IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 7
	)	
DSI RENAL HOLDINGS, LLC, *et al.*,	)	Case No. 11-11722 (KBO)
	)	
Debtors.	)	(Jointly Administered)
_____	)	
	)	
ALFRED T. GIULIANO, Chapter 7 Trustee,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. Proc. No. 14-50356 (KBO)
	)	
MICHAEL SCHNABEL, *et al.*,	)	
	)	
Defendants.	)	
_____	)	

OPINION[1]

Before the Court is the *Defendants' Motion For Partial Summary Judgment Limiting Any Recoveries To The Amount Necessary To Satisfy Allowed Creditor Claims*[2] (the "Capping Motion") filed in the above-captioned adversary proceeding commenced by plaintiff Alfred T. Giuliano (the "Trustee"), as the chapter 7 trustee for the estates of DSI Renal Holdings, LLC, DSI Hospitals, Inc., and DSI Facility Development, LLC (each a "Debtor" and together the "Debtors"). For the reasons set forth herein, the Court will grant the relief requested in the Capping Motion with respect to damages that may be awarded on account of Count 4 (Recovery of Transfers Under 11 U.S.C. § 550) but will deny the relief requested with respect to those that may be awarded on account of Counts 5 (Breach of Fiduciary Duty), 6 (Aiding and Abetting Breach of Fiduciary Duty), and 7 (Corporate Waste).

I. JURISDICTION

The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 1334 and 157(a). As this Court held in the Dismissal Opinion (as defined herein), certain Counts of the Complaint are core proceedings while others are non-core.[3] The Trustee demands a jury trial for all Counts

[1] This Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

[2] *See* D.I. 188.

[3] *See* Op. at 3-4, D.I. 56.

of the Complaint. Neither the Trustee nor the Defendants consent to the entry of a final judgment or adjudication by this Court. Nonetheless, the Court has the authority to hear and enter an order on the Capping Motion.[4]

II. RELEVANT BACKGROUND

A. *The Prepetition Restructuring and Sale of the Renal Business*

The claims asserted in the Trustee's Complaint spring from a complex prepetition restructuring of Debtor DSI Renal Holdings, LLC ("DSI Renal Holdings") and certain of its subsidiaries (the "Restructuring"). Prior to the Restructuring, non-Debtor DSI Holding Company, Inc. ("DSI Parent") wholly owned the Debtors. DSI Parent's indirect subsidiaries owned substantially all of the operating assets of the enterprise, including a hospital in Bucks County, Pennsylvania and kidney dialysis clinics throughout the United States (the "Renal Business"). The hospital was owned by non-Debtor[5] Bucks County Oncoplastic Institute, LLC ("Bucks County"), a subsidiary of Debtor DSI Hospitals Inc. The Renal Business was owned by non-Debtor DSI Renal, Inc. ("DSI Renal"), a wholly owned subsidiary of Debtor DSI Renal Holdings.

On January 11, 2010, the Restructuring was effectuated through a series of transactions as contemplated by and set forth in a Global Restructuring Agreement ("GRA") entered into by, among others, DSI Parent, DSI Parent's equity holders (including Defendants The Northwestern Mutual Life Insurance Company ("NML"), Apollo Investment Corp. ("AIC"), and certain Centre Defendants[6]),[7] DSI Renal Holdings, DSI Renal, and the lenders under DSI Renal's credit facilities (including certain Centre Defendants, NML, Ares Capital Corp. ("ARCC"), and AIC).[8] In sum, the following relevant events occurred to effectuate the Restructuring:

---

[4] *See, e.g.*, *Burtch v. Owlstone, Inc. (In re Advance Nanotech, Inc.)*, No. 13-51215, 2014 WL 1320145, *2 (Bankr. D. Del. Apr. 2, 2014) ("After *Stern v. Marshall*, the ability of bankruptcy judges to enter interlocutory orders in proceedings . . . has been reaffirmed . . . ."); *Boyd v. King Par, LLC*, No. 11-CV-1106, 2011 WL 5509873, at *2 (W.D. Mich. Nov. 10, 2011) ("[U]ncertainty regarding the bankruptcy court's ability to enter a final judgment . . . does not deprive the bankruptcy court of the power to entertain all pretrial proceedings, including summary judgment motions.").

[5] Prior to the Restructuring, on March 30, 2009, Bucks County filed a voluntary chapter 7 petition for relief in the United States Bankruptcy Court for the Middle District of Tennessee.

[6] The Centre Defendants are Centre Partners Management LLC, Centre Bregal Partners, L.P., Centre Bregal Partners II, L.P., Centre Capital Investors IV, L.P., Centre Capital Investors V, L.P., Centre Capital Non-Qualified Investors IV, L.P., Centre Capital Non-Qualified Investors V, L.P., Centre Partners Coinvestment IV, L.P., Centre Partners Coinvestment V, L.P., Centre Partners IV, L.P., Centre Partners IV, LLC, Centre Partners V, L.P., and Centre Partners V, LLC.

