

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE**

In re:	)	Chapter 7
	)	
PERVACIO, INC.,	)	Case No. 20-12096 (JTD)
	)	
_____ Debtor.	)	<b>D.I. 76</b>

**MEMORANDUM ORDER**

Following the entry of the Bid Procedures Order in this case (D.I. 27), the chapter 7 Trustee solicited bids for the sale of substantially all of the Debtor’s assets. A bid by Debtor’s prepetition and post-petition lender, Partners for Growth (“PFG”) was selected as the highest and best offer. As part of the consideration for the purchase of the assets, PFG negotiated for a full release of all estate claims against it, with the release being subject to Court approval pursuant to Federal Rule of Bankruptcy Procedure 9019. See Notice of Successful Bid and Bidder for the Debtor’s Assets and attached Asset Purchase Agreement (D.I. 60). Accordingly, the Trustee filed a Motion for an Order Approving Settlement and Release (the “Motion”) (D.I. 76). Citibank, N.A. (“Citibank”), objected to the Motion (the “Objection”) on the grounds that it believes substantial claims exist against PFG that the estate should not release. (D.I. 95). PFG replied to the Objection (the “Reply”) (D.I. 100) and a hearing was held on the Motion on February 9, 2021. For the reasons detailed below, the Objection is overruled, and the Motion is granted.

**JURISDICTION**

This Court has jurisdiction over this Motion under 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2), and venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

## DISCUSSION

Bankruptcy Rule 9019(a) provides that “on motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.” Fed. R. Bankr. Proc. 9019(a). In addition, section 105(a) of the Bankruptcy Code provides that “the court may issue any order . . . that is necessary or appropriate to carry out the provisions of this title.” 11 U.S.C. § 105(a). In evaluating the reasonableness of a proposed settlement, a bankruptcy judge should “assess and balance the value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal.” *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996). The Third Circuit recognizes “four criteria that a bankruptcy court should consider in striking this balance: (1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience, and delay necessarily attending it; and (4) the paramount interest of creditors.” *Id.* “In approving a settlement, the court does not have to be convinced that the settlement is the best possible compromise. Rather, the court must only conclude that the compromise or settlement falls within the reasonable range of litigation possibilities. That is, the settlement need only be above ‘the lowest point in the range of reasonableness.’” *In re Coram Healthcare Corporation*, 315 B.R. 321, 330 (Bankr. D. Del. 2004) (citing *In re Pennsylvania Truck Lines*, 150 B.R. 595, 598 (E.D. Pa. 1992)). When a motion to compromise presents the Trustee with “a conflict between [his] fiduciary duty to the creditor body as a whole and the alleged duty to go forward with a settlement agreement favoring one creditor but otherwise detrimental to the estate,” it is the duty of the Court, not the Trustee, to choose between these conflicting legal obligations. *Martin*, 91 F.3d at 394; Rule 9019(a).

The Trustee argues that the settlement falls well within the range of reasonableness. In support of this position, the Trustee notes that although he did not conduct extensive discovery

due to the limited resources available, the only potential claim he is aware of against PFG involves PFG's receipt of \$425,000 of a \$975,000 loan issued to the debtor. (Motion, D.I. 76, at 4-5). However, that transaction occurred prior to the 90-day preference period before the petition date. Further, the Trustee observed, even if the estate had a viable claim against PFG for the return the \$425,000, the consideration the estate would receive in connection with the settlement, which has an approximate cash value of \$80,000, represents 20% of such a claim, without any of the associated costs and expenses of litigation. *Id.* Accordingly, the Trustee argues, settlement is in the best interests of the estate.

Citibank, the provider of the prepetition loan, argues that the settlement should not be approved because the estate holds substantial claims against PFG arising out of the debtor's procurement of the loan under "highly suspicious circumstances" and at the direction and control of PFG. (Objection, D.I. 95, at 1-2). The loan was one issued pursuant to the newly created federal government funded Paycheck Protection Program ("PPP"), as part of the CARES Act, enacted into law to provide relief to small businesses impacted by the COVID-19 pandemic. *See* 15 U.S.C. §§ 636. PPP loans are subject to several rules and regulations regarding how funds may be used, and the loans are eligible for forgiveness if those rules and regulations are followed. With respect to the Debtor's obtaining the PPP loan, Citibank alleges that:

- PFG encouraged Pervacio to apply for a PPP loan on at least two separate occasions
- The PPP loan application contained materially misleading information designed to obtain approval of a loan for more than the amount to which the Debtor would have otherwise been entitled
- The Debtor anticipated being approved for a small loan in the range of \$100,000 to \$150,000 and the \$975,000 it received was significantly more than anticipated

- Within 48 hours after the PPP Loan was funded, the Debtor’s accounting firm resigned because “they were uncomfortable with the situation”
- Once the loan was approved and funded, PFG immediately exercised exclusive control over the loan proceeds by virtue of its control of the Debtor’s deposit accounts, sweeping \$425,000 to its own account and releasing the remaining \$550,000 to Debtor’s Canadian affiliate
- PFG’s sweep and retention of the PPP loan proceeds were in violation of regulations regarding how PPP loan proceeds can be used, turning a potentially forgivable loan into a \$975,000 fixed unsecured claim
- Two weeks before the Petition date, when bankruptcy was imminent, Debtor emailed counsel for PFG to discuss returning the PPP loan proceeds, but PFG refused, stating that if the loan is not forgiven it simply will be an unsecured debt, behind PFG, in the bankruptcy

(Objection, D.I. 95, at 5-11). Citibank argues that these allegations are sufficient for the estate to adequately state claims against PFG for any number of causes of action, including aiding and abetting a breach of fiduciary duty, aiding and abetting a fraud, interference with an existing contract, unjust enrichment, and fraudulent transfer. *Id.* at 16-19.

