IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: SEABOARD HOTEL MEMBER ASSOCIATES, LLC, et al., Post-Effective Date Plan Debtors.	Chapter 11 Case No. 15-12510 (LSS) (Jointly Administered)
NCA INVESTORS LIQUIDATING TRUST, Plaintiff, v. BERKOWITZ, TRAGER & TRAGER, LLC, Defendant.	Adv. No. 19-50257

MEMORANDUM

Berkowitz, Trager & Trager, LLC ("Defendant" or "BTT") filed a motion to dismiss the Complaint[1] filed in this adversary proceeding.[2] For the reasons set forth below, I will grant the Motion to Dismiss for failure to state a cause of action as it relates to Counts I and II, but with leave to replead.

[1] Complaint by NCA Investors Liquidating Trust against Berkowitz, Trager & Trager, LLC ("Complaint"), A.P. 1.

[2] All references to the docket of the above-captioned adversary proceeding will be cited as "A.P." References to the docket of the main bankruptcy case will be cited as "D.I."

Background[3]

Plaintiff is a trust ("Investors Trust") created pursuant to that certain Amended Chapter 11 Plan of Liquidation (the "Plan") filed in the jointly administered cases under the caption *In re Newbury Commons Associates, LLC*, Case No. 15-12507.[4] Debtors were twenty-six entities that filed voluntary bankruptcy proceedings in this court from December 13, 2015 through March 17, 2016.[5] The bankruptcy cases were jointly administered, but not substantively consolidated.

Prepetition, Debtors were limited liability companies created by John J. DiMenna, Jr., William A. Merritt, Jr. and Thomas L. Kelly, Jr. to hold, directly or indirectly, commercial, hotel and multi-family residential real estate located in Connecticut. With a few exceptions,

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[3] As required on a motion to dismiss the facts recited herein are taken from the Complaint. *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir. 1993). A court is not required to make findings of fact or conclusions of law on a motion to dismiss under Fed. R. Civ. P. 12, made applicable by Fed. R. Bankr. P. 7012, and I make none. *See* Fed. R. Civ. P. 52(a)(3), made applicable by Fed. R. Bankr. P. 7052.

[4] D.I. 1808.

[5] The Debtors are: (i) 300 Main Street Member Associates, LLC; (ii) 300 Main Street Associates, LLC; (iii) 300 Main Street Management, Inc.; (iv) 316 Courtland Avenue Associates, LLC; (v) 220 Elm Street I, LLC; (vi) 220 Elm Street II, LLC; (vii) 88 Hamilton Avenue Member Associates, LLC; (viii) 88 Hamilton Avenue Associates, LLC; (ix) One Atlantic Member Associates, LLC; (x) One Atlantic Associates, LLC; (xi) Park Square West Member Associates, LLC; (xii) Park Square West Associates, LLC; (xiii) PSWMA I, LLC; (xiv) PSWMA II, LLC; (xv) Seaboard Hotel Member Associates, LLC; (xvi) Seaboard Hotel Associates, LLC; (xvii) Seaboard Hotel LTS Member Associates LLC; (xviii) Seaboard Hotel LTS Associates LLC; (xix) 600 Summer Street Stamford Associates, LLC; (xx) Century Plaza Investor Associates, LLC; (xxi) Clocktower Close Associates, LLC; (xxii) Seaboard Residential, LLC; (xxiii) Tag Forest, LLC; (xxiv) Newbury Common Member Associates, LLC; (xxv) Newbury Common Associates, LLC; and (xxvi) Seaboard Realty, LLC.

Plan Debtors are all Debtors other than Newbury Common Associates, LLC, Newbury Common Members Associates, LLC and Seaboard Realty LLC. The bankruptcy cases of Newbury Common Associates, LLC and Newbury Common Member Associates, LLC were dismissed. Order (A) Dismissing the Newbury Common Associates, LLC and Newbury Common Member Associates, LLC Chapter 11 Cases and (B) Granting Other Related Relief, D.I. 1872. The bankruptcy case of Seaboard Realty, LLC was converted to a chapter 7 case. Order Converting the Seaboard Realty, LLC Case From Chapter 11 to Chapter 7 of the Bankruptcy Code, D.I. 1873.

Debtors were either "PropCo" Debtors, that is an entity established to acquire, hold and manage interest in one of the ten pieces of real estate or "HoldCo Debtors," that is an entity created to own and manage a PropCo Debtor.[6]

DiMenna, Merritt and Kelly were also co-managing members of another entity, Seaboard Realty LLC ("Seaboard Realty"), which managed each Debtor and also held an equity interest (usually 25%) in all but a few of the HoldCo Debtors. The remaining 75% equity interest in each HoldCo Debtor was marketed to individual investors. Seaboard Realty had no employees. It generally made arrangements with Seaboard Property Management, Inc., a company wholly owned by DiMenna, to perform the day-to-day management functions.

From 2010 until sometime in 2015, DiMenna conducted a massive financial fraud upon Debtors' investors and lenders and ultimately, on Debtors themselves. After an investigation by the United States Attorney's Office for the District of Connecticut, the U.S. Attorney concluded that DiMenna engaged in criminal fraud from 2010 to 2016, defrauding lenders and investors out of $64.7 million. DiMenna ultimately entered into a plea agreement and was sentenced to serve over seven years in jail.

DiMenna admitted in his plea agreement that as part of his scheme, he (i) used funds from cash-positive Debtors to support capital improvements, construction and operating expenditures for Debtors that needed cash; (ii) entered into financing arrangements for Debtors without consent or authorization from Kelly or Merritt and forged their names on various documents to secure financing for Debtors, including personal guarantees;

[6] The Complaint details the pairing of PropCo Debtors, HoldCo Debtors and real estate.

(iii) submitted false financial material and fraudulent guarantees to a number of banks in connection with seeking financing of Century Plaza, One Atlantic Street, Park Square West, Marriott Residence Inn, 300 Main Street and 88 Hamilton Avenue; and (iv) sold excess subscriptions for interests in the Park Square West and 88 Hamilton Avenue projects.

From 2010 through 2015, BTT served as Debtors' principal transactional attorneys. BTT represented Debtors in twenty-three real estate-related transactions in connection with Debtors' real estate and with respect to loans as detailed in paragraph 58 of the Complaint. The fees paid to BTT for its representation of Debtors in real estate or loan transactions generally ranged from $7,500 to $52,000. In each of the twenty-three loan transactions, BTT issued opinion letters to lenders on behalf of the Debtor-borrowers who they represented.

BTT did not communicate with Kelly or Merritt about any of the loan transactions, including the seventeen loan transactions in which lenders sought their personal guarantees. BTT knew that each of DiMenna, Merritt and Kelly were all managing members of Seaboard Realty and that to the extent corporate level approval was needed for a particular action, none of DiMenna, Merritt or Kelly could exercise a controlling vote.

Plaintiff alleges that BTT had a professional duty to keep all three members of Seaboard Realty—DiMenna, Merritt and Kelly—informed with respect to all significant actions and undertakings, including major borrowings and of all conduct which would violate loan covenants and cause defaults. BTT failed to advise Merritt and Kelly of major borrowings being undertaken by certain Debtors that would violate loan agreement covenants and cause defaults. Indeed, BTT did not communicate with Merritt or Kelly regarding any of the loans, real estate purchases or sales undertaken or considered by any Debtor.