[7] As of the Restructuring, DSI Parent issued redeemable preferred stock, convertible preferred stock, and common stock. The redeemable preferred stock was held by NML and AIC. The convertible preferred stock and common stock was held by certain Centre Defendants, NML, and non-Defendant investors.

[8] Prior to the Restructuring, DSI Renal's outstanding obligations under its credit facilities totaled approximately $464 million. More specifically, approximately $282 million, $169 million, and $12 million were outstanding under the Existing Senior Secured Credit Agreement, the Senior Subordinated Loan Agreement, and the Junior Subordinated Loan Agreement (as such terms are defined in the GRA),

- DSI Renal Holdings formed CDSI I Holding Company, Inc. ("CDSI I"), which formed a wholly owned subsidiary, CDSI II Holding Company Inc. ("CDSI II");

- Certain Centre Defendants, AIC, NML, and ARCC converted (the "Creditors") an aggregate of approximately $55 million of their DSI Renal subordinated debt holdings into, among other things, 55,000 DSI Renal shares and contributed those DSI Renal shares to CDSI I in return for, among other things, approximately 55,000 CDSI I shares;

- DSI Renal Holdings contributed all of its 1,000 DSI Renal shares to CDSI I in return for one of its shares;

- Certain Centre Defendants and NML invested (the "New Investors") $71 million (the "Investment Proceeds") into CDSI I for, among other things, approximately 77,000 CDSI I shares;

- CDSI I contributed the Investment Proceeds and 56,000 DSI Renal shares to CDSI II;

- Certain shareholders of DSI Parent received equity interests in CDSI I from the New Investors and Creditors; and

- DSI Parent merged with and into DSI Renal Holdings, with DSI Renal Holdings surviving, and the former shareholders of DSI Parent receiving ownership interests in DSI Renal Holdings in the same numbers and series or classes as they held in DSI Parent prior to the Restructuring.

There is no dispute that each of the Restructuring transactions were part of an integrated transaction and that the effectiveness of each transaction was conditioned upon the substantially simultaneous consummation of each of the other transactions.

As a consequence of the Restructuring, DSI Renal Holdings ceased to wholly own and benefit from DSI Renal and its Renal Business. Rather, DSI Renal and its Renal Business became wholly owned by CDSI I, indirectly through its subsidiary CDSI II. DSI Renal Holdings held one share of CDSI I. Defendants Centre Defendants, NML, ARCC, and AIC, along with other non-Defendants, held the remainder.

A little over one year later, DaVita, Inc. ("DaVita"), a third-party who is not a Defendant, entered into a merger agreement with CDSI I. The transaction closed on September 2, 2011, with DaVita acquiring CDSI I for approximately $689 million (the "DaVita Acquisition"). The Defendants received in the aggregate approximately $440 million on account of, among other things, their shares in CDSI I and/or as repayment of DSI Renal's outstanding debt obligations.

---

respectively. Certain Centre Defendants, ARCC, AIC, and NML were lenders under the senior subordinated facility. NML was the lender under the junior subordinated facility.

B. *The Bankruptcy Proceedings*

On June 3, 2011 (the "Petition Date"), each of the Debtors filed in this Court voluntary petitions for relief under chapter 7 of title 11 of the United States Code (the "Bankruptcy Code"). The Trustee was appointed as the chapter 7 trustee for the Debtors' estates and, on May 20, 2013, commenced this proceeding in the United States District Court for the Eastern District of Pennsylvania. Ultimately, it was transferred to the United States District Court for the District of Delaware and referred to this Court.

The gravamen of the Trustee's Complaint is that the Defendants – Messrs. Schnabel, Murphy, Pollack, Bergmann, and Yalowitz (together, the "D&O Defendants") (former officers and directors of entities affiliated with DSI Renal Holdings) and the Centre Defendants, NML, AIC, and ARCC – effectuated a fraudulent scheme leading up to and through the Restructuring that stripped the Debtors of substantially all of their valuable assets, namely the Renal Business, for little to no consideration and then turned around and sold those assets for over half a billion dollars. According to the Trustee, while the Defendants received hundreds of millions of dollars for their wrongful activity, the Debtors and their creditors were left with little except millions of dollars' worth of non-insider claims. Accordingly, the Trustee has asserted claims for the avoidance and recovery of fraudulent transfers as well as claims arising from breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and corporate waste.[9]

The Defendants contest the Trustee's claims and allegations. However, the Court need not address issues of ultimate liability at this stage. Rather, the Capping Motion relates only to the extent of damages sought by the Trustee. Briefing on the Capping Motion is complete, oral argument was held on September 13, 2019, and the matter is ripe for decision.

