESTMENT PARTNERS II, LP; ARK ANGELS VIII, LLC; PATRIARCH PARTNERS MANAGEMENT GROUP, LLC; PATRIARCH PARTNERS AGENCY SERVICES, LLC; and LYNN TILTON,	)	**Related to Docket No. 211**
	)	
Defendants, and	)	
	)	
180S, INC.; BLACK MOUNTAIN DOORS, LLC; CROSCILL HOME, LLC; DURO TEXTILES, LLC; GLOBAL	)	

[1] The Debtor in this chapter 11 case, along with the last four digits of its federal tax identification number, is Zohar III, Corp. (9612). The Debtor's address is c/o Province, LLC 70 Canal Street, Suite 12E, Stamford, CT 06902. In addition to Zohar III, Corp., the Debtor's affiliates include the following debtors whose bankruptcy cases have been closed prior to the date hereof, along with the last four digits of their respective federal tax identification numbers and chapter 11 case numbers: Zohar II 2005-1, Corp. (4059) (Case No. 18-10513); Zohar CDO 2003-1, Corp. (3724) (Case No. 18-10514); Zohar III, Limited (9261) (Case No. 18-10515); Zohar II 2005-1, Limited (8297) (Case No. 18-10516); Zohar CDO 2003-1, Limited (5119) (Case No. 18-10517). All motions, contested matters, and adversary proceedings that remained open as of the closing of such cases, or that are opened after the date thereof, with respect to such closed-case debtors, are administered in this remaining chapter 11 case.

AUTOMOTIVE SYSTEMS, LLC; HERITAGE AVIATION, LTD.; INTREPID U.S.A., INC.; IMG HOLDINGS, INC.; JEWEL OF JANE, LLC; MOBILE ARMORED VEHICLES, LLC; SCAN-OPTICS, LLC; SILVERACK, LLC; STILA STYLES, LLC; SNELLING STAFFING, LLC; VULCAN ENGINEERING, INC; and XPIENT SOLUTIONS, LLC, Nominal Defendants.	)
PATRIARCH PARTNERS VIII, LLC; PATRIARCH PARTNERS XIV, LLC; PATRIARCH PARTNER XV, LLC; OCTALUNA LLC; OCTALUNA II LLC; OCTALUNA III LLC; PATRIARCH PARTNERS AGENCY SERVICES, LLC; and PATRIARCH PARTNERS, LLC, Counterclaim and Third-Party Claimants, -against- ZOHAR CDO 2003-1, LIMITED; ZOHAR CDO 2003-1, CORP.; ZOHAR II 2005-1, LIMITED; ZOHAR II 2005-1, CORP.; ZOHAR III, LIMITED; ZOHAR III, CORP., Counterclaim and Third-Party Defendants.	)

MEMORANDUM ORDER GRANTING IN PART AND DENYING IN PART THE ZOHAR LITIGATION TRUST-A'S MOTION TO DISMISS DEFENDANTS' COUNTERCLAIMS AND THIRD-PARTY CLAIMS

Before the Court is the *Zohar Litigation Trust-A's Motion to Dismiss Defendants' Counterclaims and Third-Party Claims* [Adv. D.I. 211] (the "Motion to Dismiss"). For the reasons set forth herein, the Motion to Dismiss is granted in part and denied in part.[2]

[2] The Court has subject matter jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157(a) and 1334(b). Venue is proper pursuant to 28 U.S.C. § 1409(a).

I. PROCEDURAL HISTORY

This adversary proceeding (the "Zohar Adversary") relates to the bankruptcy cases of Zohar III, Corp., Zohar II 2005-1, Corp., Zohar CDO 2003-1, Corp., Zohar III, Limited, Zohar II 2005-1, Limited, and Zohar CDO 2003-1, Limited (collectively, the "Debtors").[3] Their chapter 11 cases were commenced on May 11, 2018. On June 21, 2022, the Court entered an order (the "Confirmation Order")[4] approving the *Third Amended Joint Plan of Liquidation Under Chapter 11 of the Bankruptcy Code for Zohar III, Corp. and Its Affiliated Debtors*. Shortly thereafter, the Court approved certain modifications to this plan and confirmed the *Fourth Amended Joint Plan of Liquidation Under Chapter 11 of the Bankruptcy Code for Zohar III, Corp. and its Affiliated Debtors* (the "Plan").[5] The Confirmation Order was not appealed and is final. The Plan went effective on August 2, 2022 (the "Effective Date").[6]

Prior to the Effective Date, debtors Zohar CDO 2003-1, Limited, Zohar II 2005-1, Limited, Zohar III, Limited (together, the "Zohar Funds") filed a complaint (the "Complaint") against Lynn Tilton and a variety of her affiliated entities (collectively, the "Defendants"), commencing the Zohar Adversary. The current third amended Complaint[7] contains forty-one counts, alleging claims for, among other things, breach of contract, tortious interference, breach of fiduciary duty, conversion, unjust enrichment, and fraudulent transfer.[8] In accordance with the Plan, the claims of the Debtors were transferred to the Zohar Litigation Trust-A (the "Litigation Trust"),[9] and the Litigation Trust was substituted as Plaintiff in the Zohar Adversary.[10]

II. SUMMARY OF COUNTERCLAIMANTS' CLAIMS

Defendants Patriarch Partners VIII, LLC, Patriarch Partners XIV, LLC, and Patriarch Partners XV, LLC (the "Patriarch Managers"), Octaluna LLC, Octaluna II LLC, and Octaluna III LLC (the "Octaluna Entities"), Patriarch Partners Agency Services, LLC ("PPAS"), and Patriarch Partners, LLC ("Patriarch Partners" and collectively, the "Counterclaimants") assert eight counterclaims and third-party claims against the Debtors in the Zohar Adversary.[11] Disputes amongst the Debtors, the Defendants, and other stakeholders have been ongoing in various state and federal courts for over a decade. The parties are well familiar with each other, the various

[3] Defendants refer to the Debtors collectively as the "Zohar Obligors".

[4] Case No. 18-10512, D.I. 3400.

[5] *Id.*, D.I. 3467 (Confirmation Order) & 3474 (Plan).

[6] *Id.*, D.I. 3476.

[7] *See* Adv. D.I. 295. The Litigation Trust filed the third amendment to the Complaint on December 8, 2022 following completion of briefing on the Motion to Dismiss.

[8] Forty-two counts are included but one is "reserved".

[9] *See, e.g.*, Confirmation Order ¶¶ 13, 23; Plan §§ 6.1, 6.8; Case No. 18-10512, D.I. 3391 (Plan Supplement), Ex. H-1 § 1.2 & n.7.

[10] *See, e.g.*, Confirmation Order ¶ 23.

[11] *See* Adv. D.I. 188 (the "Answer").

claims and causes of action alleged between them, and the asserted factual underpinnings for them. The Court has tailored this Memorandum Order accordingly.

Count 1 alleges that the Debtors failed to pay the Patriarch Managers fees due for collateral management services in breach of the Zohar Funds' obligations under applicable collateral management agreements (the "CMAs"). Count 2 asserts that the Zohar Funds failed to indemnify the Patriarch Managers for fees and expenses incurred in connection with two prior litigations referred to as the "Books and Records Action" and the "Interpleader Action"[12] in breach of their obligations under the CMAs. Count 3 asserts another indemnification claim against the Zohar Funds, alleging that they failed to reimburse PPAS for losses and expenses it incurred arising from its activities as administrative agent under the credit agreements between the Debtors and various portfolio company borrowers (the "Credit Agreements"). Count 4 is Patriarch Partners' indemnification claim against the Zohar Funds arising under the credit agreement of portfolio company borrowers Inter-Marketing Group, Inc., Dana Classic Fragrance, Inc., and Dana, S.A.U. (together "IMG") related to fees and expenses incurred in connection with the defense of six asbestos lawsuits in which Patriarch Partners is a named defendant (the "Asbestos Actions"). In Count 5, the Octaluna Entities seek repayment from the Debtors of three matured Class B secured notes (the "Class B Notes") issued prepetition in principal amounts totaling $546 million (the "Class B Note Claims"). Finally, the Counterclaimants assert against the Debtors an unjust enrichment claim (Count 6) for the amounts sought in Counts 1 through 5 as well as "claims" for recoupment (Count 7) and setoff (Count 8) for amounts sought in Counts 1 through 6.

The Motion to Dismiss seeks dismissal of all Counts under Rule 12(b)(6) of the Federal Rules of Civil Procedure (the "Federal Rules"), which has been made applicable to this proceeding by Rule 7012 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

III. LEGAL STANDARD UNDER FEDERAL RULE 12(b)(6)

Federal Rule 8(a)(2), made applicable to this proceeding by Bankruptcy Rule 7008, provides that to state a claim for relief, a pleading must contain "a short and plain statement of the claim showing that the pleader is entitled to relief[.]"[13] This rule imposes a "notice pleading standard . . . to give the defendant fair notice of what the claim is and the grounds upon which it

[12] The Books and Records Action was commenced in 2016 by Alvarez and Marsal Zohar Management, LLC ("AMZM"), as then-collateral manager for the Zohar Funds, in the Delaware Court of Chancery and is captioned *Zohar CDO 2003-1, LLC v. Patriarch Partners, LLC*, No. 12247 (Del. Ch. Ct. 2016). Answer at 93 ¶ 36, at 95 ¶ 42. On behalf of the Zohar Funds, AMZM alleged that the Patriarch Managers failed to turn over required books and records following their resignation as the Zohar Funds' collateral manager in March 2016. *Id.* at 92 ¶ 35, at 95 ¶¶ 42-43. The Delaware Court of Chancery ultimately required the Patriarch Managers to turnover certain books and records. *Id.* at 95 ¶ 43.

The Interpleader Action was commenced in New York Supreme Court and captioned *U.S. Bank Nat'l Ass'n v. Patriarch Partners XIV, LLC*, Index No. 652173/2016 (N.Y. Sup. Ct. 2016). *Id.* at 95 ¶ 42. The action was filed after AMZM refused to allow the Patriarch Managers to receive certain collateral management fees after their resignation. *Id.* at 93-95 ¶¶ 38-42. The claims related to these unpaid fees will now be decided in the Books and Records Action. *Id.* at 95 ¶ 44.