In some of the opinion letters issued by BTT with respect to the real estate-related loans, BTT effectively attested to the validity of the signatures of the Debtor-borrower and guarantors. For example, in BTT's March 2013 opinion letter to Israel Discount Bank, BTT opines:

> In our examination of such agreements, instruments, certificates and other documents, *we have assumed without investigation that: . . . (b) except for those documents executed by representatives of Borrower and by Guarantors, the signatures on documents and instruments submitted to us as originals are authentic*;
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> . . .
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> Based upon and subject to the foregoing, and subject to the assumptions, qualifications and exceptions set forth below, we are of the opinion that:
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> . . .
>
> 3. The execution and delivery by Borrower of the Borrower Loan Documents, and the performance by Borrower of its obligations thereunder, have been duly authorized by all necessary limited liability company action on the part of the Borrower
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> . . .
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> 5. The Guaranty is the valid and binding obligation of the respective Guarantors, enforceable against Guarantors in accordance with its respective terms.

Other opinion letters contain similar opinions. BTT did not communicate with Kelly or Merritt regarding their signatures on the guarantees or on any of the loan documents where their notarized signatures were required.

BTT also advised Debtors with respect to the purchase of property known as Park Square West for $13.4 million in cash and the assumption of a $26 million loan from Connecticut Housing Finance Authority ("CHFA"). In connection with the purchase, DiMenna formed a PropCo (PSW Associates) and a HoldCo (PSW Member Associates). As is typical, PSW Associates owned the real estate and PSW Member Associates owned 100% of the membership interests in PSW Associates. To help finance the purchase, DiMenna raised $5 million in investments in PSW Member Associates from individual investors.

DiMenna also sought financing from Titan Capital ID, LLC in the nature of an $11 million mezzanine loan. Prior to closing on the loan, BTT learned that the principal collateral for Titan's loan would be 100% of the membership interests in PSW Member Associates. BTT attorneys internally expressed concern that this would cause a default in the CHFA loan. And, notwithstanding BTT's knowledge that investors had already subscribed to PSW Member Associates in the amount of $5 million, BTT conducted a closing on the Titan mezzanine loan, letting Titan believe it had been pledged 100% ownership of PSW Member Associates. The closing was facilitated by BTT's suggestion that two more Debtor LLCs be created (PSWMA I, LLC and PSWMA II, LLC); further BTT determined not to send notice to those investors who previously subscribed to PSW Member Associates. When Titan's loan was replaced by a loan from UCF 1 Trust 1, it too believed that it held (through PSWMA I LLC) 100% of the interests in PSW Member Associates.

Plaintiff contends that BTT's issuance of the opinion letters and closing of the Titan loan and subsequent UCF 1 Trust 1 Loan was a breach of BTT's duties to Debtors. Plaintiff contends that if BTT had properly performed its duties as Debtors' legal counsel, the forging of Kelly's and Merritt's signatures would have been discovered no later than the first instance of it and would have averted the massive fraud. Plaintiff contends that if DiMenna's fraud had been discovered earlier: (i) less cash would have been siphoned from those Debtors that were cash flow positive and instead they would have remained operational and (ii) the losses of those Debtors that did not have sufficient cash could have been stanched, mitigated and held to a minimum.

The Bankruptcy Cases

During the course of the bankruptcy cases, a chief restructuring officer ("CRO") was appointed for all Debtors. Through a court-sanctioned process, each of the parcels of real estate were sold. Five secured lenders with mortgages on Debtors' real estate collectively had over $31 million in deficiency claims.

As described in the Disclosure Statement,[7] following completion of the sales, the CRO established a Work Plan[8] consisting of a seven-step process to see whether a consensual resolution of the bankruptcy cases could be achieved among all parties-in-interest. The Work Plan included continued forensic work by Anchin Block & Anchin, LLP of Debtors' records. Debtors convened a settlement conference on November 17, 2016 which included certain lenders and any investor who chose to participate. Thereafter, Debtors circulated a draft term sheet, convened a second settlement conference, and ultimately prepared a plan of liquidation consistent with the negotiated resolution.

The Plan is a separate plan for each Plan Debtor, that, as described in the Disclosure Statement, reflects a "multi-pronged global settlement." The key elements of the settlement are:

- An intra-creditor ("Settling Lenders") resolution of the mezzanine debt placed on multiple parcels of real estate through falsified documents.
- A settlement among the Settling Lenders and the holders of Investor Claims[9] and Equity Interests[10] by which:

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[7] D.I. 1679. The Disclosure Statement is referenced in the Complaint, as is the global settlement. Complaint ¶¶ 20–24. I will refer to the Disclosure Statement as appropriate.

[8] D.I. 1202.

[9] Investor Claims are claims that relate to claims arising out of the purchase of Equity Interests or alleged obligations arising out of quasi-equity transactions or alleged investments in the Plan Debtors that were fraudulent or never manifested. Plan § 1.48.

[10] Equity Interests means either rights with respect to preferred or common stock, membership

- Settling Lenders received a share of a pot of funds and releases from Debtors and holders of Investor Claims and Equity Interests (estimated to be a 23% recovery);

- Lenders waived their deficiency claims;

- the Investor Trust was established, seeded with $1 million and vested with the Investor Trust Causes of Action;

- an agreement that the beneficiaries of the Investor Trust would be the holders of Investor Trust Claims and Equity Interests in a subset of Debtors, the "Investor Trust Debtors;"[11] and

- the release of any claw-back litigation against holders of Investor Claims and Equity Interests in all Plan Debtors if the class in which these holders were placed voted to accept the Plan.

- A settlement of claims of professionals by which fees were reduced by at least $1.5 million.

- A settlement of substantial contribution claims.

- The settlement of all intercompany debts owed between various Plan Debtors by the establishment of a Distribution Escrow Account, with subaccounts for each Plan Debtor as set forth in the Plan. The cash in the Distribution Escrow Account was used to satisfy claims in the order of priority specified in the Plan.

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interests, or direct or indirect equity interests in any Plan Debtors or the right to acquire any of the foregoing. Plan § 1.33.

[11] The Investor Trust Debtors are: 88 Hamilton Avenue Associations, LLC, 88 Hamilton Avenue Member Associates LLC, Park Square West Associates, LLC, Park Square West Member Associates, LLC, Seaboard Hotel Associates, LLC, Seaboard Hotel Member Associates, LLC, PSWMA I, LLC and PSWMA II, LLC.

Recoveries for holders of general unsecured claims ("GUC"), Investor Claims and Equity Interests depended on the Debtor entity:

Debtor	GUC	Investor Claims	Equity Interests
Investor Trust Debtors	35%–65%	To be determined based on proceeds of Investor Trust	To be determined based on proceeds of Investor Trust
Seaboard Hotel LTS and Seaboard Hotel LTS Member	0%	Limited to value of Plan Releases (if applicable)	Limited to value of Plan Releases (if applicable)
All Other Plan Debtors	10%–40%	Limited to value of Plan Releases (if applicable)	Limited to value of Plan Releases (if applicable)

On May 22, 2017, the Plan was confirmed in a largely consensual confirmation hearing and it went effective on June 8, 2017.[12]

Since confirmation, the Investor Trust has been pursuing litigation vested in it pursuant to the Plan. The Plan provides that the Investor Trust shall be vested with the Investor Trust Assets. Investor Trust Assets means:

> (a) the initial cash in the amount of $1,000,000 transferred to the Investor Trust on the Effective Date, (b) the Investor Trust Causes of Action, (c) any residual funds in the Professional Fee Claim Escrow distributed to the Investor Trust in accordance with Section 7.2(b) of the Plan, and (d) the proceeds, product and offspring of each of the foregoing.