III. SUMMARY OF THE PARTIES' POSITIONS

On account of his claims, the Trustee seeks damages in the amount of approximately $678 million, which represents the amount of DaVita Acquisition proceeds received by the Defendants plus interest as calculated by the Trustee. However, according to the Official Claims Register maintained in the Debtors' bankruptcy proceedings, only approximately $166 million of claims have been asserted against the Debtors to date. Accordingly, if the Trustee succeeds, it is likely

[9] The Complaint as filed alleged nine counts against some or all of the Defendants plus CDSI I, CDSI II, and Ken Kencel. The Trustee voluntarily dismissed without prejudice CDSI I and CDSI II on August 2, 2013 and Mr. Kencel on November 1, 2013. Motions to dismiss were filed in August 2013. During oral argument on the motions, the Trustee voluntarily withdrew without prejudice Count 9 of the Complaint. On July 20, 2017, the Court issued its Opinion on the dismissal motions (*see* D.I. 56, the "Dismissal Opinion"), granting, denying, or deferring them in part.

As a result of the foregoing, seven counts remain against some or all of the Defendants. More specifically, Counts 1-4, alleged against all Defendants, seek the avoidance and recovery of alleged fraudulent transfers under 11 U.S.C. § 548(a)(1)(A), 11 U.S.C. § 548(a)(1)(B), 11 U.S.C. § 544 and 6 Del. C. §§ 1304 and 1305, and 11 U.S.C. § 550, respectively. Count 5, alleged against the D&O Defendants and the Centre Defendants, asserts claims for breach of fiduciary duty. Count 6, alleged against all Defendants, asserts claims for aiding and abetting breach of fiduciary duty. The final remaining count, Count 7, alleged against all D&O Defendants except Mr. Yalowitz, asserts claims for corporate waste.

that he will be able to pay all claims in full and have a substantial surplus for distribution to the Debtors and, ultimately, to DSI Renal Holdings' interest holders.[10] This is an unusual circumstance for a chapter 7 proceeding and has led to the question before the Court. Namely, if the Trustee ultimately prevails on his claims in this proceeding, can he recover from the Defendants more than the total amount of the allowed claims asserted against the Debtors in their chapter 7 cases, thus enabling the Debtors to benefit from the surplus?

The Defendants assert that the Bankruptcy Code, applicable state law, controlling precedent, and equity preclude the Trustee from recovering in excess of creditor claims. Among other things, they rely on the plain language of section 550(a) of the Bankruptcy Code and the holdings of several decisions of the United States Court of Appeals for the Third Circuit, which the Defendants contend require avoidance recoveries to benefit creditors only. In addition, the Defendants argue that limiting the Trustee's recovery will avoid the inequitable and absurd result that will arise if recoveries are ultimately distributed to the Debtors' interest holders by way of the Debtors. Specifically, the Defendants contend that these recipients, who participated in and ratified the Restructuring, agreed under the GRA to return to the Defendants all proceeds received as a result of this proceeding. Accordingly, once creditors are paid in full, they assert that there is no remedy to be accomplished. The damages will be disbursed back to them but will be reduced by the Trustee's fee and those of his professionals. This, the Defendants assert, will only serve to penalize them and provide a windfall to the Trustee and his professionals. For similar reasons, the Defendants seek to cap recoveries on account the Trustee's state law claims.

The Trustee opposes the relief sought in the Capping Motion. While he agrees with the "unremarkable proposition" that debtors are not entitled to benefit from avoidance and that any attempt to do so must be curtailed so that only creditors benefit,[11] he argues that this proceeding is distinguishable as he seeks avoidance as a chapter 7 trustee on behalf of the Debtors' estates. Moreover, relying extensively on the reasoning set forth in *Tronox Inc. v. Anadarko Petroleum Corp. (In re Tronox, Inc.)*,[12] the Trustee argues that recoveries are not limited by the amount of allowed creditor claims because section 550(a) requires only that avoidance proceeds provide, at minimum, some benefit to creditors. In other words, section 550(a) prevents a debtor from being the only beneficiary of an avoidance action but does not prevent a debtor from receiving surplus proceeds following satisfaction of allowed creditor claims. For the Trustee, section 550(a) establishes not a maximum recovery but rather, a minimum one that must provide some benefit to creditors. Accordingly, the Trustee contends that, pursuant to the United States Supreme Court holding in *Moore v. Bay (In re Estate of Sassard & Kimball, Inc.)*,[13] once the challenged transfer is avoided in its entirety, he is entitled to fully recover it (or the value thereof) to restore the Debtors' estates to their prior position regardless of the quantum of creditor claims.

---

[10] The deadline for creditors to submit proofs of claim expired on October 26, 2011. *See* No. 11-11722, D.I. 23.

[11] *Trustee's Omnibus Mem. in Opp. to Defs' Mot. for Summ. J.* (the "Trustee Mem.") at 74, D.I. 205.

[12] 464 B.R. 606 (Bankr. S.D.N.Y. 2012).

[13] 284 U.S. 4, 5 (1931).