[13] FED. R. CIV. P. 8(a).

rests."[14] While detailed facts are not necessary, "a plaintiff is required to put the defendant on notice as to the basics of the plaintiff's complaint [and] to set forth the facts with sufficient particularity to apprise the defendant fairly of the charges made against him so that he can prepare an adequate answer."[15] When reviewing a motion to dismiss under Federal Rule 12(b)(6) challenging the sufficiency of a plaintiff's statement of claim, a court must "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the complaint, the plaintiff may be entitled to relief."[16] Under the standards set forth by the United States Supreme Court in *Ashcroft v. Iqbal*[17] and *Bell Atlantic Corp. v. Twombly*[18], this is a plausibility, not a probability, standard.[19] It requires more than a sheer possibility that a defendant acted unlawfully. Rather, a plaintiff must allege sufficient facts that nudge the claims "across the line from conceivable to plausible[.]"[20]

IV. LEGAL DISCUSSION

The parties advance many, and often overlapping, issues in connection with the Motion to Dismiss. The Court has attempted to address the arguments relevant to each Count in an efficient manner. In light of the conclusions reached herein, it is unnecessary to address all issues briefed.

A. The Plan and Confirmation Order Bar Counterclaimants' Affirmative Damage Claims in Counts 1-6

Counts 1 through 6 assert claims against the Debtors for monetary damages. As the Counterclaimants admit, these claims are reflected in the Counterclaimants' proofs of claim asserted against the Debtors in their bankruptcy proceedings.[21] The confirmed Plan classifies the Counterclaimants' claims, addresses the procedures for resolving disputes, and provides for their treatment if allowed. Specifically, a portion of Counterclaimants' claims for alleged unpaid

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[14] *Phillips v. Cnty. of Allegheny*, 515 F.3d 224, 233 (3d Cir. 2008) (citing *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007)).

[15] *In re Lexington Healthcare Grp., Inc.*, 339 B.R. 570, 575 (Bankr. D. Del. 2006) (internal quotations and citations omitted); *see also In re APF Co.*, 308 B.R. 183, 188 (Bankr. D. Del. 2004); *Mervyn's LLC v. Lubert-Adler Grp. IV, LLC (In re Mervyn's Holdings, LLC)*, 426 B.R. 488, 495 (Bankr. D. Del. 2010).

[16] *Crystallex Int'l Corp. v. Petrolesos De Venezuela, S.A.*, 879 F.3d 79, 83 n.6 (3d Cir. 2018) (quoting *F.T.C. v. Wyndham Worldwide Corp.*, 799 F.3d 236, 242 (3d Cir. 2015)).

[17] 556 U.S. 662 (2007).

[18] 550 U.S. 544 (2007).

[19] *Iqbal*, 556 U.S. at 678.

[20] *Twombly*, 550 U.S. at 570.

[21] *See* Adv. D.I. 244 ¶ 22; *see also* Case No. 18-10512, Claim 8-1 (Patriarch Partners XV, LLC), 9-1 (Octaluna III, LLC) (incorporating Counterclaims and preserving rights of setoff and/or recoupment); Case No. 18-10513, Claim 5-1 (Patriarch Partners XIV, LLC), 6-1 (Octaluna II, LLC) (same); Case No. 18-10514, Claim 4-1 (Patriarch Partners VIII, LLC), 5-1 (Octaluna, LLC) (same); Case No. 18-10515, Claim 9-1 (Patriarch Partners XV, LLC), 10-1 (Octaluna III, LLC), 11-1 (Patriarch Partners Agency Services, LLC), 12-1 (Patriarch Partners, LLC) (same); Case No. 18-10516, Claim 9-1 (Patriarch Partners XIV, LLC), 10-1 (Octaluna II, LLC), 11-1 (Patriarch Partners Agency Services, LLC), 12-1 (Patriarch Partners, LLC) (same); Case No. 18-10517, Claim 10-1 (Patriarch Partners VIII, LLC), 11-1 (Octaluna, LLC), 12-1 (Patriarch Partners Agency Services, LLC), 13-1 (Patriarch Partners, LLC) (same).

collateral management fees deemed the "Patriarch Disputed CMA Fee Claims" is classified in Classes 2A, 9A, and 14A and is unimpaired.[22] They are to be adjudicated by the Delaware Court of Chancery in the Books and Records Action as agreed to in the Plan.[23] Any amounts determined to be owed will be paid from funds set aside in the "Patriarch Disputed CMA Fee Escrow."[24] The remainder of Counterclaimants' claims are classified in Classes 6, 7, 11, 12, 17, 18. They are impaired by the Plan and will receive no distribution.[25] To the extent that the claims must be litigated, the Plan contains general procedures governing the procedure for resolution.

As a means for implementation, the Plan provides, among other things, that "[o]n the Effective Date, except to the extent otherwise specifically provided for in the Plan . . . the obligations of the Debtors pursuant, relating, or pertaining to the Zohar Indentures, the Interests in the Debtors and all other Cancelled Debt and Equity Documentation shall be fully released, settled, and compromised[.]"[26] It also makes clear that:

> From and after the Effective Date, the parties to the Zohar Indentures and the Transaction Documents and such other Canceled Debt and Equity Documentation will have no rights against the Debtors arising [there]from or related [there]to . . ., all such rights being expressly extinguished pursuant to this Plan; *provided*, that, . . . any such Zohar Indenture or other Cancelled Debt and Equity Documentation that governs the rights of the Holder of a Claim or Interest shall continue in effect solely . . . for purposes of enabling Holders of Allowed Claims to receive distributions under the Plan solely as expressly provided herein . . . .[27]

Finally, the Plan imposes an injunction applicable to any claimant:

> Subject to the occurrence of the Effective Date, Confirmation of the Plan shall act as a permanent injunction against any Entity commencing or continuing any action, employment of process, or act to collect, offset (except as permitted by Section 10.8 of the Plan) or recover any claim, interest, or Cause of Action satisfied, released

[22] The Plan defines the "Patriarch Disputed CMA Fee Claims" as claims asserted by the Patriarch Managers for "'Disputed Collateral Management Fees,' including any 'Newly Payable Disputed Collateral Management Fees,' as such terms are defined in the Patriarch CMA Fee Dispute Documents." *See* Plan §§ 1.149, 1.165, 1.182. The Patriarch CMA Fee Dispute Documents include an escrow agreement, a confidential settlement agreement, and a Stipulation and Order filed in the Books and Records Action. *Id.* § 1.101.

[23] *Id.* § 6.16 (directing Litigation Trustee to prosecute to conclusion or settlement the dispute over the Patriarch Disputed CMA Fee Claims in accordance with the Patriarch CMA Fee Dispute Documents); *see also* Adv. D.I. 244 ¶ 62 (admitting that the Patriarch Disputed CMA Fee Claims are being pursued in the Books and Records Action); Jan. 30, 2023 Hr'g Tr. 67:6-8 (same).

[24] *See* Plan §§ 4.3(c), 4.12(c), 4.19(c).

[25] *See id.* §§ 4.8, 4.9, 4.15, 4.16, 4.22, 4.23.

[26] *See id.* § 6.3.

[27] *Id.*

> or exculpated under the Plan to the fullest extent authorized or provided by the Bankruptcy Code.
>
> Without limiting the foregoing, from and after the Effective Date, all Entities that have held, hold, or may hold claims, interests, or Causes of Action satisfied, released or exculpated under the Plan shall be permanently enjoined from taking any of the following actions against, as applicable, the Deferred Transfer Assets, the Asset Recovery Entity, Asset Recovery Manager, Litigation Trust(s), Litigation Trustee, Wind-Down Company (if any), Wind-Down Administrator, Released Parties or Exculpated Parties, on account of any such claims, interests, or Causes of Action: (a) commencing or continuing in any manner any suit, action or other proceeding; (b) enforcing, attaching, collecting, or recovering by any manner or means any judgment, award, decree, or order; (c) creating, perfecting, or enforcing any encumbrance of any kind; and (d) commencing or continuing in any manner any action or other proceeding of any kind.[28]

In light of these Plan provisions, the Litigation Trust requests the dismissal of Counts 1 through 6 because the Counterclaimants seek to recover damages against the Debtors in violation of the Plan. In opposition, the Counterclaimants acknowledge that they are only entitled to damages to the extent that the claims are allowed and entitled to a distribution under the Plan. However, they argue that claim allowance and distributions are not subject to the Plan injunction.

While that may be the case, the Counterclaimants' unilateral pursuit of their damage claims in the Zohar Adversary is plainly inconsistent with the Plan's claims allowance procedures, classification and treatment provisions, and injunction, to which they did not object and are therefore bound.[29] Moreover, as mentioned, the Plan provides that the Patriarch Disputed CMA Fee Claims will be adjudicated in the Books and Records Action and satisfied from the established escrow. However, because of insufficient estate assets, the remainder of the Counterclaimants' claims are not entitled to any distribution under the Plan. In the unlikely event that the claims need be addressed, the Litigation Trustee has been given the authority under the Plan to object to Counterclaimants' claims no later than 180 days after the Plan's Effective Date (or longer if the

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[28] *See id.* § 10.6.

[29] *See* 11 U.S.C. § 1141(a) ("the provisions of a confirmed plan bind the debtor . . . and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan."); *see also In re Arctic Glacier Int'l, Inc.*, 901 F.3d 162, 166 (3d Cir. 2018), as amended (Oct. 24, 2018) ("When a bankruptcy court enters a confirmation order, it renders a final judgment. That judgment, like any other judgment, is res judicata. It bars all challenges to the plan that could have been raised. Challengers must instead raise any issues beforehand by objecting to confirmation." (internal citations omitted)); *Donaldson v. Bernstein*, 104 F.3d 547, 554 (3d Cir. 1997) ("It is true that 'a confirmation order is res judicata as to all issues decided or which could have been decided at the hearing on confirmation.'" (quoting *In re Szostek*, 886 F.2d 1405, 1408 (3d Cir. 1989)).