Investor Trust Causes of Action means:

> (a) any claim or cause of action held by any Plan Debtor against any third party (other than a Released Party), ***including claims and causes of action against*** (i) John J. DiMenna, Jr., William A. Merritt, Jr., and Thomas Kelly, Jr., or (ii) any Insider of the individuals identified in (i) other than a Plan Debtor, and (iii) ***accounting, legal, and other advisory firms that were retained by the Debtors***; (b) those certain claims being prosecuted by UCF Trust I, LLC in the action styled as UCF I Trust 1 et al. v. John J. DiMenna, Jr. et al., Civ. No. 16-156 (VAB) (D. Conn.); and (c) any direct

[12] Notice of (A) Entry of Order Confirming Amended Joint Plan of Liquidation Under Chapter 11 of the Bankruptcy Code for Propco Debtors and Holdco Debtors (With Technical Modifications); (B) Occurrence of Effective Date Thereunder; and (C) Related Deadlines, D.I. 1847.

claim or cause of action held by a Trust Beneficiary that arises out of or is related to an Investor Claim or Equity Interest that is contributed to the Investor Trust.[13]

The Adversary Proceeding

The Complaint was filed on June 6, 2019 and contains four counts. In Count I, Plaintiff alleges that Defendant's legal representation of Debtors failed to conform to the applicable standard of care, and that failure constitutes attorney malpractice. In Count II, Plaintiff alleges that Defendant breached oral contracts with Debtors and the implied duty of good faith and fair dealing embedded in those contracts caused Debtors' damages ("Counts I and II, collectively, the "State Law Claims"). In Count III, Plaintiff alleges fourteen (14) transfers ("Transfers") made to Defendant in the total amount of $100,541.25 are avoidable as preferences under 11 U.S.C. § 547 and recoverable under 11 U.S.C. § 550. In Count IV, Plaintiff alternatively alleges that the Transfers are avoidable as constructive fraudulent transfers under 11 U.S.C. § 548(a) and recoverable under 11 U.S.C. § 550. Plaintiff seeks damages in an amount to be determined at trial on the State Law Claims and $100,541.25 in recoveries on Counts III and IV.

On September 4, 2019, Plaintiff filed the Motion to Dismiss.[14] Defendant moves to dismiss Count I and II on four grounds: (i) the Investor Trust lacks standing to assert the State Law Claims (ii) the Court lacks subject matter jurisdiction (iii) the Complaint fails to state a cause of action and (iv) the State Law Claims are barred by the *in pari delicto* doctrine. Defendant moves to dismiss Count III and IV of the Complaint because (i) the Investor Trust

[13] Plan § 1.51 (emphasis added).

[14] Defendant Berkowitz, Trager & Trager, LLC's Motion to Dismiss Plaintiff's Complaint ("Motion to Dismiss"), A.P. 16

lacks standing to assert avoidance actions and (ii) the Complaint fails to state a cause of action.

Briefing is complete[15] and I heard oral argument. This matter is ripe for decision.

Jurisdiction

Defendant challenges that subject matter jurisdiction exists over the State Law Claims alleged in the Complaint. For the reasons set forth below, I conclude that I have subject matter jurisdiction.

Plaintiff takes the position that this matter is in part a non-core proceeding (Counts I and II) and in part a core proceeding (Counts III and IV). Plaintiff further states that it consents to my entry of final orders or judgments if it is determined that the bankruptcy court cannot enter final order or judgments consistent with the Constitution absent consent. By arguing that subject matter jurisdiction does not exist over the state law causes of action (Counts I and II), Defendant impliedly concedes that subject matter jurisdiction exists over the federal causes of action (Counts III and IV). Defendant makes no statement regarding consent to final orders or judgments.

As set forth below, jurisdiction exists over all Counts of the Complaint. Given my ruling, I need not decide whether I can enter final orders on each Count.

Legal Standard

On a Rule 12(b)(6) motion to dismiss the court reviews the complaint to determine whether the plaintiff has adequately pled facts sufficient to show that the plaintiff "has a

[15] Brief in Support of Defendant Berkowitz, Trager & Trager, LLC's Motion to Dismiss Plaintiff's Complaint ("Opening Brief"), A.P. 16-3; Plaintiff's Response to Defendant's Motion to Dismiss the Complaint ("Answering Brief"), A.P. 29; Reply Brief in Support of Berkowitz, Trager & Trager, LLC's Motion to Dismiss Plaintiff's Complaint ("Reply Brief"), A.P. 31.

'plausible claim for relief.'"[16] In reviewing the complaint under Rule 12(b)(6), the court must first accept all well-pled facts as true, but may disregard legal conclusions.[17] "A claim is facially plausible when the factual allegations allow the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[18] "Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice."[19] Rather, "a complaint . . . must contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under some viable legal theory."[20] A court draws on "its judicial experience and common sense" to determine if the complaint meets these requirements.[21] The moving party has the burden.[22]

Discussion

I. Subject Matter Jurisdiction Exists Over Each Count of the Complaint

A court has the independent obligation to address its subject matter jurisdiction over a lawsuit. Because I must dismiss the Complaint if subject matter jurisdiction does not exist, I address this matter first.

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[16] *THQ Inc. v. Starcom Worldwide, Inc. (In re THQ, Inc.)*, 2016 WL 1599798, at *2 (Bankr. D. Del. Apr. 18, 2016) (citing *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)).

[17] *See THQ*, 2016 WL 1599798, at *2.

[18] *Merck Sharp & Dohme Corp. v. Teva Pharm. USA, Inc.*, 2015 WL 4036951, at *5 (D. Del. July 1, 2015) (citing *Iqbal*, 556 U.S. at 663; *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555–56 (2007)).

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

[20] *Twombly*, 550 U.S. at 562 (quoting *Car Carriers, Inc. v. Ford Motor Co.*, 745 F.2d 1101, 1106 (7th Cir. 1984)).

[21] *THQ*, 2016 WL 1599798, at *2 (quoting *Burtch v. Huston (In re USDigital, Inc.)*, 443 B.R. 22, 35 (Bankr. D. Del. 2011)).

[22] *THQ*, 2016 WL 1599798, at *2.

Defendant asserts that the court does not have even "related to" jurisdiction over Counts I and II of the Complaint as the State Law Claims do not require an interpretation of the Plan or the Trust Agreement. Plaintiff argues that the court has jurisdiction over the State Law Claims as the Plan specifically contemplated this litigation against Debtors' prepetition law firms making this litigation central to the Plan's administration. Both parties agree that the starting point is the Third Circuit's *Resorts*[23] decision and whether the *Resorts* "close nexus" test is satisfied, but past that, they diverge.

Whether a proceeding "relates to" a bankruptcy case varies depending on whether the proceeding is commenced pre- or post-confirmation. Pre-confirmation, a proceeding "relates to" a bankruptcy case if it meets the Third Circuit *Pacor* standard: whether "the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy."[24] Examples of "related to" jurisdiction pre-confirmation typically include causes of action, like the State Law Claims, that come into the bankruptcy estate under § 541 of the Bankruptcy Code and lawsuits between third parties that, absent the bankruptcy case, could have been brought in a district court or a state court.[25] Post-confirmation, a bankruptcy court's "related to" jurisdiction shrinks, and a proceeding relates to a bankruptcy case only if "there is a close nexus to the bankruptcy plan or proceeding sufficient to uphold bankruptcy court jurisdiction over the matter."[26] "Related to" jurisdiction post-confirmation includes proceedings to construe and enforce provisions of a plan, and matters affecting the

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[23] *In re Resorts Int'l, Inc.*, 372 F.3d 154 (3d Cir. 2004).