IV. APPLICABLE LEGAL STANDARD

Rule 56 of the Federal Rules of Civil Procedure, made applicable to this proceeding by Rule 7056 of the Federal Rules of Bankruptcy Procedure, provides that a court may grant summary judgment on whole or in part of a claim or defense "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."[14] A material fact is one that "might affect the outcome of the suit under governing law."[15] A dispute concerning a material fact is present "when reasonable minds could disagree on the result."[16] The moving party bears the burden of demonstrating an entitlement to summary judgment.[17]

Summary judgment serves to "isolate and dispose of factually unsupported claims or defenses" and avoid unnecessary trial where the facts are settled.[18] Thus, at the summary judgment stage, the court's function is not to weigh the evidence and determine the truth of the matter, but to determine whether there is a genuine issue for trial.[19] A court should view the facts and all permissible inferences from those facts in the light most favorable to the non-moving party.[20] Any doubt must be construed in the non-moving party's favor.[21]

A moving party bears the initial burden of demonstrating the absence of a dispute of material fact.[22] "[W]hen the moving party has met its burden . . . the nonmoving party must come forward with specific facts showing that there is a genuine issue for trial."[23] In other words, "the mere existence of some alleged factual dispute between the parties" cannot defeat a properly supported summary judgment motion.[24] Rather, the dispute must relate to a genuine issue of material fact.[25] Thus, a non-moving party cannot defeat a summary judgment motion based on conclusory allegations and denials, but instead must provide supportive arguments or facts that show the necessity of a trial.[26]

---

[14] FED. R. CIV. P. 56(a).

[15] *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

[16] *In re Delta Mills, Inc.*, 404 B.R. 95, 105 (Bankr. D. Del. 2009).

[17] *Gans v. Mundy*, 762 F.2d 338, 340-41 (3d Cir. 1985).

[18] *Delta Mills*, 404 B.R. at 104 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986)).

[19] *Pearson v. Component Tech. Corp.*, 247 F.3d 471, 482 (3d Cir. 2001) (citing *Celotex*, 477 U.S. at 317); *see also* FED. R. CIV. P. 56(c).

[20] *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587-88 (1986).

[21] *Delta Mills*, 404 B.R. at 105.

[22] *Celotex*, 477 U.S. at 323.

[23] *Matsushita*, 475 U.S. at 586-87.

[24] *Anderson*, 477 U.S. at 247-48.

[25] *Delta Mills*, 404 B.R. at 105.

[26] *Schoch v. First Fidelity Bancorporation*, 912 F.2d 654, 657 (3d Cir. 1990).

Summary judgment should be granted if, after drawing all reasonable inferences from the underlying facts in the light most favorable to the non-moving party, the court concludes that there is no genuine issue of material fact to be resolved at trial and the moving party is entitled to judgment as a matter of law.[27]

V. LEGAL DISCUSSION

In the Capping Motion, the Defendants request this Court to limit recoveries that may be obtained by the Trustee on account of his fraudulent transfer claims, on one hand, and his state law claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and corporate waste, on the other. The Court will discuss the merits of each request below.

A. *Limiting Recoveries Under 11 U.S.C. § 550(a)*

Under the Bankruptcy Code, avoidance of a fraudulent transfer and recovery on account of such transfer are two separate concepts. "Specifically, after demonstrating the *right* to recover conveyances . . ., a trustee must then establish the *amount* of recovery under section 550(a) of the Bankruptcy Code . . . ."[28] Accordingly, to decide the Capping Motion, the Court must assume that the Trustee will succeed in avoiding the alleged fraudulent transfers.

As a threshold matter, the Trustee argues that the Court's decision on the Capping Motion is an inappropriate advisory opinion that should be delayed until the record is fully developed at trial and notions of fairness and equity can be considered. However, the Court disagrees. The use of partial summary judgment here will streamline issues at trial and may enhance settlement possibilities.[29] Moreover, while the Trustee's factual allegations are relevant to avoidability under sections 548 and 544, they are not for recovery under section 550(a).[30]

Section 550(a) provides in pertinent part that "to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of [the Bankruptcy Code], the trustee may recover, *for the benefit of the estate*, the property transferred, or, if the court so orders, the value of such property . . . ."[31] Numerous questions have been presented to courts regarding the import of section 550(a)'s phrase "for the benefit of the estate," including those with respect to a plaintiff's standing to exercise avoidance powers and the extent of recovery upon avoidance. The Third Circuit equates such phrase to mean "for the benefit of creditors" and has prohibited debtors from

---

[27] FED. R. CIV. P. 56(a).

[28] *Acequia v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 809 (9th Cir. 1994).

[29] *See, e.g.*, *Hotel 71 Mezz Lender LLC v. Nat'l Ret. Fund*, 778 F.3d 593, 606 (7th Cir. 2015) ("A request for partial summary judgment can serve a useful brush-clearing function even if it does not obviate the need for a trial, . . . and it may also facilitate the resolution of the remainder of the case through settlement." (internal citations omitted)).