With these potential causes of action in mind, Citibank argues, the *Martin* factors weigh in favor of denying the settlement because: (1) the estate would likely succeed in prosecuting at least some of its claims against PFG, (2) any judgment would be readily collectible against PFG, a wealthy venture capital firm that has already availed itself of this Court’s jurisdiction; (3) the prosecution of estate claims will be straightforward and expedient because they only involve one creditor and some discovery has already taken place; and (4) the estate could realize at least \$425,000 of additional value. *Id.* at 19-21. Accordingly, Citibank concludes, the proposed settlement is unreasonable.

PFG joined the Trustee’s motion and filed a reply to Citibank’s objection on its own behalf. (Reply, D.I. 100). Addressing the *Martin* factors in order, PFG argues first that there is a low possibility of a success on the claim. PFG argues that Citibank has not set forth any

evidence suggesting that litigation would be successful on the merits, but rather has only described allegations that, at best, would be sufficient to state a claim. Moreover, PFG disputes the accuracy of those allegations, arguing that Citibank is mischaracterizing the events surrounding the PPP loan. For example, it argues, its withdrawal of the PPP loan proceeds was fully authorized both by its loan agreements with Pervacio and by a Deposit Account Control Agreement that was executed more than a year prior, of which Citibank was aware because the account was with Citibank. *Id.* at 3-11. Second, with respect to the likelihood of collection, PFG does admit to having the ability to pay, but also notes that its financial health is a double-edged sword as it also has the resources to vigorously contest what it views to be baseless charges. Third, PFG argues that any litigation against PFG is not going to be straightforward or expedient but would instead be complex and expensive. Prosecution of any of the claims identified by Citibank would require lengthy discovery, some of which would need to be obtained internationally, and PFG would fully deploy its expansive resources to defend itself through trial and beyond, if necessary. Fourth, PFG argues that the settlement here furthers the interests of the creditors. As Citibank itself acknowledged, because PFG has a first-priority lien on substantially all of the Debtor's assets, the amount of which far exceeds the estate's available assets, the unsecured creditors will likely go unpaid. Any hypothetical recovery by the estate on these claims would not alter the unsecured creditors' fate because amounts recovered would just go right back to PFG. *Id.* at 12-13. Accordingly, PFG argues, analysis of the *Martin* factors weighs in favor of approving the settlement. I agree.

Each of the four *Martin* factors weighs in favor of settlement here. The first factor – the probability of success in litigation – requires that I consider the likelihood that the estate would be successful in litigating the claims. Here, even though Citibank has already engaged in some

discovery, it did not put any facts into the record that would support the conclusion that the estate could succeed in litigating claims against PFG. For example, I have no facts before me regarding the ways in which the loan application was allegedly misleading, let alone that PFG had any knowledge that it was misleading, or any facts that suggest that PFG took any action with respect to the procurement of the loan at all beyond asking if the Debtor had applied for one. All I have here are allegations. While well-plead allegations may be sufficient to survive a motion to dismiss, they are not sufficient for me to conclude that the estate is likely to be successful in litigating claims to their conclusion.

The second factor – the likely difficulties in collection – also weighs in favor of settlement. PFG has clearly stated its intention to throw its resources into vigorously defending against any claims related to the PPP loan. (Reply, D.I. 100, at 13). It has demonstrated as much in its defense against Citibank’s attempts at discovery to date, which Citibank noted resulted in the production of fewer documents than anticipated from PFG, prompting the need for discovery from third parties. Taken to its logical conclusion, PFG’s expressed intent to defend to the end here means it would very likely appeal any judgment against it, which would add even more time and expense to the estate’s collection efforts. It is a proper exercise of the Trustee’s business judgment to decide against going down that road.

Similarly, the third factor - the complexity of the litigation involved, and the expense, inconvenience, and delay necessarily attending it -- weighs in favor of settlement as well. In addition to the fact that PFG has stated its intention to put up a potentially costly and prolonged defense, claims like those identified by Citibank -- involving fraud and deceit – are notoriously difficult to prove and require extensive discovery into the defendants’ state of mind, among other things. Moreover, as PFG stated, Pervacio’s principal is located in India, adding another layer of

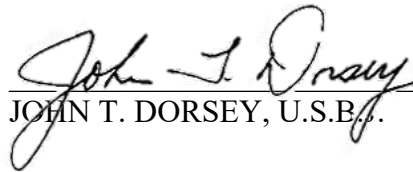
complexity and expense to the litigation. With very little to begin with, the estate is likely to run out of money long before any judgment could be obtained, making the entire process a waste of the limited resources available.

Lastly, the fourth factor of the *Martin* test - the paramount interest of creditors -- also weighs in favor of settlement here. As Citibank itself acknowledges, the estate's present finances suggest that unsecured creditors are not likely to recover at all. A judgment against PFG would not change this, as even assuming the estate could recover the full amount of the PPP loan, PFG's claim far exceeds that amount. With that in mind, I see no benefit to the estate in undertaking the task of litigation against PFG.

As each of the *Martin* factors weigh in favor of settlement here, I am satisfied that the settlement proposed is reasonable and is in the best interests of the estate. Citibank's objection is therefore overruled. However, I will note that the settlement before me only releases PFG from claims by the estate. It does not release any claims that Citibank or any other third parties might hold against PFG or its affiliates. To the extent Citibank believes it has claims directly against PFG, it remains free to pursue them.

SO ORDERED.

Dated: February 22, 2021

  
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JOHN T. DORSEY, U.S.B.J.