[24] *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984).

[25] 1 Collier on Bankruptcy ¶ 3.01(3)(e)(ii) (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2016).

[26] *Resorts*, 372 F.3d at 166–67.

interpretation, implementation, consummation, execution or administration of a confirmed plan.[27]

This adversary proceeding contains claims that came into the bankruptcy estate under §541 of the Bankruptcy Code. Pre-confirmation, then, subject matter jurisdiction would exist as the claims are at least "related to" the bankruptcy case under the *Pacor* standard. But, as the lawsuit was filed post-confirmation, the question becomes whether Counts I and II have a "close nexus" to the bankruptcy plan or proceeding to satisfy the *Resorts* test. I conclude that they do.

If I were to look solely at the Complaint, I would likely conclude that subject matter jurisdiction does not exist post-confirmation. But, I am not so limited. A "related to" jurisdiction analysis looks beyond the four corners of the complaint to whether the outcome of the proceeding could conceivably have any impact on the estate (pre-confirmation) or whether there is a "close nexus" to the plan or proceeding (post-confirmation). These two tests focus not on the complaint, but on the outcome, the end result of the litigation or whether the matter affects the interpretation, implementation, consummation, execution or administration of a confirmed plan. Thus, the court must take a look at the matter as a whole to determine whether "related to" jurisdiction exists.[28]

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[27] *Id.* at 167–69.

[28] I acknowledge a possible split in bankruptcy cases discussing whether the "well-pleaded complaint" rule applies in analyzing whether bankruptcy jurisdiction exists. *Compare In re Brooks Mays Music Co.*, 363 B.R. 801, 815 (Bankr. N.D. Tex. 2007) (holding that the well-pleaded complaint rule only applies to "arising under" jurisdiction, not "arising in" or "related to" jurisdiction) *with Malesovas v. Sanders*, 2005 WL 1155073, at *2 (S.D. Tex. May 16, 2005) ("Although most cases involving the well-pleaded complaint rule involve federal question jurisdiction under 28 U.S.C. § 1331, courts consistently have applied the well-pleaded complaint rule to cases involving bankruptcy jurisdiction under 28 U.S.C. § 1334."). As discussed thoroughly by Judge Jernigan in *Brooks Mays*, the well-pleaded complaint rule is used to analyze whether *federal question* jurisdiction exists and can be limited to that context. If it is imported into a bankruptcy jurisdiction analysis, then it could be applicable to "arising under"

As evidenced most clearly in Defendant's Reply Brief, Defendant moves to dismiss the Complaint as inconsistent with the Plan and Trust Agreement. It argues that the Plan is the source of the claims assigned to the Investor Trust and makes multiple and various arguments that either the Plan did not assign certain claims to the Investor Trust or challenges the ability of the Debtors to assign the claims under the Plan.[29] As such, in order to determine the Motion to Dismiss, and perhaps other arguments in the future, I will need to settle a dispute over whether the Plan permits the Investor Trust to assert the claims detailed in the Complaint. The need to interpret the Plan satisfies the "close nexus" test.[30]

Additionally, subject matter jurisdiction exists because Defendant has filed four proofs of claim, one each against Park Square West Associates, LLC, One Atlantic Investor Associates, LLC, 88 Hamilton Avenue Associates, LLC, and Seaboard Hotel Associates, LLC, each of which is a Plan Debtor. Even though a complaint may not be framed as a counterclaim to a proof of claim, in appropriate circumstances, it can be considered as such.[31]

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jurisdiction. But the logic underlying the well-pleaded complaint rule does not support applying the rule to "related to" jurisdiction. *Brooks Mays*, 363 B.R. at 815 ("[I]t is clear that the 'related to' test is one that focuses on the potential outcome or end result of the litigation—rather than on the face of the complaint. It is intended to have a much broader jurisdictional reach.")

[29] Reply Brief 1–5. After detailing various theories under which Plaintiff cannot proceed with its claims, Defendant concludes: "The Trust has not explained how it can proceed with a complaint that is inconsistent with the Plan and Trust Agreement whether the Court considers the issue as a challenge to subject matter jurisdiction or as a failure to state a claim upon which relief can be granted. The Plan binds the Trust and either does not provide for the claims advanced by the Trust or reveals the invalidity of the assignments upon which the claims are based (or both). Accordingly, BTT's motion to dismiss the complaint should be granted and the Trust's complaint should be dismissed." *Id.* at 5. Defendant also asserts that "The parties also apparently agree that the Plan and Trust Agreement should be considered by the Court as fairly incorporated into and part of, the pleadings. Both parties relied on the Plan documents as the Court's source for what claims were assigned and preserved." *Id.* at 2.

[30] *See Resorts*, 372 F.3d at 167 (citing *In re Resorts Int'l, Inc.*, 199 B.R. 113 (Bankr. D.N.J. 1996)) (finding that post-confirmation dispute over whether a litigation trust or the debtor is entitled to accrued interest satisfies "close nexus" test, conferring post-confirmation jurisdiction to bankruptcy court).

[31] *See, e.g., In re Venoco, LLC*, 596 B.R. 480 (Bankr. D. Del. 2019) (citing *ResCap Liq. Trust v. PHH Morg.*

To the extent any of the enumerated Plan Debtors have claims against Defendant (see further discussion below), this provides an additional nexus for related-to jurisdiction. Whether by way of setoff[32] or as an affirmative defense to the proofs of claim,[33] the Complaint—at least as to the four previously named Plan Debtors—can be characterized as part of the claims administration process.

Singularly, or taken together, I conclude based on the above discussion, that at least "related to" subject matter exists over each Count of the Complaint.[34]

II. The Investor Trust Has Standing to Bring Each Count in the Complaint on Behalf of the Plan Debtors

Defendant contends that the Complaint must be dismissed because Plaintiff lacks constitutional standing to bring both the State Law Claims and the avoidance actions. Both contentions implicate the first prong of constitutional standing, injury in fact.[35]

Corp., 518 B.R. 259, 264 (S.D.N.Y. 2014)) (construing state-law complaint in adversary proceeding as a counterclaim to defendant's unrelated proofs of claim filed against the estate, thus conferring core subject matter jurisdiction over complaint).

[32] *See* Joint Motion of the Wind-down Administrator and Investor Trustee for an Order Extending the Claims Objection Deadline Under the Plan to October 13, 2021 at 6, *In re Seaboard Hotel Member Associates, LLC*, No. 15-12510, D.I. 215 ("The Investor Trust has asserted various potential claims and causes of action under the Plan against BTT as reflected in a complaint filed on June 6, 2019 [], any or all of which could give rise to setoff rights in favor of the Investor Trust.").

[33] *See Nickerson v. Martin*, 34 Conn. Supp. 22, 26–30 (Super. Ct. 1976) (recognizing malpractice-based recoupment defense to collection action); *see also Billing v. Ravin, Greenberg & Zackin, P.A.*, 22 F.3d 1242, 1253 (3d Cir. 1994) ("We hold that an allegation of legal malpractice raised as a defense to post-petition fees for bankruptcy counsel likewise falls within the process of the allowance and disallowance of claims.").