[30] *See, e.g.*, *Danning v. Miller*, 922 F.2d 544, 546 n.2 (9th Cir. 1991). Indeed, the Trustee does not dispute this conclusion. *See* Trustee Mem. at 63-64 ("[T]he recovery of a properly avoided transfer is treated the same under § 550, without regard to the trustee's basis for avoidance.").

[31] 11 U.S.C. § 550(a) (emphasis added).

benefiting from the Bankruptcy Code's avoidance powers.[32]

While the Trustee asserts that this prohibition applies when a debtor is the only party who stands to benefit from an avoidance action[33] and not in instances such as this proceeding where the Trustee is acting for the benefit of the estates and creditors will benefit, the Court disagrees. First, it is true that the Trustee is empowered to pursue the Bankruptcy Code's avoidance powers to maximize recoveries for the Debtors' creditors.[34] But to decide whether to limit those recoveries, the Court must look to ***who will benefit*** from the recoveries and not ***who is bringing the action***.

Second, there is no dispute that creditors stand to greatly benefit from recoveries the Trustee may obtain from his avoidance claims and that, if and when creditors' claims are paid in full from the recoveries, the Debtors will receive the available excess. However, under the facts and circumstances presented, the Court holds that the Debtors' receipt of such excess would be impermissible. As an initial matter, receipt of such funds would provide no accompanying benefit to creditors as they would have already received payment in full. Moreover, receipt would serve to give rights and value to the Debtors to which they were not entitled outside, nor were given inside, bankruptcy. If the Trustee were to prevail on the fraudulent transfer claims, the state law rights and obligations of the Debtors vis-à-vis the Defendants as a result of the Restructuring remain unchanged. They are neither entitled to avoid the Restructuring as a fraudulent transfer nor benefit from the Trustee's avoidance, and nothing in the Bankruptcy Code expands this lack of entitlement.[35] Two Third Circuit cases cited by the Defendants in support of the relief requested – *In re Messina*[36] and *In re Majestic Star Casino, LLC v. Barden Development, Inc. (In re Majestic Star Casino, LLC)*[37] – are illustrative to the issue presented.

---

[32] *See, e.g.*, *In re Cybergenics Corp.*, 226 F.3d 237, 243-47 (3d Cir. 2000).

[33] It is black-letter law that a debtor cannot invoke avoidance powers if it is the only party who stands to benefit. *See, e.g.*, *Wellman v. Wellman*, 933 F.2d 215, 219 (9th Cir. 1991) (finding that a chapter 11 debtor lacked standing to avoid an allegedly fraudulent transfer where the recovery to be obtained would benefit only the debtor); *Whiteford Plastics Co., Inc. v. Chase Nat'l Bank of N.Y.C.*, 179 F.2d 582 (2d Cir. 1950) ("It would be a mockery of justice to say that the alleged bankrupt may claim through and in the right of creditors whose debts have been paid and discharged; that he may avoid a transaction, valid as to himself but voidable as to creditors, in the right of non-existing creditors." (quoting *In re J.C. Winship Co.*, 120 F. 93, 96 (7th Cir. 1903)); *Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 80, 92-97 (S.D.N.Y. 2008) (holding that, because the Bankruptcy Code's avoidance powers can only be asserted to benefit creditors and not the debtor itself, avoidance actions could not be maintained in a circumstance where creditors did not stand to receive any benefit from the recoveries); *New Life Adult Med. Day Care Ctr., Inc. v. Failla & Banks, LLC (In re New Life Adult Med. Day Care Ctr., Inc.)*, No. 13-1076, 2014 WL 6851258, at *6 (Bankr. D. N.J. Dec. 3, 2014) (granting summary judgment in favor of defendants in fraudulent transfer action where the entity standing to benefit was the sole owner of the debtor).

[34] *See Cybergenics*, 226 F.3d at 245.

[35] *See Butner v. United States*, 440 U.S. 48, 55 (1979) ("Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

[36] 687 F.3d 74 (3d Cir. 2002).

[37] 716 F.3d 736 (3d Cir. 2013).

In *Messina*, chapter 7 debtors' residential property was fully encumbered by two mortgages as of the petition date, one of which was defective under state law.[38] During the bankruptcy proceeding, the chapter 7 trustee avoided the defective lien, which resulted in unencumbered sale proceeds to which the debtors then sought to apply their section 522(d)(1) and (d)(5) exemptions.[39] The trustee objected, contending that the exemptions were valueless given that the avoided mortgage remained valid as to the debtors.[40] The Third Circuit agreed.[41] To reach this conclusion, the Court held that the commencement of the debtors' chapter 7 proceedings did not create new property rights or value for the debtors in the fully encumbered property and, therefore, the debtors had no equity to exempt.[42] For the debtors to obtain equity, they must have avoidance powers themselves or the ability to benefit from those of the trustee.[43] The Third Circuit held that neither of these exceptions applied and, thus the exemptions were valueless.[44]