Court extends the claims objection deadline).[30] If an objection is pursued, the Court may order the consolidation of such contested matter with the Zohar Adversary at that time.[31] Accordingly, the Court will grant the relief requested by the Litigation Trust and dismiss Counts 1 through 6.[32]

B. Federal Rule 12(f) - Not Federal Rule 12(b)(6) – Applies to the Recoupment and Setoff Defenses in Counts 7 and 8

The Litigation Trust has moved to dismiss Counts 7 and 8 under Federal Rule 12(b)(6). Counterclaimants argue that this is procedurally improper with respect to Count 7 and that the Litigation Trust was required to move under Federal Rule 12(f).[33] The Court agrees with the Counterclaimants and extends its conclusion to Count 8 as well.

Count 7 asserts a claim for recoupment. Count 8 asserts a claim for setoff. Both are more appropriately labeled as affirmative defenses, not claims.[34] The Counts do "not seek[] to recover money on an enforceable obligation . . , but rather, . . . assert[] only defenses to claims" to diminish them or defeat recovery.[35] Consequently, Federal Rule 12(f) applies – not Federal Rule 12(b)(6).[36] Under this rule, a court "may strike from a pleading an insufficient defense or any redundant, immaterial, impertinent, or scandalous matter."[37] The purpose is "to clean up the pleadings, streamline litigation, and avoid unnecessary forays into immaterial matters."[38]

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[30] *See* Plan, Art. VIII ("Procedures for Resolving Contingent, Unliquidated, and Disputed Claims").

[31] The Litigation Trust filed a claims objection, seeking disallowance of the Octaluna Entities' Class B Note Claims for reasons set forth in the Motion to Dismiss. *See* Case No. 18-10512, D.I. 3487. The Octaluna Entities responded. *Id.*, D.I. 3566. Further prosecution of the claims objection has not occurred, and no further objections to the Counterclaimants' claims have been brought.

[32] The Counterclaimants also argue in their opposition brief that their claims in Counts 1 through 6 should not be dismissed because of the equitable subordination claim that they had asserted against certain of the Debtors' secured noteholders, which if successful could reorder creditor priority or disgorge rights and assets distributed under the Plan. This Court dismissed that claim in March 2022. *Tilton v. MBIA Inc. (In re Zohar III, Corp.)*, 639 B.R. 73 (Bankr. D. Del. 2022). An appeal was pursued, and the Delaware District Court subsequently affirmed the dismissal. *Tilton v. MBIA Inc. (In re Zohar III, Corp.)*, No. 22-400, 2022 WL 3278836 (D. Del. Aug. 11, 2022). A further appeal was taken but later abandoned after briefing was complete on the Motion to Dismiss. *See Order, In re Zohar III, Corp.*, No. 22-2695, D.I. 32 (3d Cir. Nov. 10, 2022) (dismissing appeal in accordance with the agreement of the parties). Accordingly, any argument resting upon possible equitable subordination is moot.

[33] The Litigation Trust had the opportunity to respond to this argument but did not.

[34] *See, e.g.*, *Folger Adam Security, Inc. v. DeMatteis/MacGregor, JV,* 209 F.3d 252, 260-62 (3d Cir. 2000).

[35] *Id.*

[36] *See, e.g.*, *Yucaipa Am. Alliance Fund II, LP v. BDCM Opportunity Fund II, LP (In re ASHINC Corp.)*, No. 14-50971, 2017 WL 2774736, at *3 (D. Del. June 27, 2017) ("Indeed, Rule 12(b)(6) does not offer a mechanism for dismissing affirmative defenses because it refers only to 'claim[s].'" (quoting *Senju Pharm. Co. v. Apotex, Inc.*, 921 F. Supp. 2d 297, 301 (D. Del. 2013)).

[37] FED. R. CIV. P. 12(f).

[38] *Yucaipa*, No. 14-50971, 2017 WL 2774736, at *5 (quoting *Boatright v. Crozer-Keystone Health Sys.*, No. 14-7041, 2015 WL 4506559, at *5 (E.D. Pa. July 24, 2015)).

In this district, affirmative defenses are not subject to the pleading standards of *Twombly* and *Iqbal*.[39] Rather, affirmative defenses must only provide fair notice of the issue involved. They should be struck if "the insufficiency of the defense is 'clearly apparent[.]'"[40] Insufficiency exists if an affirmative defense "is not recognized as a defense to the cause of action[.]"[41] It can also be established "on the basis of the pleadings alone 'if the defense asserted could not possibly prevent recovery under any pleaded or inferable set of facts."[42] However, a motion to strike should "not be granted where the sufficiency of the defense depends on disputed issues of facts or where it is used to determine disputed and substantial questions of law."[43]

Under Federal Rule 8(c)(2), "[i]f a party mistakenly designates a defense as a counterclaim . . ., the court must, if justice requires, treat the pleading as though it were correctly designated, and may impose terms for doing so."[44] The Court concludes that justice requires that it treat Counts 7 and 8 as defenses and the Motion to Dismiss, as it pertains to Counts 7 and 8, as a motion to strike to ensure that it applies the correct legal standard to the matter before it.[45]

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[39] *See, e.g.*, *Bayer Cropscience AG v. Dow Agrosciences LLC*, No. 10-1045, 2011 WL 6934557, *1 (D. Del. Dec. 30, 2011) (setting forth nine reasons why affirmative defenses are not subject to *Twombly/Iqbal* pleading standards, including the textual differences between Federal Rules 8(a) and 8(c), the fairness to defendants who have limited response time, and the diminished concern that plaintiffs receive notice); *Senju Pharm. Co., Ltd. v. Apotex, Inc.*, 921 F.Supp.2d 297, 303 (D. Del. 2013) ("Due to the differences between Rules 8(a) and 8(c) in text and purpose, [] *Twombly* and *Iqbal* do not apply to affirmative defenses, which need not be plausible to survive. An affirmative defense must merely provide fair notice of the issue involved.") (internal quotations and citations omitted); *Yucaipa*, No. 14-50971, 2017 WL 2774736, at *3 (analyzing whether the bankruptcy court applied the correct standard when striking defenses); *see also Bench Walk Lighting LLC v. Everlight Elecs. Co., Ltd.*, No. 20-cv-49, 2020 WL 5128086, at *1 (D. Del. Aug. 31, 2020) (refusing to strike certain affirmative defenses based on factual deficiency); *Internet Media Corp. v. Hearst Newspapers, LLC*, No. 10-690, 2012 WL 3867165, **1-3 (D. Del. Sept. 6, 2012) (denying motion to strike where no facts were provided to support affirmative defenses aside from a brief description of the parties and a jurisdictional statement); *Intell. Ventures I LLC v. Symantec Corp.*, No. 13-440, 2014 WL 4773954, at *1 (D. Del. Sept. 24, 2014) (agreeing that the pleading requirements of *Twombly* and *Iqbal* do not apply to affirmative defenses); *Cadence Pharm., Inc. v. Paddock Labs., Inc.*, No. 11-733, 2012 WL 4565013, at *1 (D. Del. Oct. 1, 2012) (describing as unavailing plaintiffs' argument that defendants' affirmative defenses were not pled in compliance with *Twombly* and *Iqbal*).

[40] *Cipollone v. Liggett Grp., Inc.*, 789 F.2d 181, 188 (3d Cir. 1986), *rev'd on other grounds*, 505 U.S. 504 (1992).

[41] *Yucaipa*, No. 14-50971, 2017 WL 2774736, at *5 (quoting *Newborn Bros. Co., Inc. v. Albion Eng'g Co.*, 299 F.R.D. 90, 93 (D.N.J. 2014)).

[42] *Id.*

[43] *Intell. Ventures*, No. 13-440, 2014 WL 4773954, at *2 (quoting *Cadence Pharm.*, No. 11-733, 2012 WL 4565013 at *1).

[44] FED. R. CIV. P. 8(c)(2).

[45] *See, e.g.*, *Nat'l Union Fire Ins. Co. of Pittsburgh v. City Sav., F.S.B.*, 28 F.3d 376, 394 (3d Cir. 1994) (noting that courts are competent to answer "[w]hether an assertion is truly a defense, an affirmative defense, or a counterclaim" and should not allow parties to avoid the applicable legal standard "by simply labelling what is actually a counterclaim as a defense or affirmative defense."); *Yucaipa*, No. 14-50971, 2017 WL 2774736, at *4 (denying interlocutory appeal of bankruptcy court's decision to strike defenses and explaining, in part, that "[b]ecause Rule 12(f) indisputably governs the relief requested in the motion to strike, and there is no indication that the bankruptcy court ruled to strike Yucaipa's affirmative defenses as insufficiently pled, Yucaipa cannot demonstrate a genuine doubt regarding the correct legal standard."); *In re DHP Holdings II Corp.*, 435 B.R. 220, 231 (Bankr. D. Del. 2010) ("Courts need not accept the label that a litigant places on its purported defense or counterclaim.").

C. The Court Will Strike The Counterclaimants' Setoff (Count 8) and Recoupment (Count 7) Defenses In Part[46]

1. Section 1141(c)[47] Does Not Bar The Setoff Claims

The Litigation Trust urges this Court to prohibit Counterclaimants from setting off any amounts the Debtors may owe them against any damages that they may owe the Litigation Trust on the Debtors' claims because such claims were transferred to the Litigation Trust "free and clear" of setoff rights pursuant to section 1141(c).[48] Counterclaimants assert that section 1141(c) did not strip away their setoff rights. Rather, they argue that these rights were expressly preserved by section 553(a) and their actions taken during the Debtors' bankruptcy cases. The Court agrees that the rights are preserved.

With limited exception, section 553(a) preserves a creditors' right to set off mutual debts between itself and a debtor that arose prior to the commencement of a debtor's bankruptcy proceeding by providing that:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .[49]

However, upon confirmation of a debtor's plan, section 553(a)'s setoff preservation comes into tension with section 1141(c), which allows for a plan to transfer property free and clear of claims and interests of creditors.[50] Section 1141(c) provides that:

> Except . . . as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.[51]

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[46] The briefing addresses Count 8 before Count 7. The Court will follow the parties' lead and do the same.