[34] Subject matter jurisdiction clearly exists over Count III (preference claims) and Count IV (fraudulent transfer claims) of the Complaint, which are statutorily core matters. 28 U.S.C. § 157 (b)(2)(F), (H). Defendant does not contend otherwise.

[35] *Lexmark Int'l, Inc. v. Static Control Components, Inc.*, 572 U.S. 118, 125 (2014) ("Constitutional standing has only three elements: (1) a concrete and particularized injury in fact, (2) that is fairly traceable to the defendant's conduct, and (3) that a favorable judicial decision would likely redress.") (quotations and citations omitted).

A. The Complaint Will Be Dismissed, with Leave to Amend, with Respect to Any Claims That Belong to Non-Plan Debtors

Defendant spends several pages of its briefing contending that Plaintiff can only pursue claims belonging to Plan Debtors. Specifically, Defendant argues that the Investor Trust cannot assert claims on behalf of non-Debtors Seaboard Realty, LLC, Newbury Common Associates, LLC, 600 Summer Street Investor Associates, LLC, Seaboard Stamford Investor Associates, LLC, Seaboard Properties, Inc., Seaboard Property Management, LLC, 300 Main Street Management, Inc., Kelly and Merritt.[36] Defendant further contends that Plaintiff lacks standing to pursue harm to investors or lenders. Defendant apparently reads the malpractice counts of the Complaint as being based on duties owed by Defendant to non-Debtors Seaboard, Kelly and Merritt and the damages as belonging to investors or lenders.[37]

Plaintiff is in vehement agreement. It argues that Defendant is misreading the Complaint in that Plaintiff's claims are based on Defendant's breach of its contractual and non-contractual duties to Plan Debtors only.[38] It points to paragraphs 11-12, 53-54 and 58, all of which assert that Defendant represented Debtors and owed a duty to exercise care and competence in its representation of Debtors. And, Plaintiff contends it is not purporting to assert rights on behalf of lenders or investors.[39]

Both parties acknowledge that the Plan dictates, in the first instance, the causes of action the Investor Trust can assert. The Plan provides that Plan Debtors shall be deemed to automatically transfer all of their right, title and interest in Investor Trust Assets to the

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[36] Opening Brief 17.

[37] *Id.* at 17–21.

[38] Answering Brief 6.

[39] *Id.* at 6–7.

Investor Trust.[40] Investor Trust Assets includes certain cash and Investor Trust Causes of Action.[41] As relevant here, Investor Trust Causes of Action include all causes of action held by any Plan Debtor against Debtors' accounting, legal and other advisory firms.[42] All of this is to say that the claims that the Investor Trust can pursue belong only to Plan Debtors.

Having reviewed the Complaint, Defendants are correct, in part. I do not read the Complaint to be asserting claims belonging to non-Debtors. But, notwithstanding Plaintiff's professed intent to step only into the shoes of Plan Debtors, the Counts of the Complaint are framed as claims belonging to *Debtors*—not just Plan Debtors (i.e. Defendant failed to conform to the standard of care in its representation of *Debtors*, *Debtors* suffered great injury, Defendant was a substantial and proximate cause of *Debtors'* injuries).[43] Asserting claims on behalf of Debtors that are not Plan Debtors is beyond the scope of the causes of action preserved for prosecution by the Investor Trust.[44] Accordingly, I will grant the Motion to Dismiss, but with leave to replead.

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[40] Plan § 7.3(f) ("Debtors shall be deemed to have automatically transferred to the Investor Trust all of their right, title, and interest in and to all of the Investor Trust Assets . . .").

[41] Plan § 1.50.

[42] Plan § 1.51 ("'Investor Trust Causes of Action' means . . . claims and causes of action against . . . accounting, legal, and other advisory firms that were retained by the Debtors.").

[43] *See, e.g.*, Complaint ¶¶ 117, 119, 120.

[44] There are only three Debtors that are not Plan Debtors. Complaint ¶ 8 n.3 ("After the Plan was confirmed, the bankruptcy cases of Newbury Common Associates, LLC and Newbury Common Member Associates, LLC were dismissed and the case of Seaboard Realty, LLC (15-12508) was converted to Chapter 7. The remaining Debtors are referred to as the 'Plan Debtors.'"). Defendant asserts that not all Plan Debtors' claims were transferred to the Trust. Reply Brief 7. That is incorrect.

B. Plan Debtors Properly Retained for Plaintiff the Right to Bring Preference Actions against Defendant

Defendant also moves to dismiss the Complaint for lack of standing contending that Plan Debtors did not retain in the Plan the right for Plaintiff to assert avoidance actions. Section 7.3(a) of the Plan provides in pertinent part:

> On the Effective Date, the Investor Trust will be created, and the Investor Trust Assets will be transferred to and vest in the Investor Trust as of the Effective Date. *Pursuant to section 1123(b)(3)(B) of the Bankruptcy Code, from and after the Effective Date, only the Investor Trust and the Investor Trustee shall have the right to pursue or not to pursue, or subject to the terms of the Plan and the Investor Trust Agreement, compromise or settle any Investor Trust Causes of Action.* From and after the Effective Date, the Investor Trust and the Investor Trustee may commence, litigate, and settle any Causes of Action or Claims relating to the Investor Trust Assets or rights to payment or Claims that belong to the Plan Debtors as of the Effective Date or are instituted by the Investor Trust or Investor Trustee on or after the Effective Date, except as otherwise expressly provided in the Plan and the Investor Trust Agreement. The Investor Trust shall be entitled to enforce all defenses and counterclaims to all Claims asserted against the Plan Debtors and their Estates, including setoff, recoupment and any rights under section 502(d) of the Bankruptcy Code.[45]

In turn, Investor Trust Causes of Action means, as relevant here:

> "(a) any claim or cause of action held by any Plan Debtor against any third party (other than a Released Party), including claims and causes of action against . . . (iii) accounting, legal, and other advisory firms that were retained by the Debtors."[46]

Notwithstanding the quoted sections, Defendant asserts that Plaintiff does not have standing to bring avoidance actions. First, Defendant argues that the words "chapter 5 causes of action," "avoidance claims" or the equivalent do not appear in the above language and so such claims were not adequately preserved. Second, Defendant argues that the potential beneficiaries of a recovery are misaligned with the owners of the causes of action such that the Investor Trust cannot bring any chapter 5 causes of action that were preserved in the Plan.

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[45] Plan § 7.3(a) (emphasis added).

[46] Plan § 1.51.

Plaintiff counters that the above language adequately preserves all causes of action against Defendant and Plaintiff's cases are largely distinguishable.

I conclude that the above language is sufficiently specific to preserve all causes of action—including avoidance actions—against Defendant.[47] Cases cited by Defendant do not address the scenario here: this Plan specifically provides Plaintiff with the right to pursue "any cause of action" held by any Plan Debtor against "accounting, legal and other advisory firms." While the Plan does not list Defendant by name, BTT is included within the category of professional firms in the defined term Investor Trust Causes of Action. BTT does not argue otherwise; indeed, it does not argue that the State Law Claims were inadequately preserved—only avoidance actions.

Cases cited by Defendant by do not compel a different result. In none of those cases does the court explore a plan in which all causes of action are preserved against a named Defendant or category of persons. For example, in *Petrowax*, there was no preservation language at all; rather, plaintiff was relying on a jurisdictional provision (not a preservation provision) that did not even reference the type of action asserted in the complaint.[48] In *USN Communications*,[49] the plan provisions at issue preserved avoidance actions, generally, but did not identify specific claims (i.e., a claim against specific defendants). The court found such a

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[47] I make no comment with respect to whether avoidance actions were preserved as to other persons.