In *Majestic*, the bankruptcy court permitted reorganized debtors to avoid under section 549 a postpetition revocation of the "S" corporation status of a debtor's non-debtor, indirect parent.[45] This revocation caused the debtor-subsidiary to lose its status as a qualified subchapter S subsidiary (a "Qsub") and subjected it to federal taxation.[46] As a remedy following avoidance, the bankruptcy court ordered the reinstatement of the non-debtor parent's S-corporation status.[47] On direct appeal, the Third Circuit vacated the lower court's decision.[48] The Court held, *inter alia*, that under the Internal Revenue Code and related regulations the debtor did not have a property interest in its Qsub status and that, even if it did, the interest would belong to the non-debtor parent.[49] Therefore, given that the bankruptcy laws did not alter or expand the debtor's interest in

---

[38] 687 F.3d at 76-77.

[39] *Id.* Section 552(d)(1) and (d)(5) afford an individual debtor the opportunity to exempt from property of the estate such individual's interest in, among other things, certain residential property up to a certain specified amount.

[40] *Id.* at 82.

[41] *Id.*

[42] *Id.* (citing *Butner*, 440 U.S. at 55).

[43] *Id.*

[44] *Id.* at 82-83 (citing *Cybergenics Corp.*, 226 F.3d at 244-47). In *Messina*, the Third Circuit recognized that "a debtor may benefit from avoidance if he files an exemption, pursuant to 11 U.S.C. § 522(g)." *Id.* at 83. Section 522(g) provides that under certain circumstances and "[n]otwithstanding sections 550 and 551 [of the Bankruptcy Code], the debtor may exempt under [section 552(b)] property that the trustee recovers under section . . . 550 . . . ." 11 U.S.C. § 522(g). This limited exception, inapplicable to these proceedings, was not helpful to the debtors in *Messina* because they did not file for an exemption under such section. *Messina*, 687 F.3d at 83.

[45] 716 F.3d at 741.

[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Id.* at 759-61.

the asset, the Third Circuit opined that the debtor-subsidiary should not have been permitted to "stymie" legitimate transactions of its parent.[50]

"For similar reasons," the Third Circuit questioned the appropriateness of the non-debtor parent's tax status reinstatement as the avoidance remedy under section 550(a).[51] The remedy was of infinite duration so it would benefit the reorganized debtors long after the debtor's secured creditors (who obtained membership interests in the reorganized debtors) were compensated and sold their interests.[52] Accordingly, the Court determined that the relief ran afoul of limitations placed on the scope of available relief under section 550(a), including that "[a] debtor is not entitled to benefit from any avoidance[.]"[53]

The principles of *Cybergenics*, *Messina*, and *Majestic* have led this Court to conclude for the reasons set forth above that it is impermissible for the Debtors to receive any surplus avoidance recoveries obtained in this proceeding. Thus, the Court must fashion a remedy to avoid this result by capping the recoveries that might otherwise be available to the Trustee. Indeed, courts facing analogous circumstances to those currently presented have persuasively - and consistent with the Third Circuit's holdings - limited recoveries that would otherwise inure solely to the benefit of a debtor.[54]

As the Trustee correctly highlights, some courts have refused to impose caps on avoidance recoveries and even have permitted reorganized debtors to receive avoidance recoveries. However, those cases are distinguishable. In *Tronox* and similar cases, courts were tasked with deciding whether creditors may receive *more than* their allowed claims from avoidance recoveries.[55] Moreover, in *Trans World Airlines, Inc. v. Travellers International AG (In re Trans*

---

[50] *Id.*

[51] *Id.* at 761 n.26.

[52] *Id.*

[53] *Id.* (citing *Messina*, 687 F.3d at 82-84).

[54] *See Allonhill, LLC v. Stewart Lender Servs., Inc. (In re Allonhill, LLC)*, No. 16-50419, 2019 WL 1868610, at *52 (Bankr. D. Del. Apr. 25, 2019) (noting that, if the chapter 11 debtor prevailed on its avoidance claims, it could not recover damages exceeding the amount of outstanding creditor claims as such recovery would result in a windfall to equity that is precluded by section 550 and Third Circuit law); *Balaber-Strauss v. Murphy (In re Murphy)*, 331 B.R. 107, 126 (Bankr. S.D.N.Y. 2005) (limiting chapter 7 trustee's section 550 recovery and holding that a chapter 7 debtor did not have the right to surplus fraudulent transfer recoveries following payment of creditor claims as there was no federal interest warranting the adjustment of the pre-existing legal rights of the debtor and defendant in the surplus).