[47] Unless otherwise indicated, all section references are to title 11 of the United States Code (the "Bankruptcy Code").

[48] *See* Plan §§ 6.6(d), 6.8(d) (transferring Remaining Assets and Litigation Assets "free and clear of all Claims, Liens, and other interests" in accordance with section 1141 and subject only to certain non-applicable exceptions).

[49] 11 U.S.C. § 553(a).

[50] *See, e.g.*, *In re Ditech Holding Corp.*, 606 B.R. 544, 587-88 (Bankr. S.D.N.Y. 2019) (holding that section 1141(c) makes it unnecessary to comply with section 363(f) to confirm a plan that provides for a sale free and clear of claims upon confirmation).

[51] 11 U.S.C. § 1141(c).

Because section 553(a) does not explicitly subject setoff rights to section 1141 as it does for sections 362 and 363, several courts have been tasked with deciding whether creditors lose their right to setoff when a plan transfers or vests debtor property to or in another. For example, in *Carolco Television Inc. v. National Broadcasting Co. (In re De Laurentiis Entertainment Group Inc.)*, a debtor's plan transferred to a third party (CTI) a cause of action for unpaid debt against a creditor (NBC) free and clear of all pre-bankruptcy claims or interests.[52] Then, CTI sued NBC to recover on the claim.[53] In response, NBC asserted as a setoff a prepetition claim against the debtor.[54] CTI objected to the setoff, arguing that NBC lost its right when the plan was confirmed under section 1141(c).[55] After a thorough analysis of relevant case law, the structure of section 553, and the historical primacy of setoff rights in bankruptcy, the Court of Appeals for the Ninth Circuit concluded that section 553 prevails over section 1141 and permitted NBC to assert its setoff against CTI.[56]

The Court of the Appeals for the Third Circuit has also addressed the issue. In *United States v. Continental Airlines (In re Continental Airlines)*, the debtors' confirmed plan did not provide creditors with a post-confirmation right to setoff.[57] Nonetheless, a prepetition creditor asserted a right of setoff for the first time post-confirmation by filing an amended proof of claim.[58] In precluding the creditor from asserting setoff against the reorganized debtor, the court "recognize[d] that a right of set-off is preserved under § 553 in a bankruptcy proceeding" but determined that the creditor did not timely assert such right and therefore, imposed section 1141 to extinguish it.[59] The court distinguished the circumstances presented to the court in *De Laurentiis*, explaining that the creditor there asserted its setoff right in a timely filed proof of claim and also filed a motion for relief from the automatic stay prior to confirmation of the plan.[60] The bankruptcy court in *De Laurentiis* converted the setoff claim into an adversary proceeding, which continued even after confirmation.[61] In *Continental*, on the other hand, no such actions were taken and the plan "proceeded on the justifiable assumption that the reorganized debtor faced no set-off claim."[62] Accordingly, the Third Circuit observed that allowing the setoff would be "unfair to other creditors and the Debtors, and [could] conceivably undermine the plan of reorganization and

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[52] 963 F.2d 1269, 1271 (9th Cir. 1992).

[53] *Id.*

[54] *Id.* at 1274.

[55] *Id.*

[56] *Id.* at 1274-78; *accord In re Morris*, 616 B.R. 499, 503 (Bankr. N.D. Miss. 2020).

[57] 134 F.3d 536, 539 (3d Cir. 1998).

[58] *Id.* at 537-38.

[59] *Id.* at 541-42; *see also United States v. Norton*, 717 F.2d 767, 774 (3d Cir. 1983) (concluding that chapter 13 plan precluded IRS from exercising setoff because, among other things, estate property vested in the debtor upon confirmation free and clear of any claim or interest of the IRS pursuant to section 1327 and IRS failed to object to the plan despite having notice).

[60] 134 F.3d at 541.

[61] *Id.*; *see also De Laurentiis*, 963 F.2d at 1277.

[62] *Continental*, 134 F.3d at 541.

the objectives and structure of the Bankruptcy Code."[63] Ultimately, it held that "the right of a creditor to set-off in a bankruptcy reorganization proceeding must be duly exercised in the bankruptcy court before the plan of reorganization is confirmed; the failure to do so extinguishes the claim."[64]

Unlike *De Laurentiis* and *Continental*, the Debtors' Plan expressly preserves a creditor's right to offset its claims against a claim or cause of action of the Debtors if such creditor preserved the right in a timely filed proof of claim or asserted it in a motion to setoff. Section 10.8 of the Plan provides:

> ***Notwithstanding anything in the Plan***, in no event shall any Holder of a Claim be entitled to setoff any Claim against any claim, right, or cause of action of the Debtors, ***unless*** such Holder preserves its right to setoff by preserving such right to set-off in a timely filed proof of claim or filing a motion for authority to effect such setoff on or before the Confirmation Date (regardless of whether such motion is heard prior to or after the Confirmation Date).[65]

With its opening "notwithstanding" clause, the plain language of this provision alters any language of the Plan transferring the Debtors' claims to the Litigation Trust free and clear if a right to setoff was preserved prior to confirmation in a proof of claim or motion to setoff.

The Counterclaimants timely filed proofs of claim on account of their claims prior to the confirmation proceedings and therein preserved the right to setoff.[66] They also asserted their setoff rights in the Zohar Adversary preconfirmation and objected to the Plan to the extent it impacted their setoff rights post-confirmation.[67] The Debtors and the creditor beneficiaries of the Litigation Trust had ample notice that the Counterclaimants intended to assert their setoff rights against the transferred debtor claims post-confirmation.

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[63] *Id.* at 542.

[64] *Id.*; *see also id.* at 541 ("[T]he right must be exercised by the creditor in timely fashion and appropriately asserted in accordance with other provisions of the Bankruptcy Code."); *see also Daewoo Intern. (Am.) Corp. Creditor Tr. v. SSTS Am. Corp.*, 2003 WL 21355214 at *5 (S.D.N.Y. 2003) ("In light of the fact that the confirmed plan of reorganization . . . included a specific prohibition on the assertion of setoff or recoupment claims . . ., we agree with the Third Circuit's reasoning [in *Continental*] that 'allowing the creditor to come forward after the plan of reorganization has been confirmed and . . . decide that it has a valid set-off without timely filing a proof of claim and asserting the set-off in the reorganization proceedings, has a probability of disrupting the plan of reorganization . . . and can conceivably undermine . . . the objectives and structure of the Bankruptcy Code.'"); *In re Ronnie Dowdy, Inc.*, 314 B.R. 182 (Bankr. E.D. Ark. 2004) (concluding that confirmation of a plan does not affect a setoff right because section 1141 does not apply to section 553 but that a creditor may still waive the right).

[65] Plan. § 10.8 (emphasis added).

[66] *See supra* note 21.

[67] Case No. 18-10512, D.I. 3326.

Accordingly, by the plain language of the Plan,[68] the Counterclaimants' rights to set off against the Debtors' claims now pursued by the Litigation Trust are preserved. Moreover, under the holding of *Continental*, the Counterclaimants' timely pursuit of their setoff rights during the Debtors' bankruptcy case was sufficient to prevent their extinguishment by section 1141. The Litigation Trust's request to strike Count 8 on this basis will therefore be denied.

2. The Court Will Strike The Setoff And Recoupment Defenses Arising From The Claims In Counts 1, 2, and 5

a. The Claims Are Nonrecourse And Have Been Extinguished

The Litigation Trust argues that the Counterclaimants' claims for unpaid CMA fees (Count 1), indemnification under the CMAs (Count 2), and the Class B note obligations (Count 5) are nonrecourse and were extinguished on the Plan's Effective Date when the Debtors divested all of their assets to partially satisfy the senior claims held by holders of the Class A secured notes (the "Class A Notes").[69] Because the Counterclaimants are without a claim to use defensively for setoff or recoupment, it urges the Court to strike Counts 7 and 8 as it pertains to Counts 1, 2, and 5.

Section 2.6(i) of the Indentures provides the following:

> Notwithstanding anything contained herein to the contrary, ***the obligations of each Co-Issuer under the Notes and this Indenture and under each other Transaction Document*** to which it is a party ***are limited recourse obligations of the Co-Issuers payable solely from the Collateral*** . . ., and ***following realization of the Collateral***, ***any claims of the Noteholders***, the Credit Enhancer, ***the Collateral Manager***, the Administrator, the Collateral Administrator, the Placement Agent and each other counterparty to any Zohar Obligor ***under the Transaction Documents*** . . . ***shall be extinguished***. . . . It is understood that the foregoing provisions of this Section 2.6(i) shall not (i) prevent recourse to the Collateral for the sums due or to become due . . ., (ii) limit the rights of the . . . Holders of the Notes . . . or (iii) constitute a waiver, release or discharge of any indebtedness or obligation evidenced by the Notes or secured by this Indenture ***until such Collateral has been realized, whereupon any outstanding indebtedness or obligation shall be extinguished***. It is further understood that the foregoing provisions of this Section 2.6(i) shall not limit the right of any Person to name any Zohar Obligor as a party defendant in any action or suit or in the exercise of any other remedy under the Notes or this Indenture, so long as no judgment in the nature of a deficiency judgment or seeking personal

[68] *But see Ditech*, 606 B.R. at 597 (quoting narrower language from a plan that preserved setoff rights against the debtors but extinguished them as against an asset purchaser).

[69] Defendants agree that, under the interclass priority waterfall provisions of the Indentures, the Class B Note Claims are subordinate in right of payment to the Class A Notes also issued by the Zohar Funds. *See* Answer at 100 ¶ 60.