[48] *Matter of Petrowax P.A., Inc.*, 200 B.R. 538, 540–541 (Bankr. D. Del. 1996) ("Petrowax believes this clause somehow satisfies the retention requirement of 11 U.S.C. § 1123(b)(3)(B). It does not. Petrowax's complaint is not an avoidance action. It is also not a turnover order. Most importantly, Article 13.01.4 retains subject matter jurisdiction for the court. It does not establish retained rights of the debtor.")

[49] *In re USN Commc'ns, Inc.*, 280 B.R. 573, 594 (Bankr. D. Del. 2002).

preservation of rights sufficient, but it did not hold the converse—that retaining all causes of action against a specified defendant was insufficient.[50]

The Plan expressly invokes § 1123(b)(3)(B) of the Bankruptcy Code with respect to Investor Causes of Action and such actions include all causes of action against BTT. This is specific enough to preserve avoidance actions against BTT.[51]

Defendant next contends that Plaintiff can only avoid transfers made by Investor Trust Debtors and not transfers made by Plan Debtors whose creditors are not beneficiaries of the Investor Trust.[52] Relying on *HH Liquidation*,[53] which in turn relies on *Adelphia Recovery Trust*,[54] Defendant argues that a debtor is unable to assert avoidance actions when there is no "benefit

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[50] Defendant cites *USN Commc'ns* for the proposition that "retention language must be 'sufficiently informative to provide creditors with notice that their claims may be challenged post-confirmation.'" Opening Brief 20; *but see In re Bridgeport Holdings, Inc.*, 326 B.R. 312, 327 (Bankr. D. Del. 2005), *as amended* (Aug. 12, 2005), *amended*, No. 03-12825(PJW), 2005 WL 1943535 (Bankr. D. Del. Aug. 12, 2005) ("§ 1123(b)(3) was intended to benefit the creditors of a bankruptcy estate, not the potential defendants of the preserved claims."). Assuming notice to creditors is relevant, I find notice sufficient here.

[51] In reviewing the Plan, I note that section 7.3(a) provides that the Investor Trust "shall be entitled to enforce all defenses and counterclaims to all Claims asserted against the Plan Debtors and their Estates, including setoff, recoupment and any rights under section 502(d) of the Bankruptcy Code." Section 502(d) provides that the court shall disallow claims of any entity that is a transferee of an avoidable transfer, including under section 547 of the Bankruptcy Code. This language arguably provides additional support for the preservation of avoidance actions as against BTT to the extent it filed a proof of claim. But, as neither party referenced this section, I do not rely on it.

[52] Specifically, Defendant objects to the inclusion of transfers made by Seaboard Hotel LTS Member, Seaboard Residential, 220 Elm Street I & II, LLC, Seaboard Hotel LTS Member Assoc., Park SQ West Member Assoc., Century Plaza Investor Assoc. and Tag Forest, constituting $66,013.75 of the $100,541.25 sought in total. *See* Complaint Ex. A, A.P. 1-1.

[53] *In re HH Liquidation, LLC*, 590 B.R. 211, 262 (Bankr. D. Del. 2018).

[54] *Adelphia Recovery Tr. v. Bank of Am., N.A.*, 390 B.R. 80, 95 (S.D.N.Y. 2008), *aff'd*, 379 F. App'x 10 (2d Cir. 2010) ("It is clear from the Joint Plan's provisions that all of the creditors of the Obligor Debtors have been paid in full. Under the principles of federal jurisdiction, a party does not have standing to sue where the party is not able to allege an injury that is likely to be redressed by the relief sought. Given that the creditors of the Obligor Debtors have received full payment with interest under the Plans, it follows that these creditors do not stand to benefit from recovery on the Bankruptcy Claims at issue here, and the [postpetition litigation trust] does not have standing to bring these claims on their behalf.") (internal citations omitted).

to the creditors of the actual transferors."[55] Plaintiff responds that Defendant's position is contrary to the Plan and an impermissible collateral attack on the Plan, that no creditors were paid in full under the Plan and that courts hold that § 550 recoveries on avoidance actions are permissible where they provide a benefit to the estate. Plaintiff further asserts that there is no statutory authority requiring traceability to Investor Trust Beneficiaries.

"Whether unsecured creditors benefit from a preference action is determined on a case-by-case basis."[56] Here, the starting place for this analysis is the Plan, which Defendant did not explore and Plaintiff invokes, but does not fully explore. As described above, the Plan reflects a "multi-pronged global settlement." While the Plan is a separate plan for each Plan Debtor, the key elements of the Plan were the result of intensive negotiation among the Plan Debtors, the lenders to each Plan Debtor, certain investors who chose to participate in negotiations and professionals. The Plan resolved inter-debtor disputes and lenders settled claims, but no creditors or investors were paid in full. As for claims held by Plan Debtors, it was agreed that they would be assigned to the Investor Trust, and it was further agreed that the beneficiaries would only be holders of Investor Trust Claims and Equity Interests in the Investor Trust Debtors, not all Plan Debtors. As part of the global settlement, holders of Investor Trust Claims and Equity Interests in *all* Plan Debtors received a release of claw back litigation.

HH Liquidation and *Adelphia* are unhelpful in the instant scenario because in those cases the creditor bodies of the transferor-debtors were paid in full. I find more helpful *TWA*, in

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[55] Opening Brief 21.

[56] *Trans World Airlines, Inc. v. Travellers International AG., et al. (In re Trans World Airlines, Inc.)*, 163 B.R. 964, 969 (Bankr. D. Del. 1994) (citing *In re Tennessee Wheel & Rubber Co.*, 64 B.R. 721, 726 (Bankr. M.D. Tenn. 1986), *aff'd sub nom. Tennessee Wheel & Rubber Co. v. Am. Exp. Travel Related Servs., Co.*, 75 B.R. 1 (M.D. Tenn. 1987)).

which this court ruled that an avoidance action could proceed where there was a benefit, even if indirect, to the debtor's estate. In *TWA*, the court ruled that unsecured creditors would benefit from any recoveries of avoidance actions by reorganized TWA because under the confirmed plan creditors were given stock in or notes payable by reorganized TWA.[57]

Tennessee Wheel (cited in *TWA*) is also instructive. In that case, avoidance actions were retained pursuant to § 1123(b)(3)(B) for prosecution post-confirmation by the reorganized debtor. The confirmed plan provided for a distribution of $100,000 (pro rata) to unsecured creditors who were not insiders and no distribution to insiders. The claim of the secured creditor was to be paid over a fifteen-year period funded by an up-front payment from a line of credit and further payments from recoveries of avoidance actions and further infusions of cash. Reviewing the plan and the bankruptcy case, the court held that there was a great benefit to Tennessee Wheel's creditors because without the contributions of the secured creditor, unsecureds would receive nothing. Further, the secured creditor's advancement of funds to make any distribution to unsecureds was to be repaid, in part, by avoidance action recoveries. The estate also had administrative creditors and unpaid postpetition trade creditors who would receive payment if the plan was confirmed. Finally, the court found that "major provisions of the confirmed plan would be nullified" notwithstanding provisions for postconfirmation retention of avoidance actions such that "substantial reliance" on the confirmation order "would be displaced."[58]

Under the facts here, I find that the retention of causes of action belonging to all Plan Debtors was a central tenet of the Plan that permitted the global resolution to be accomplished

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[57] *TWA*, 163 B.R. at 973–74.