[55] *See Tronox*, 464 B.R. at 613-18 (Bankr. S.D.N.Y. 2012) (refusing at the summary judgment stage to cap the $15.5 billion recoveries sought by a litigation trust at the total amount of the trust beneficiaries' $2 billion claims but noting that there could be limits placed on the recovery after trial); *see also Kipperman v. Onex Corp.*, 411 B.R. 805, 876-79 (N.D. Ga. 2009) (allowing litigation trust for the benefit of unsecured creditors holding $14 million of claims to bring an action for damages in excess of the trust beneficiary claims); *PAH Litig. Trust v. Water St. Healthcare Partners, L.P. (In re Physiotherapy Holdings, Inc.)*, 2017 WL 5054308, No. 15-51238 (Bankr. D. Del. Nov. 1, 2017) (refusing to impose a maximum recovery on avoidance recoveries sought by a litigation trust even though certain trust beneficiaries would receive more than the amount of their allowed claims).

World Airlines, Inc.) and similar cases, courts were asked to decide whether reorganized debtors could pursue and benefit from avoidance actions and recoveries, with those permitting reorganized debtors to recover identifying a direct or indirect benefit for creditors achieved as a result of the recoveries, such as the furtherance of the reorganization effort or the indirect recovery of creditor claims.[56] The circumstances of *Tronox*, *Trans World Airlines*, and the like are not present here.[57] The Debtors' proceedings are ones under chapter 7. Creditors will not receive more than their allowed claims with interest, and there is no reorganized debtor to receive avoidance recoveries.

Similarly, the Trustee's reliance on the Supreme Court's decision in *Moore* is misplaced. In *Moore*, the Supreme Court addressed which creditors may benefit from avoidance and recovery rights that are derivative of "triggering creditors" under section 544. It also addressed the extent that a transfer may be avoided and recovered if the amount at issue is larger than the triggering creditors' claims. The *Moore* Court clarified that avoidance and recovery under section 544 is for the benefit of all creditors (not just triggering creditors) and that avoidance and recovery is not limited to the amount of triggering creditors' claims.[58] These holdings are not relevant to the Court's decision to limit the Trustee's avoidance recoveries in this proceeding.

---

[56] *See Trans World Airlines, Inc. v. Travellers Int'l AG (In re Trans World Airlines, Inc.),* 163 B.R. 964 (Bankr. D. Del. 1994) (permitting post-confirmation prosecution of avoidance action by reorganized debtor in part because recoveries would benefit unsecured creditors that received notes and preferred stock in the reorganized debtor); *see also Acequia v. Clinton (In re Acequia, Inc.),* 34 F.3d 800, 808-12 (9th Cir. 1994) (allowing a reorganized debtor's post-confirmation fraudulent transfer action because the prepetition secured creditor would benefit from the recoveries as a noteholder of the reorganized debtor); *MC Asset Recovery, LLC v. Commerzbank AG*, 441 B.R. 791 (N.D. Tex. 2010) (finding that creditors, as stockholders of the reorganized debtor, would receive an indirect benefit from avoidance action), *rev'd on other grounds by* 675 F.3d 530 (5th Cir. 2012); *MC Asset Recovery, LLC v. Southern Co.*, No. 06-CV-0417, 2006 WL 5112612, at **6-7 (N.D. Ga. Dec. 11, 2006) (same); *Sheffield Steel Corp. v. HMK Enters., Inc. (In re Sheffield Steel Corp.),* 320 B.R. 423, 446-48 (Bankr. N.D. Okla. 2004) (holding that avoidance recoveries would benefit the estate when they were shared between the reorganized debtor and unsecured creditors pursuant to a settlement because the prepetition secured creditors held notes of and stock in the reorganized debtor and because all estate constituents, including unsecured creditors, received an indirect benefit when the settlement was reached).

[57] *See* COLLIER ON BANKRUPTCY ¶ 544.06[4] (16th ed.) ("Once a transfer has been avoided under section 544(b), the extent of recovery remains undetermined. The governing provision, section 550(a), provides in part that if a transfer is avoided under one of the avoiding powers, 'the trustee may recover, for the benefit of the estate' . . . . The overwhelming majority of the courts interpret the phrase 'benefit of the estate' liberally, holding that the property or its value may be recovered even if creditors have been paid in full under a plan. [Citing, *inter alia*, *Acequia* and *Tronox*]. *What the result might be in a chapter 7 case in which creditors have been paid in full with interest and any excess recovery would go to the debtor has not been decided.*" (emphasis added)).

[58] *Moore*, 284 U.S. at 5; *accord Cybergenics*, 226 F.3d at 243 ("The avoidance power provided in section 544(b) is distinct from others because a trustee or debtor in possession can use this power only if there is an unsecured creditor of the debtor that actually has the requisite nonbankruptcy cause of action. Yet, once avoidable pursuant to this provision, the transfer is avoided in its entirety for the benefit of all creditors, not just to the extent necessary to satisfy the individual creditor actually holding the avoidance claim." (citing *Moore*, 284 U.S. at 5)).