> liability shall be asked for or (if obtained) enforced against any such Person or entity.[70]

The Indentures define "Collateral" as the Debtors' rights, title, and interests in, to, and under any and all property owned by them other than certain nominal excluded property.[71] The CMAs incorporate this definition of Collateral[72] and contain a provision similar to section 2.6(i) of the Indentures. For example, section 7.13(a) of the Zohar I and Zohar II CMAs provides:

> ***The Collateral Manager shall have recourse solely to the Collateral*** described in the Indenture ***for the payment and performance of all of the obligations of the Company under this Agreement***. ***Upon final realization of such Collateral, any outstanding obligations of the Company hereunder shall be extinguished*** and shall not thereafter revive, and the Collateral Manager shall not be entitled to take any further steps against the Company . . ., to recover any sums due from the Company but still unpaid.[73]

The Counterclaimants argue that section 2.6(i) cannot be interpreted to render obligations under the Class B Notes and CMAs nonrecourse.[74] Rather, they submit that the provision permits them to assert recourse deficiency claims. However, the plain meaning of section 2.6(i) contradicts this interpretation. It provides that the obligations of the Debtors under the notes, Indentures, and CMAs[75] "are payable solely from the Collateral" and that "following realization of the Collateral, any claims of the noteholders and the Collateral Manager thereunder "shall be extinguished". It further provides that upon realization of the Collateral, "any outstanding indebtedness or obligation shall be extinguished." The Counterclaimants focus the Court on the final sentence of section

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[70] Adv. D.I. 171 (the "Corrected Second Amended Complaint"), Ex. 1 (the "Zohar I Indenture") § 2.6(i), Ex. 2 (the "Zohar II Indenture") § 2.6(i); Ex. 3 (the "Zohar III Indenture") § 2.6(i) (emphasis added).

[71] Zohar I Indenture at 1 (Granting Clauses) & 19 (definition of "Collateral"); Zohar II Indenture at 1 & 17 (same); Zohar III Indenture at 1 & 17 (same) (emphasis added).

The Indentures, upon which all parties rely, are attached to and incorporated by reference in the Complaint. Accordingly, the Court may consider them for purposes of ruling on the Motion to Dismiss. *Tanksley v. Daniels*, 902 F.3d 165, 172 (3d Cir. 2018); *Davis v. Wells Fargo*, 824 F.3d 333, 341 (3d Cir. 2016); *McTernan v. City of York*, 577 F.3d 521, 526 (3d Cir. 2009).

[72] *See* Corrected Second Amended Complaint, Ex. 4 ("Zohar I CMA") § 1.1, Ex. 5 ("Zohar II CMA") § 1.1, Ex. 6 ("Zohar III CMA") § 1.1. Like the Indentures, the CMAs are attached to and incorporated by reference in the Complaint.

[73] Zohar I CMA § 7.13(a), Zohar II CMA § 7.13(a) (emphasis added). Section 7.12 of the Zohar III CMA is substantially similar. *See* Zohar III CMA § 7.12 (emphasis added).

[74] The Counterclaimants appear to have waived this argument at oral argument. Jan. 30, 2023 Hr'g Tr. 53:7-13 ("In other words, the trustee argues that there's no direct *in personam* claim against the Zohars under the indentures and, therefore, no right to use those claims for purposes of setoff and recoupment. And while we don't disagree with the notion that, outside of bankruptcy, this may be true, their argument fails to account for the impact of Section 1111(b) on Patriarch's claims."). Moreover, they make no arguments to rebut the language of the CMAs.

[75] The CMAs are "Transaction Documents." *See* Zohar I Indenture at 59; Zohar II Indenture at 64; Zohar III Indenture at 61.

2.6(i) but it fails to help. That sentence preserves a party's ability to seek other rights and remedies under the applicable notes and Indentures but prohibits deficiency and personal liability judgments. If obtained, they are unenforceable.

The Indentures and CMAs are unambiguous.[76] The claims of the Counterclaimants arising from Counts 1, 2, and 5 are enforceable only against the Collateral and not the Debtors. Thus, they are nonrecourse: "The term 'nonrecourse' describes a type of debt that is 'of, relating to or involving an obligation that can be satisfied only out of the collateral securing the obligation and not out of the debtor's other assets.'"[77]

Notwithstanding section 2.6(i) of the Indentures and those similar in the CMAs, the Counterclaimants next argue that their claims were rendered recourse by virtue of section 1111(b)(1)(A) of the Bankruptcy Code. Generally, "if a debtor elects to continue using encumbered property in its reorganization," this provision grants a "nonrecourse creditor, whose claim is secured by an interest in that property, an allowed claim under section 502 as if its security interest had recourse."[78] In other words, undersecured nonrecourse creditors are allowed an unsecured deficiency claim ***against a debtor*** that they would not normally receive under section 502(b)(1) because "[a] claim secured by a nonrecourse security interest is, by definition, enforceable only against the debtor's property."[79]

However, this statutory recourse status is subject to certain exceptions, one of which applies to the present circumstances:

> ***A claim secured by a lien on property of the estate shall be allowed*** or disallowed under section 502 of this title ***the same as if the holder of such claim had recourse against the debtor on account of such claim***, whether or not such holder has such recourse ***unless*** (i) the class of which such claim is a part elects . . . application of paragraph (2) of this subsection; or ***(ii) such holder does not have such recourse and such property*** is sold under section 363 of [the Bankruptcy Code] or ***is to be sold under the plan***.[80]

By its plain terms, section 1111(b)(1)(A) is ineffectual if there is a sale of property securing a lien under either section 363 or a chapter 11 plan.[81] Here, the Plan and Confirmation Order sold the

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[76] *See* notes 100-103 and accompany text.

[77] *Taberna Preferred Funding IV, Ltd. v. Opportunities II Ltd.*, 594 B.R. 576, 586-87 (Bankr. S.D.N.Y. 2018) (quoting BLACK'S LAW DICTIONARY (10th ed. 2014)) (interpreting a similar indenture provision and determining that the note obligations thereunder were nonrecourse).

[78] *In re Montgomery Ward, LLC*, 634 F.3d 732, 739 (3d Cir. 2011).

[79] *Id.* at 740.

[80] 11 U.S.C. § 1111(b)(1)(A) (emphasis added); *see also id.* § 1111(b)(2) ("If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.").

[81] *See* 11 U.S.C. § 1111(b)(1)(A)(ii); *see also* 124 Cong. Rec. 32, H11103-04 (daily ed. Sep. 28, 1978, at 32407) ("Sale of property under section 363 or under the plan is excluded from . . . section 1111(b) because of the secured party's right to bid in the full amount of his allowed claim at any sale of collateral under section 363(k) . . .").

Debtors' remaining assets as of the Effective Date (including their claims against the Defendants) to MBIA Insurance Company ("MBIA") and "Asset Recovery Entities" (entities created and controlled by the senior noteholders).[82]

The Defendants reserved the right in the Confirmation Order to dispute that the sale occurred under section 363 to avoid the possible extinguishment of their setoff rights under section 363(f)[83] and the holding of *Folger Adam Security, Inc. v. DeMatteis/MacGregor, JV*.[84] However, they did not reserve the right to challenge that a sale occurred under the Plan outside of section 363,[85] as the Debtors' Plan did. Under these circumstances, the Counterclaimants' reliance on section 1111(b)(1)(A) to maintain a deficiency claim for purposes of setoff and recoupment fails.

Moreover, as the Court of Appeals for the Third Circuit held in *In re Montgomery Ward, LLC*, the recourse transformation under section 1111(b) is "for distribution purposes only" and "does not change the nature or terms of a creditor's security interest."[86] Therefore, section 1111(b)

Section 1111(b)(1)(A) is also inapplicable if an election is made by holders of claims in a particular class to treat the claims in the class as secured. The Patriarch Managers made this election for the Patriarch Disputed CMA Fee Claims, a portion of which is sought in Count 1. *See* Case No. 18-10512, D.I. 3191.

[82] Confirmation Order ¶¶ Z, 10; Plan, Art. VI (Means of Implementation of the Plan). The Plan gave effect to a prior, but challenged, sale of Zohar I assets to MBIA. Confirmation Order ¶ 56; Plan § 6.1(b); *see also Tilton v. MBIA, Inc. (In re Zohar III, Corp.)*, 639 B.R. 73, 95-97 (Bankr. D. Del. 2022) (describing an earlier auction of the collateral securing the Zohar I notes and subsequent court proceedings). Assets not sold were deemed abandoned. Plan § 6.19.

[83] Paragraph 58 of the Confirmation Order provides that:

> The effect of the transfer of the Debtors' assets "free and clear" of Patriarch's asserted set-off rights is not being decided in the Confirmation Order. The right of the Debtors, Litigation Trustee, and Asset Recovery Entities to argue that the effect of this "free and clear" relief extinguishes any of Patriarch's set off rights is preserved. Patriarch reserves the right to argue that the effect of this "free and clear" relief does not extinguish any of Patriarch's set off rights, that the transfer of the Litigation Assets under the Plan is not a "sale" under section 363 of the Bankruptcy Code, or that the Court possesses and should exercise discretion to not extinguish any of Patriarch's set off rights under the facts and circumstances of this case. If the court finds transfer did not extinguish Patriarch's set off rights, all parties' rights are preserved to argue whether a valid right to set off exists and should be permitted to be exercised. All parties' rights and defenses to the foregoing are preserved.

Counterclaimants also reserved "all rights and remedies with respect to their existing litigation claims and positions relating to the beneficial ownership of equity interests prior to March 21, 2020 and the Zohar I Auction." *Id.* ¶ 56.

[84] 209 F.3d at 263-64 (holding that unexercised setoff rights are subject to section 363(f) under section 553 and are therefore extinguished by a free and clear sale).

[85] *See* 11 U.S.C. § 1123(b)(4) (allowing for plans to "provide for the sale of all or substantially all of the property of the estate").

[86] *Montgomery Ward*, 634 F.3d at 740; *accord Taberna*, 594 B.R. at 591 ("Section 1111(b) does not . . . unequivocally treat all nonrecourse claims as recourse under all circumstances . . . . Instead, *for allowance purposes*, it permits an undersecured nonrecourse claim to be allowed as recourse claim *only if* certain requirements are met[.]"); *Matter of DRW Prop. Co. 82*, 57 B.R. 987, 992 (Bankr. N.D. Tex. 1986) ("The transformation of non-recourse claims . . . is for *distribution purposes only* in a Chapter 11 reorganization case where the debtor has been given the power to retain encumbered property (over the objection of the secured creditor) for use in its plan of reorganization.") (emphasis added); 7 COLLIER ON BANKRUPTCY ¶ 1111.03[1](c) (16th ed. 2018) ("Thus, although the claim becomes recourse against the debtor for purposes of distribution, it remains a nonrecourse claim for all other purposes.").

would convert the Counterclaimants' nonrecourse claims to recourse only for allowance and distribution purposes in the Debtors' bankruptcy cases and would not otherwise affect the underlying nonrecourse nature of the claims for all other purposes, including, defensive use.