[58] *Tennessee Wheel*, 64 B.R. at 725.

and the Plan to be confirmed. As is apparent from the face of the Plan and as described in the Disclosure Statement, plan negotiations were hard fought and part of an inseparable whole, which included resolution of inter-debtor debt and claims, lender claims, investor claims, substantial contribution claims and claims of professionals. The Plan Debtor claims preserved for prosecution by the Investor Trust were a bargained for provision and provided a benefit to the holders of claims and interests in the non-Investor Trust Debtors by permitting confirmation of a plan which provided for distributions to lenders to non-Investor Trust Debtors, payment of administrative claims and professional fees against non-Investor Trust Debtors and potential recoveries to Investor Trust Beneficiaries from preserved causes of action. The Plan also provided for release of claw-back litigation against all holders of Investor Trust Claims and Equity Interests in *all* Plan Debtors.

The deal struck between the creditors and investors of all of the Plan Debtors as embodied in the Plan provided a direct benefit to creditors of and holders of equity in each Plan Debtor. Or, if not a direct benefit, certainly an indirect benefit sufficient to permit the Investor Trust to prosecute the causes of action preserved in the Plan. "Denying avoidance powers to the [Investor Trust] would imbalance the equities of this case."[59]

I will not dismiss Counts III and IV on these grounds.

[59] *Tennessee Wheel*, 64 B.R. at 726.

C. The Malpractice Claims Are Assignable Under Connecticut Law and the Prosecution by the Investor Trust Is Not Champertous[60]

Defendant next contends that the Investor Trust cannot prosecute the malpractice claims because they are not assignable. Defendant cites to Connecticut law for the proposition that assignment is against public policy and Delaware law for the proposition that assignment constitutes impermissible champerty. Plaintiff asserts that the malpractice claims were appropriately assigned by operation of federal law and, in particular, § 1123(b)(3)(B) of the Bankruptcy Code. Plaintiff also asserts that assignment is not against the public policy of the State of Connecticut nor champertous.

Plaintiff relies on *Antioch Litig. Tr. v. McDermott Will & Emery LLP*.[61] Parallel to the instant action, in *Antioch* a confirmed plan provided for a litigation trust to pursue certain causes of action. The defendant moved to dismiss the malpractice action on the ground that Ohio state law forbade the sale of legal malpractice claims. The *Antioch* court held that "the Bankruptcy Code authorizes the creation of post-confirmation entities whose purpose is to liquidate the property of the estate for the benefit of the creditors," and that the "rule against the transfer of malpractice claims should not be applied where assignment is authorized by

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[60] Parties and courts often discuss *assignment* in the context of § 1123(b)(3)(B), but the Bankruptcy Code does not use that word. Rather, under § 1123(b)(3)(B), a plan may provide for "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest." Under the Plan, the legal malpractice claim was retained for enforcement by the Investor Trustee, who was appointed for that purpose. Plan § 7.3(b) ("On the Effective Date, the Investor Trustee shall be appointed and shall constitute a representative of the Plan Debtors' estates under § 1123 of the Bankruptcy Code."). Thus, I question whether the concept of assignment is relevant at all. *See, e.g., Tennessee Wheel*, 64 B.R. at 724–25 (finding no "assignment" of avoidance actions where such claims vested in reorganized debtor under § 1123(b)(3)(B) of the Bankruptcy Code). Indeed, at argument, Defendant's counsel recognized that the legal malpractice claim was not really being assigned to anyone else, but rather "it's just a new entity to preserve the same rights."

[61] 738 F. Supp. 2d 758, 782 (S.D. Ohio 2010).

law, where the policy concerns of the rule are not implicated, and where the rule would frustrate the Bankruptcy Code."[62] Defendant does not dispute that the Investor Trust is an estate representative appointed under § 1123(b)(3)(B) for the purpose of pursuing the malpractice claims. But, Defendant argues that the public policy of Connecticut prohibits assignment of malpractice claims, citing the Connecticut Supreme Court's decision in *Gurski*.[63] Defendant also argues that Delaware law does not permit the assignment of claims that constitute champerty.

While the parties cite to both Connecticut and Delaware law, Delaware law is not applicable to the malpractice claims. State substantive law applies to non-core proceedings, and the law of the forum determines which state substantive law to apply.[64] Delaware courts apply the "most significant relationship test" to determine choice of law, which considers: "(a) the place the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicile, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered."[65] Given the allegations in the Complaint, there is no doubt that Connecticut law applies: (i) the cause of action is for legal malpractice; (ii) the attorney-client relationship is between a Connecticut law firm and clients located in Connecticut regarding loan transactions related to real estate

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[62] *Antioch*, 738 F. Supp. 2d at 782 (citing *Parrett v. Nat'l Century Fin. Enterprises, Inc.*, No. 2:04-CV-489, 2006 WL 783361, at *4 (S.D. Ohio Mar. 23, 2006).

[63] *Gurski v. Rosenblum & Filan, LLC*, 276 Conn. 257, 268–85 (2005).

[64] *In re SemCrude LP*, 407 B.R. 82, 104 (Bankr. D. Del. 2009) ("In the absence of a specific federal policy or interest dictating the use of federal choice of law rules, it is well settled in this Circuit that a bankruptcy court faced with the issue of which substantive state law to apply to a claim for relief in an adversary proceeding applies the choice of law rules of the forum state.").

[65] *In re Uni-Marts, LLC*, 405 B.R. 113, 124 n.4 (Bankr. D. Del. 2009) *quoting Travelers Indem. Co. v. Lake*, 594 A. 2d. 38, 47 (Del. 1991) *quoting Restatement (Second) of Conflicts of Laws* § 145(2).

located in Connecticut and (iii) the clear inference from the Complaint is that the individuals involved all worked in or were residents of Connecticut.

The Connecticut Supreme Court, in a comprehensive decision, addressed the assignability of malpractice claims. In *Gurski*, the Connecticut Supreme Court rejected a per se bar on such assignments, holding that "we are not persuaded that every voluntary assignment of a legal malpractice action should be barred as a matter of law."[66] Rather, the Supreme Court adopted a narrow view, ruling that "public policy considerations warrant the barring of an assignment of a legal malpractice action to an adversary in the underlying litigation."[67] The Connecticut Supreme Court reasoned that permitting assignment to the adversary in the underlying litigation give rise to the opportunity for an unholy alliance between the two former adversaries.

In *Gurski*, Lee (Gurski's patient) sued Gurski (a podiatrist) for negligence in his treatment of her. After Gurski's lawyers, supplied by his insurer, permitted a default judgment to be entered against Gurski, he sued his lawyers for legal malpractice. Gurski then assigned his malpractice action to Lee. As the Connecticut Supreme Court observed, in order for Lee to prevail in her medical malpractice claim against Gurski she had to prove Gurski was negligent. But, to prevail in his legal malpractice action Gurski had to prove he would have prevailed in Lee's malpractice action—that is, that he was *not* negligent. Once the legal malpractice action was assigned, Lee now had a vested interest in the jury finding that Gurski had *not* been negligent in Lee's treatment. It was this type of assignment—one in which the assignee benefitted from the lawyer's legal malpractice in the underlying action and was now

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[66] *Gurski*, 276 Conn. at 273.

[67] *Id.* at 279.

colluding with the assignor against the law firm— that the Connecticut Supreme Court was unwilling to sanction.