Accordingly, for the foregoing reasons, the Court holds that under the facts and circumstances presented, any recovery obtained by the Trustee on account of Count 4 must be limited to the total amount necessary to satisfy all allowed creditor claims and expenses in the Debtors' bankruptcy cases as provided for under section 726(a)(1)-(5). This includes allowed secured, administrative, priority, and general unsecured claims and, for the avoidance of doubt, the allowed compensation of the Trustee and his professionals.

B. *Limiting Recoveries Under State Law*

In support of limiting recoveries awarded for the Trustee's state law claims of breach of fiduciary duty, aiding and abetting fiduciary duty, and corporate waste, the Defendants contend that once all allowed creditor claims are satisfied, there will no longer be an injury to redress and no interest left to be satisfied. Specifically, they argue that the Debtors' interest holders (who stand to benefit from any distribution to the Debtors) participated in and ratified the Restructuring as parties to the GRA and are obligated to "carry out the purpose and intent" of the GRA and "refrain from taking any action which would frustrate the purposes and intent of" the GRA.[59] Moreover, the Defendants assert that the holders are bound by an implied covenant of good faith and fair dealing and are legally barred from receiving any more than they already received in the Restructuring.[60] The Trustee has not explained his opposition to the relief requested by the Defendants.

The Court agrees with the Defendants that under applicable Delaware law[61] monetary damages cannot be awarded if there is no loss.[62] However, the rights and obligations of the Debtors' interest holders vis-à-vis the Defendants should the Trustee succeed on his state law claims are unclear, and there has been no further justification offered to support limiting the

---

[59] *See, e.g.*, GRA § 8.13, D.I. 196-114 & 206-33 ("Subject to the terms and conditions of this Agreement, the Parties agree to use their reasonable best efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary or desirable under applicable law to carry out the purposes and intent of this Agreement and the other Transaction Documents and shall refrain from taking any action which would frustrate the purposes and intent of this Agreement or any of the other Transactions").

[60] *See id.*

[61] When choosing which state law governs a matter, the Court must apply Delaware choice-of-law rules. *See, e.g.*, *See Klaxon Co. v. Stentor Elec. Mfg. Co., Inc.*, 313 U.S. 487, 496 (1941); *LaSala v. Bordier et Cie*, 519 F.3d 121, 140 (3d Cir. 2008). Here, Delaware is the Debtors' state of formation and incorporation, as applicable, and Delaware choice-of-law doctrine dictates that this Court apply Delaware law to the Trustee's state law claims:

> In deciding disputes between and among corporate actors, Delaware subscribes to the internal affairs doctrine, a conflict of laws principle under which the internal affairs of a corporate entity are governed by the laws of the state of incorporation . . . . Claims implicating an entity's internal affairs include breach of fiduciary duty, aiding and abetting, and waste.

Enzo Life Scis., Inc., v. Adipogen Corp., 82 F. Supp. 3d 568, 597 (D. Del. 2015) (citing *Xcell Energy & Coal Co., LLC v. Energy Inv. Grp., LLC*, No. 8652, 2014 WL 2964076 at *3 (Del. Ch. June 30, 2014)).

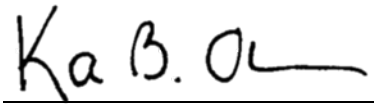
[62] *See, e.g.*, *In re Nine Sys. Corp. S'holders Litig.*, No. 3940, 2014 WL 4383127, at *51 (Del. Ch. Sept. 4, 2014), *aff'd sub nom Fuchs v. Wren Holdings, LLC*, 129 A.3d 882 (Del. 2015).

Trustee's potential state law damages. Based on the record before it, the Court finds that the Defendants have not satisfied their burden under Rule 56 and will deny the relief they seek with respect to Counts 5, 6, and 7.

VI. CONCLUSION

For the reasons set forth herein, the Court will grant the relief requested in the Capping Motion only with respect to Count 4 (Recovery of Transfers Under 11 U.S.C. § 550). The remainder of the relief sought will be denied. An appropriate order will follow.

Dated: February 4, 2020



Karen B. Owens
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 7
	)	
DSI RENAL HOLDINGS, LLC, *et al.*,	)	Case No. 11-11722 (KBO)
	)	
Debtors.	)	(Jointly Administered)
_____	)	
	)	
ALFRED T. GIULIANO, Chapter 7 Trustee,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. Proc. No. 14-50356 (KBO)
	)	
MICHAEL SCHNABEL, *et al.*,	)	
	)	
Defendants.	)	
_____	)	

ORDER

For the reasons set forth in the accompanying Opinion dated February 4, 2020, the *Defendants' Motion For Partial Summary Judgment Limiting Any Recoveries To The Amount Necessary To Satisfy Allowed Creditor Claims* (Adv. D.I. 188) is hereby **GRANTED** in part and **DENIED** in part.

Dated: February 4, 2020

Karen B. Owens
United States Bankruptcy Judge