This conclusion is supported by the purpose underlying section 1111(b). It is intended to protect the benefit of the lienholder's original loan bargain, "i.e. either full payment (or at least a claim against the estate for the full amount of the debt and the ability to vote on the plan to the extent of its claim), or the right to foreclose and bid on the property at public auction."[87] That occurred here. The Collateral securing Counterclaimants' nonrecourse claims was sold through the Debtors' Plan to the senior noteholders. Counterclaimants had the opportunity to submit a superior bid for the Collateral but did not.[88] Their claims were classified and provided with their deserved treatment (*i.e.* no recovery) given the value of the Debtors' assets. The Counterclaimants were provided an opportunity to participate in the Plan process and did so through their objection.[89] Extending the applicability of section 1111(b) beyond its intended purpose to afford the Counterclaimants the right to setoff and recoup a deficiency claim would produce an inequitable result by according the Counterclaimants additional rights to which they would not be entitled outside of bankruptcy given the sale of the Collateral.[90] This is an outcome that neither comports with the legislative purpose of section 1111(b) nor is permitted under the Third Circuit precedent set forth in *Montgomery Ward*.[91]

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[87] *In re 680 Fifth Ave. Assocs.*, 29 F.3d 95, 97-98 (2d Cir. 1994); *accord Montgomery Ward*, 634 F.3d at 740; *Matter of Tampa Bay Assocs., Ltd.*, 864 F.2d 47, 50 (5th Cir. 1989).

[88] Among other things, the Debtors' Disclosure Statement contained the following:

> [T]he Debtors are receptive to any proposed acquisition transaction that provides value to pay the senior most classes in full and place junior-classes "in the money." No such transaction has been put before the Debtors.
>
> ***If any interested party believes that it can provide value to any one or more of the Zohar Funds to acquire their assets or the interest in the applicable Asset Recovery Entity (and related Litigation Trust) at a cash purchase price that is at or above the amount of the A-1 Notes or Credit Enhancement Liabilities, as applicable, it should promptly contact the Debtors. Subject to customary demonstrations concerning the bona fides of any party seeking to make an offer and its financial wherewithal to complete a transaction at or above the threshold amount, the Debtors will consider offers providing a purchase price at or above the amount of the senior most claims against the applicable Zohar Fund (i.e., $387,131,000.00 for Zohar III; $806,582,747.23 for Zohar II; and $20,347,522.55 for Zohar I).***

See Case No. 18-10512, D.I. 3239, Ex. 1 at 5 (emphasis in original).

[89] *Montgomery Ward*, 634 F.3d at 740 ("If the debtor elects to sell the collateral in the Chapter 11 proceeding, the creditor can bid on it. If the debtor elects to continue using the collateral, section 1111(b) ensures that the creditor has the ability to vote on the debtor's plan."); *Taberna*, 594 B.R. at 592 ("Congress enacted § 1111(b) to give undersecured creditors a voice in the Chapter 11 process to the extent that the undersecured creditor may dominate the vote within the unsecured class . . ., and because a judicial valuation of collateral . . . was not part of a nonrecourse creditor's bargain.") (internal quotations and citations omitted).

[90] Particularly troubling is the Counterclaimants' argument that their alleged unsecured deficiency claim would receive *pari passu* treatment with any unsecured deficiency claim held by holders of the priority Class A notes. *See generally* Jan. 30, 2023 Hr'g Tr. 54:5-8, 62:9-20. This uproots the noteholders' agreed-upon priority of payment waterfall in the Indentures.

[91] *See Montgomery Ward, LLC*, 634 F.3d at 740 (rejecting nonrecourse creditor's argument because it "would have the practical result of placing the nonrecourse creditor in a better position than it would have been outside of

The Counterclaimants' final argument is that "realization" of the Collateral has not yet occurred because it has not yet been converted into cash but rather, awaits future liquidation. In support of their interpretation of "realization", the Counterclaimants' cite *LCM XXII Ltd. v. Serta Simmons Bedding, LLC* in which the United States District Court for the Southern District of New York was tasked with determining whether a no-action clause of a loan agreement precluded a group of security issuers from pursuing their breach of contract claims.[92] Among other things, the relevant provision precluded secured parties from individually seeking "to realize" upon their collateral.[93] The court determined that the provision did not bar the claims because the issuers were not seeking "conversion of noncash assets into cash assets" – the definition of "realization" in BLACK'S LAW DICTIONARY. [94]

The Litigation Trust argues that this definition of "realization" is unreasonably narrow. The Court agrees. While the conversion of noncash assets into cash is one method of realization, it is not the only. As the Litigation Trust correctly points out, realization has been used by courts in the bankruptcy context to describe transactions such as those effectuated by the Debtors' Plan in which assets are transferred but cash is never exchanged. For example, in *ESL Investments, Inc. v. Sears Holdings Corp. (In re Sears Holdings Corp.)*, the Court of Appeals for the Second Circuit determined that certain lenders realized value from a credit bid which forgave debt owed by the debtors in return for substantially all of the debtors' assets.[95]

Moreover, limiting the definition of "realization" in the manner put forth by the Counterclaimants would yield an absurd result because the Debtors, by virtue of the Plan, no longer possess any assets that can serve as Collateral and be reduced to cash. It was transferred to third-parties to satisfy senior claims on the Effective Date.[96] Noteholders and other claimants are enjoined from further pursuing the Debtors to collect or recover on account of their claims.[97] The Zohar Indentures, notes, and CMAs were cancelled, the Indenture Trustee (which held in trust the security interest and lien in and on the Collateral for the secured obligations under the Indentures) was discharged of its duties, and the Collateral Manager for each Debtor terminated.[98] All liens securing claims were released except those to secure the payment of claims held by the Indenture

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bankruptcy, a result not contemplated by Section 1111(b)."); *DRW*, 57 B.R. at 992 (stating that the section 1111(b) recourse transformation "was obviously not intended by according recourse [status] to non-recourse claims that the holders of these claims would be given any additional rights under state law."); *Travelers Ins. Co. v. 633 Third Assocs.*, No. 91-5735, 1991 WL 236842, at *2 (S.D.N.Y. Oct. 31, 1991) (explaining that section 1111(b) "was not intended as a device for non-recourse creditors to enhance their position under state law – thereby repudiating their bargain").

[92] No. 21-3987, 2022 WL 953109, at **1, 14 (S.D.N.Y. 2022).

[93] *Id.* at *14.

[94] *Id.* (quoting *Realization*, BLACK'S LAW DICTIONARY (11th ed. 2019)).

[95] 51 F.4th 53, 60 (2d Cir. 2022); *see also Yucaipa Am. Alliance Fund I, LP v. SBDRE LLC*, No. 9151, 2014 WL 5509787, *13 n.58 (Del. Ch. Oct. 31, 2014) (explaining that a credit bid transaction fell within lenders' ability to realize upon their collateral under the governing credit agreement).

[96] *See* Plan, Art. VI.

[97] *Id.* § 10.6

[98] *Id.* § 6.3.

Trustee for fees, expenses, and the like.[99] Simply stated, there is no Collateral left that could be realized.

The parties' arguments turn on the interpretation of the contractual term "realization" contained in the Indentures and CMAs. Both agreements are governed by New York law.[100] Under New York law, "[t]he threshold question in a dispute over the meaning of a contract is whether the contract terms are ambiguous."[101] "Ambiguous language is language that is 'capable of more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business.'"[102] "Contract language is unambiguous when it has 'a definite and precise meaning, unattended by danger of misconception in the purport of the [contract] itself, and concerning which there is no reasonable basis for a difference of opinion.'"[103] For the reasons set forth above, there can be no reasonable disagreement – on the Effective Date, the Collateral was realized and the Debtors' obligations on account of Counts 1, 2 and 5 extinguished.

b. Mutuality Cannot Be Satisfied Because The Claims Are Nonrecourse Obligations

The nonrecourse nature of the claims alleged in Counts 1, 2, and 5 serves as an additional bar to the use of the setoff defense. "The right of setoff (also called 'offset') allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'"[104] It "is appropriate in bankruptcy only when a creditor both enjoys an independent right of setoff under applicable non-bankruptcy law" and when the debts are "mutual, prepetition debts."[105] "[D]ebts are considered 'mutual' only when they are due to and from the same persons in the same capacity. . . . [E]ach party must own his claim in his own right severally, with the right to collect in his own name against the debtor in his own right and severally."[106]

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[99] *Id.*

[100] Zohar I Indenture § 18.9; Zohar II Indenture § 18.9; Zohar III Indenture § 17.9; Zohar I CMA § 7.5; Zohar II CMA § 7.5; Zohar III CMA § 7.4.

[101] *Revson v. Cinque & Cinque, P.C.*, 221 F.3d 59, 66 (2d Cir. 2000).

[102] *Id.* (quoting *Seiden Assocs. v. ANC Holdings, Inc.*, 959 F.2d 425, 428 (2d Cir. 1992)).

[103] *Id.* (quoting *Hunt Ltd. v. Lifschultz Fast Freight, Inc.*, 889 F.2d 1274, 1277 (2d. Cir. 1989)); *see also JA Apparel Corp. v. Abboud*, 568 F.3d 390, 396 (2d Cir. 2009) ("Language whose meaning is otherwise plain does not become ambiguous merely because the parties urge different interpretations in the litigation.") (internal quotations and citations omitted); *Medidata Sol., Inc. v. Fed. Ins. Co.*, 268 F.Supp.3d 471, 480 (S.D.N.Y. 2017) (noting that in interpreting contracts, "[f]orm should not prevail over substance and a sensible meaning of words should be sought").

[104] *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (quoting *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913)).

[105] *In re SemCrude, L.P.*, 399 B.R. 388, 393 (Bankr. D. Del. 2009), *aff'd*, 428 B.R. 590 (D. Del. 2010).

[106] *Id.* (internal quotations and citations omitted).

The Litigation Trust argues that the Counterclaimants cannot satisfy this mutuality requirement because they are seeking to offset plenary obligations that would arise upon the Zohar Funds obtaining a judgment against the Counterclaimants against nonrecourse obligations of the Zohar Funds. In support, the Litigation Trust cites *DeFlora Lake Development Associates, Inc. v. Hyde Park*,[107] in which the Court of Appeals for the Second Circuit held that a fee award could not be set off against a nonrecourse debt because there was no personal liability on the nonrecourse debt and therefore "[a]pplying a setoff . . . would be, in effect, to require payment – crediting one debt against another – by a method other than the sole means by which the debt is payable under the . . . contract."[108] The Litigation Trust also cites *In re Allen-Main Associates, Ltd.*[109] for its similar holding in refusing setoff of a nonrecourse mortgage note against a judgment debt.[110]

The Counterclaimants do not attempt to distinguish these cases or otherwise object to this mutuality principle. Rather, they argue that their claims are recourse, advancing the same theories that this Court has already rejected. Furthermore, the inequity of permitting a setoff of the Counterclaimants' nonrecourse claims against the Debtors' claims shines bright. In such a scenario, the Counterclaimants would be allowed to reduce any liability that they owe the Debtors and, in doing so, effectively render the Debtors personally liable for obligations that the Indenture and CMAs squarely limit to the Debtors' Collateral.[111] Setoff cannot be permitted in such a circumstance.

c. The Indemnification Claim Of Count 2 Is Not Permitted By The CMAs

A final reason supports the elimination of the setoff and recoupment defenses arising from Count 2's indemnification claims. The Litigation Trust contends that the actions giving rise to those claims - the Books and Records Action and the Interpleader Action - raise first-party claims – *i.e.* claims between the Zohar Funds and the Patriarch Managers as indemnitor and indemnitee. As such, it argues that applicable New York law bars the indemnification claims because the relevant provisions of the CMAs do not contain express reference to first-party claim coverage. The Patriarch Managers urge the Court to construe the relevant indemnification provisions to include first-party claims. The Court cannot do so.

Section 4.5(a) of the Zohar I CMA provides:

> Indemnification. (a) The Company and the Zohar Subsidiary (in such case, the "Indemnifying Party") shall reimburse, indemnify, defend and hold harmless the Collateral Manager and its managers,

[107] 689 Fed. Appx. 99 (2d Cir. 2017).

[108] *Id.* at 101.

[109] 233 B.R. 631 (Bankr. D. Ct. 1999).

[110] *Id.* at 635.

[111] *Mullen v. Cheatham*, No. 05-99-00916, 1999 WL 1095917, at *3 (Ct. App. Tex. 1999) (applying reasoning of *Allen-Main* to hold that mutuality of obligation did not exist to allow defendant to offset a non-recourse note against its debt to plaintiff as doing so "would effectively make [plaintiff] personally liable on the note [and] contravene the clear terms of the note").

> directors, officers, stockholders, members, agents, advisors, partners and employees and any Affiliate of the Collateral Manager and its managers, directors, officers, stockholders, members, agents, advisors, partners and employees (in such case, the "Indemnified Party") from any and all expenses, losses, damages, liabilities, demands, charges and claims of any nature whatsoever (including reasonable attorneys' fees and expenses), as are incurred in investigating, preparing, pursuing or defending any claim, action, proceeding or investigation caused by, or arising out of or in connection with, the issuance of the Securities, the transactions contemplated by the Transaction Documents and/or any acts or omissions of the Collateral Manager, or its managers, directors, officers, stockholders, members, agents, advisors, partners and employees made in good faith and in the performance of the duties of the Collateral Manager under the Transaction Documents except to the extent resulting from the Indemnified Party's acts or omissions constituting fraud, bad faith, willful misconduct, gross negligence or breach of fiduciary duty in the performance, or reckless disregard, of its duties hereunder or under any other Transaction Document to which it is a party.[112]

The Zohar II and Zohar III CMAs provide substantially the same.[113] By their plain terms, they fail to include language restricting indemnification to third-party actions but also fail to state expressly that they apply to first-party actions. Under New York law, courts must take caution when inferring a party's intention to provide indemnification for first-party claims. The intention must be unmistakably clear from the language of the contract.[114] Because the contractual language here does not evince an unmistakably clear intention to cover first-party claims, the Court will not interpret it in such a manner.

The Patriarch Managers rely on the decision of the Court of Appeals for the Second Circuit in *Mid-Hudson Catskill Rural Migrant Ministry, Inc. v. Fine Host Corp.*[115] as an example where indemnification language similar to the language at issue here was held to provide for reimbursement of legal fees in first-party actions despite no express reference to such actions. However, the *Mid-Hudson* decision is distinguishable and does not lend support. The court in *Mid-Hudson* broadly read the indemnification clause at issue because of the presence of a second

[112] Zohar I CMA § 4.5.

[113] *See* Zohar II CMA § 4.5; Zohar III CMA § 4.5.

[114] *Bank of NY Trust Co., N.A. v. Franklin Advisers, Inc.*, 726 F.3d 269, 283 (2d Cir. 2013) ("Where, as here, the contract does not exclusively or unequivocally refer[] to claims between the parties themselves, we will presume that indemnification extends only to third-party disputes.") (internal quotations and citations omitted); *accord Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.*, 98 F.3d 13, 21 (2d. Cir. 1996); *Best Brands Consumer Prods., Inc. v. Versace 19.69 Abbigliamento Sportivo S.R.L.*, No. 17-cv-04593, 2020 WL 8678085, at *8 (S.D.N.Y. Oct. 1, 2020); *BNP Paribas Mortg. Corp. v. Bank of America, N.A.*, 778 F.Supp.2d 375, 412 (S.D.N.Y. 2011); *Hooper Assocs., Ltd. v. AGS Computs., Inc.*, 548 N.E.2d 903, 905 (N.Y. 1989); *Sage Sys., Inc. v. Liss*, 198 N.E.3d 768, 770 (N.Y. 2022).

[115] 418 F.3d 168 (2d Cir. 2005).

indemnification clause that limited indemnity to third-party actions.[116] This difference between the two provisions led the court to its conclusion that the parties intended the at-issue indemnification provision to apply to actions between the parties.[117]

Unlike the circumstances of *Mid-Hudson*, the CMAs contain no other indemnification provision to support an intention to include first-party claims. Rather, considering the CMAs as a whole (as this Court must),[118] the Court is led to the opposite interpretation; namely, that the parties did not intend for the provision to cover these claims. Section 4.5(d) of the CMAs imposes various notice and cooperation obligations between the indemnified and the indemnifying parties and gives the indemnifying party, among other things, an opportunity "to participate in the investigation, defense and settlement" of underlying claims against the indemnified party and "to assume the defense" of them.[119] These obligations would be rendered superfluous in first-party actions because notice, cooperation, and assumption of defense requirements have "no logical application to a suit between the [indemnified and indemnifying] parties".[120] As the Court must take caution to avoid rendering provisions meaningless when interpreting contracts,[121] it concludes that the "fair meaning" of the CMAs' indemnification provisions does not include first-party claims.[122]

In anticipation of this conclusion, the Patriarch Managers contend that two categories of their fees and expenses sought to be indemnified in Count 2 may still be recoverable. First, they reason, without supporting case law, that their costs incurred to comply with a turnover order of the Delaware Court of Chancery in the Books and Records Action are materially distinct from litigation expenses incurred therein. The Court rejects this contention. Second, they argue that the claims in the Interpleader Action are not first-party claims because the action was commenced by a third party, U.S. Bank, as the Indenture Trustee, against the Patriarch Managers and AMZM. The Court must also reject this argument. Regardless of how the action is styled, the Interpleader Action (like the Books and Records Action) was an action involving claims between the indemnitor and the indemnitee (the Zohar Funds and the Patriarch Managers) regarding the Patriarch Managers' entitlement to collateral management fees under the CMAs between the parties.[123] AMZM was a subject of the suit given its role as collateral manager for (and thus, controller of) the Zohar Funds. Moreover, the Patriarch Managers admit that they pursued claims in the Interpleader Action substantially similar to the counterclaims they pursued against the

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[116] *Id.* at 178.

[117] *Id.* at 178-79.

[118] *LaSalle Bank Nat. Ass'n v. Nomura Asset Cap. Corp.*, 424 F.3d 195, 206 (2d Cir. 2005) ("[A]n interpretation of a contract that has the effect of rendering at least one clause superfluous or meaningless . . . is not preferred and will be avoided if possible.") (internal quotations and citations omitted).

[119] Zohar I CMA § 4.5(d)(i)-(vii); Zohar II CMA § 4.5(d)(i)-(vii); Zohar III CMA § 4.5(d)(i)-(vii).

[120] *Hooper*, 548 N.E.2d at 905.

[121] *LaSalle Bank*, 424 F.3d at 206.

[122] *Hooper*, 548 N.E.2d at 905.

[123] See *supra* note 12 (describing the collateral management fees and related disputes); *see also Sage*, 198 N.E.3d at 771 ("[N]one [of the bases supporting an action for indemnity were] exclusively or unequivocally referable to claims between the parties themselves or support[ed] an inference that defendant promised to indemnify plaintiff for counsel fees in an action on the contract." (quoting *Hooper*, 548 N.E.2d at 905)) (internal quotations omitted).

Debtors in the Books and Records Action.[124] It is unreasonable to allow indemnification claims arising from the Interpleader Action when they are not permitted for the Books and Records Action.

In sum, given that the insufficiency of the Counterclaimants' defenses arising from the claims in Counts 1, 2, and 5 is clearly apparent from the pleadings, the defenses must be struck.

3. The Court Will Not Strike The Setoff And Recoupment Defenses Arising From The Credit Agreement Indemnification Claims Of Counts 3 and 4

At the outset, the Litigation Trust argues that PPAS and Patriarch Partners seek to set off their indemnification claims against all Debtor-claims regardless of the targeted Patriarch-related defendant. This, it contends, violates the principle of mutuality, which requires that the debts proposed to be setoff be due to and from the same persons in the same capacity.[125] At oral argument, the Counterclaimants clarified that they are only seeking setoff to the extent permitted under applicable law, including the same party element. [126] The issue is therefore moot.[127]

Next the Litigation Trust argues that PPAS (Count 3) and Patriarch Partners (Count 4) are not entitled to indemnification under the applicable Credit Agreements. The Court will discuss each claim in turn.

In Count 3, PPAS, as administrative agent, alleges that certain portfolio company borrowers failed to reimburse it for out-of-pocket expenses incurred in its role and failed to pay agency fees earned under the Credit Agreements. PPAS submits that its unpaid expenses and "unreimbursed losses"[128] (the agency fees[129]) are recoverable from the Zohar Funds under the applicable indemnification provision of each relevant Credit Agreement.

As a threshold matter, the Litigation Trust argues that PPAS has failed to sufficiently plead a claim for indemnifiable losses under the Credit Agreements because it did not identify all contracts and portfolio companies that form the basis of the claim. This argument fails on a motion to strike as the standards of *Twombly* and *Iqbal* do not apply.

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[124] Answer at 95 ¶ 42.

[125] *SemCrude*, 399 B.R. at 393.

[126] Jan. 30, 2023 Hr'g Tr. 58:16-59:1 ("[O]n the other elements [counsel to the Litigation Trust] mentioned, such as same parties for mutuality, [Counterclaimants] are not seeking to violate the requirements of setoff. We are seeking setoff to the extent permitted under applicable law. We are very aware of the same party element of setoff. And as [counsel to the Litigation Trust] noted when he inferred that we do not appear to be arguing that the Octaluna entities can use setoff for claims against other entities, we are not doing that and we will confirm that we are more than willing to live with and comply with the other requirements of mutuality for purposes of setoff.").

[127] The Litigation Trust's opening brief also argues that Patriarch Partners is not a Defendant. However, since the completion of briefing, the Litigation Trust amended the Complaint to add Patriarch Partners as a Defendant to Count 41. *See* Adv. D.I. 295 at 151.

[128] Answer at 103 ¶ 82.

[129] *See id.* at 97 ¶ 50 (describing unpaid agency fees as an "affirmative but unrecompensed expenditure of resources").

PPAS identifies one portfolio company - eMag Solutions, LLC ("eMag").[130] The Litigation Trust relies on its Credit Agreement to argue also that the Zohar Funds do not have the obligation to indemnify PPAS for agency fees, which are primary obligations of the portfolio company borrowers. Count 3, the Litigation Trust claims, is thus an improper attempt "to retroactively transform a standard indemnity provision covering losses and liabilities into a guarantee of the [b]orrowers' obligations."[131]

Section 9.06 of the eMag Credit Agreement provides the following:

> Right to Indemnity. ***Each Lender*** . . . agrees ***to indemnify the Agent*** [PPAS] . . . (each an "Indemnified Agent Person"), ***to the extent that the Agent shall not have been reimbursed*** by any Credit Party, ***for*** and against ***any and all*** liabilities, obligations, ***losses, damages***, penalties, actions, judgments, suits, costs, expenses (including counsel fees and disbursements) or disbursements ***of any kind or nature whatsoever which may be*** imposed on, ***incurred by*** or asserted against ***such Indemnified Agent Person in exercising its powers, rights and remedies or performing its duties hereunder*** or under the other Credit Documents ***or otherwise in its capacity as the Agent in any way relating to or arising out hereof or the other Credit Documents***; provided, no Lender shall be liable for any portion of such liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements resulting from the Agent's gross negligence or willful misconduct.[132]

It unequivocally sets forth a catalogue of bases for indemnification, including losses and damages incurred by PPAS as administrative agent. BLACK'S LAW DICTIONARY defines a loss as "[a]n undesirable outcome of a risk; the disappearance or diminution of value"[133] and damages as "[m]oney claimed by . . . a person as compensation for loss or injury".[134] Moreover, the clause contains broad, inclusive phrases such as "any and all", "of any kind or nature whatsoever", and "in any way relating to or arising out" of the eMag Credit Agreement. Given the need to strictly construe indemnification provisions to honor parties' intentions,[135] the Court is unable on the language of Section 9.06 alone to foreclose an indemnity claim for damages incurred by PPAS as

[130] Answer at 97 ¶ 49.

[131] Adv. D.I. 212 at 32.

[132] Adv. D.I. 213, Ex. 4 § 9.06 (eMag Credit Agreement) (emphasis added).

[133] BLACK'S LAW DICTIONARY (11th ed. 2019).

[134] *Id.*

[135] *See, e.g.*, *TD Waterhouse Inv. Servs., Inc. v. Integrated Fund Servs., Inc.*, No. 01-CIV-8986, 2002 WL 441123, at **3-5 (S.D.N.Y. 2002) (denying dismissal of indemnification claim after finding contractual provision sufficiently broad to include plaintiffs' earned service and agency fees for which a third-party's primarily payment obligation was waived), *rev'd in part on other grounds by Nat'l Inv. Servs. Corp. v. Integrated Fund Servs., Inc.*, 85 Fed. Appx. 779 (2d Cir. 2004).

a result of eMag's failure to pay agency fees.[136] Thus, the Litigation Trust's request to strike the Counterclaimants' setoff and recoupment defenses as they pertain to Count 3 will be denied.

In Count 4, Patriarch Partners request indemnification under the IMG Credit Agreement as an "Agent-Related Person" for legal fees and expenses incurred in defense of the Asbestos Actions. This claim is against the Zohar Funds as lenders under the IMG Credit Agreement and arises from Section 16.7 of the IMG Credit Agreement that provides the following:

> **Costs and Expenses; Indemnification.** . . . . [T]he Lenders shall indemnify upon demand the Agent-Related Persons (to the extent not reimbursed by or on behalf of Borrowers and without limiting the obligation of Borrowers to do so), according to their Pro Rata Shares, from and against any and all Indemnified Liabilities; provided, however, that no Lender shall be liable for the payment to any Agent-Related Person of any portion of such Indemnified Liabilities resulting solely from such Person's gross negligence or willful misconduct . . . .[137]

"Agent-Related Persons" means PPAS, "together with its Affiliates, officers, directors, employees, attorneys, and agents."[138] The term "Indemnified Liabilities" includes reasonable attorneys' fees and all other costs and expenses actually incurred "in connection with or arising out of . . . any Environmental Actions . . ."[139] "Environmental Actions" are defined to include "litigation . . . involving violations of Environmental Laws or releases of Hazardous Materials from [] any assets, properties, or businesses of any Loan Party, or any of their predecessors in interest", and "Hazardous Materials" include "asbestos in any form."[140]

The Litigation Trust argues that Count 4 should be struck because Patriarch Partners fails to allege that it was sued in its capacity as PPAS's "Affiliate". It submits that Patriarch Partners may only receive indemnification under New York law if it was sued as a result of its actions contemplated by the IMG Credit Agreement and not for actions taken in a capacity distinct from PPAS and its obligations under the credit agreement.[141] The Litigation Trust highlights that PPAS was not named as a defendant in the Asbestos Actions, leading it to conclude that Patriarch Partners was not sued in its capacity as an Affiliate to PPAS. In response, Counterclaimants contend that capacity is irrelevant to their indemnification rights but that even if relevant, a material dispute exists as to the capacity in which Patriarch Partners was named as defendant in the Asbestos

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[136] *See Weissman v. Sinorm Deli, Inc.*, 669 N.E.2d 242, 247-48 (N.Y. 1996) (relying on not only an indemnification provision but also extrinsic evidence to determine plaintiff was entitled only to indemnification of certain liabilities he incurred).

[137] Adv. D.I. 213, Ex. 5 § 16.7 (IMG Credit Agreement) (emphasis in original).

[138] *Id.* at Ex. 5, Schedule 1.1.

[139] *Id.* at Ex. 5 § 11.3.

[140] *Id.* at Ex. 5, Schedule 1.1.

[141] *BNP Paribas*, 778 F.Supp.2d at 416 ("There is no support in the [contract] or the law for the proposition that a party to an indemnity provision could recover losses sustained in an entirely different capacity from the one for which indemnity was extended. Not surprisingly, New York law forbids such a result . . . .").

Actions. The Court agrees that the Litigation Trust's argument ultimately rests upon a fact not yet established and need not be pled for maintaining the defenses. Therefore, striking the setoff and recoupment defenses arising from Count 4 is not appropriate.[142]

4. The Court Will Strike The Setoff And Recoupment Defenses Arising From The Unjust Enrichment Claim of Count 6

Count 6 is the Counterclaimants' unjust enrichment claim. They admit that this is an alternative claim duplicating the contract claims asserted in Counts 1 through 5.[143] The validity and enforceability of the relevant contracts are not at issue. Accordingly, the unjust enrichment claim is precluded.[144] By extension, the reliant setoff and recoupment defenses must be struck.

V. CONCLUSION

For the foregoing reasons, the Court hereby **ORDERS** the following:

1. Counts 1 through 6 are dismissed.

2. Counts 7 and 8 are struck as they pertain to the claims alleged in Counts 1, 2, 5, and 6.

3. The request to strike Counts 7 and 8 as they pertain to the claims in Counts 3 and 4 is denied.

Dated: April 13, 2023

Karen B. Owens
United States Bankruptcy Judge

[142] The Litigation Trust's demonstrative at oral argument indicates that they also seek to strike the Counterclaimants' defense of recoupment arising from the claims of Counts 3 and 4 due to a failure to satisfy the "same transaction test." It also indicates that they seek to strike the setoff defense pertaining to these claims due to principles of equity. While the briefing advanced these arguments with respect to the Octaluna Entities' Class B Note Claims in Count 5, it did not do so with respect to the indemnification claims of PPAS and Patriarch Partners.

[143] Jan. 30, 2023 Hr'g Tr. 42:18-22.

[144] *Zohar CDO 2003-1, Ltd. v. Patriarch Partners, LLC (In re Zohar III, Corp.)*, 631 B.R. 133, 176-77 (Bankr. D. Del. 2021).