Defendant argues that such an assignment exists here. In its papers, Defendant summarily argues that "Trust Beneficiaries with claims against Investor Trust Debtors that are Plan Debtors are adversaries to the Plan Debtors in the matters that give rise to the legal malpractice claims."[68] I attempted to flesh out this position at argument. As articulated by Defendant's counsel, it is not the assignment itself that creates the issue, but rather it is who benefits from the cause of action that causes the problem with the assignment. In particular, counsel argued it is the fact that the beneficiaries of the Investor Trust are only a subset of adversaries, and some are strangers (what counsel called a "mismatch"). Counsel did not specifically articulate any collusion.

I conclude that Connecticut law does not prevent the "assignment" to the Investor Trust of Plan Debtors' causes of action for legal malpractice against Defendant. First, unlike in *Gurski*, the assignment of the legal malpractice action from Plan Debtors to the § 1123(b)(3)(B) representative of the estate is not an assignment of claims to an adversary in underlying litigation. The Investor Trust, not the Investor Trust beneficiaries, has sued BTT. It is no different than Plan Debtors themselves suing on behalf of their estates with recoveries going to creditors/ investors—or here, a subset of those creditors/investors.

Second, the Investor Trust also separately sued each of Merritt, Kelly and DiMenna for their respective liability to Plan Debtors. Each of those matters has resolved either by way of settlement or judgment. Trustee has a separate theory of liability against BTT. Defendant has

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[68] Opening Brief 19.

not pointed out any inconsistency in the Investor Trust's lawsuit against BTT and its lawsuit against Merritt, Kelly or DiMenna. Whether BTT has a defense based on DiMenna's conduct is a separate matter that is addressed below. But Defendant has not shown that the Investor Trust's suit against it requires the Investor Trust to disavow the premise or result of its previous lawsuits.

I cannot conclude based on the arguments articulated by Defendant that the preservation of the legal malpractice claims for prosecution by the Investor Trust is against Connecticut public policy. The Complaint will not be dismissed on this ground.

As for Defendant's champerty argument, Defendant merely cites to the Delaware District court's decision in *Arunachalam v. Pazuniak*[69] and contends that the Trust Beneficiaries are "strangers to claims by Plan Debtors that are not Investor Trust Debtors."[70]

Defendant has not set forth a cognizable argument for champerty in the "assignment" that took place under the Plan. First, Delaware law does not apply. Second, even if it did, *Arunachalam* does not compel a different result as the Court did not actually perform an analysis of whether the assignment of claims before it was champertous. *Arunachalam* merely states that under Delaware law, "so long as the assignment does not constitute champerty, and the interest in the litigation has been properly assigned, it may proceed."[71]

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[69] 2017 WL 3978000, *9 (D. Del. Sept. 11, 2017).

[70] Opening Brief 19.

[71] 2017 WL 3978000 *9 (citing *Se. Chester Cty. Refuse Auth. v. BFI Waste Servs. of Pennsylvania, LLC*, No. CV K14C-06-016 JJC, 2017 WL 2799160, at *1 (Del. Super. Ct. June 27, 2017); *St. Search Partners, L.P. v. Ricon Int'l, L.L.C.*, No. CIV.A.04C-09-191-PLA, 2006 WL 1313859 (Del. Super. Ct. May 12, 2006)).

Third, as expressed by the Delaware Superior Court "[t]he doctrine of champerty 'is based upon the ground that no encouragement should be given to litigation by the introduction of a party to enforce those rights which the owners are *not disposed to prosecute*.'"[72] There is nothing in the averments of the Complaint (and Defendants point to nothing in the Plan) that shows that the Plan Debtors were unwilling to prosecute the Plan Debtor claims retained for prosecution by the Investor Trust. Fourth, any "mismatch" between the beneficiaries of the Investor Trust and the Plan Debtors whose claims were retained for prosecution by the Investor Trust does not make them "strangers" to the claims of non-Investor Debtor claims. As discussed before, the Plan embodied a global resolution of intercompany debts owed between various Plan Debtors as well as a resolution among and between investors and with lenders. This resolution provides the necessary relation to the parties to the dispute such that the Investor Trust (and beneficiaries, to the extent necessary) are not strangers to the litigation. The Investor Trust is simply bringing claims owned by Plan Debtors. Who Plan Debtors chose to share their recoveries with is of no concern.[73]

I will not dismiss the Complaint on this ground.

III. Failure to State a Cause of Action

Having dispensed with the jurisdictional and standing arguments, I now address Defendant's contention that Plaintiff fails to state a cause of action and related defenses raised to the State Law Claims.

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[72] *Charge Injection Techs., Inc. v. E.I. DuPont De Nemours & Co.*, C.A. No. N07C-12-134-JRJ, 2016 WL 937400, at *4, *4 n.43 (Del. Super. Ct. Mar. 9, 2016) (quoting *Gibson v. Gillespie*, 152 A. 589, 593 (Del. Super. Ct. 1928)).

[73] *See also In re Pursuit Cap. Mgmt., LLC*, 595 B.R. 631, 666–67 (Bankr. D. Del. 2018) (holding that trustee's assignment of claims to a creditor was not champerty).

Both parties cite *Grimm v. Fox* for the elements of a legal malpractice claim under Connecticut law: "In general, the plaintiff in an attorney malpractice action must establish: (1) the existence of an attorney-client relationship; (2) the attorney's wrongful act or omission; (3) causation; and (4) damages."[74] Defendant contends that the Complaint fails to adequately plead the elements of causation and damages. And, more fundamentally, Defendant argues that Plaintiff must allege facts showing which Plan Debtor is asserting a claim, the existence of an attorney-client relationship with that Plan Debtor, the matter of representation which forms the basis for the claim, the conduct which deviated from the relevant standard and damages (colloquially referred to during argument as the "straight line" argument). Plaintiff responds that plaintiff should normally plead a "straight line" except where plaintiff is a liquidating trust in bankruptcy and harms are commingled. Plaintiff also argues that it has pled causation and damages and that Defendant's contentions are a matter of proof, not pleading.

A. Plaintiff has Adequately Pled Causation and Damages, but must Amend the Complaint to Align Specific Plan Debtors with the Malpractice Claims.

I agree with Plaintiff with respect to pleading of causation and damages. At bottom, the Complaint alleges that Defendant's breach of its duties delayed discovery of DiMenna's fraudulent conduct (or permitted it) allowing for the perpetuation DiMenna's fraudulent scheme thereby causing and/or exacerbating Debtors' financial injury.[75] It also contains averments that by promulgating false information Defendant furthered the injurious scheme.[76] At this juncture of the case, based on these allegations, I find it plausible that a causal chain

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[74] *Grimm v. Fox*, 303 Conn. 322, 329 (2012).

[75] Complaint ¶¶ 104, 105.

[76] Complaint ¶ 106.

exists between Defendant's actions and the alleged injury to Plan Debtors that Plaintiff stands in the shoes of.

Defendant really argues that DiMenna's conduct breaks the chain of causation such that BTT cannot be held liable. But, as Plaintiff points out, the authority set forth in Defendant's reply brief provides that:

> The act of a third person in committing an intentional tort or crime is a superseding cause of harm to another resulting therefrom, although the actor's negligent conduct created a situation which afforded an opportunity to the third person to commit such a tort or crime, *unless the actor at the time of his negligent conduct realized or should have realized that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a tort or crime.*[77]

The italicized portion shows that whether DiMenna's intentional conduct is a superseding cause of harm absolving BTT of any responsibility is a question of fact. Fact questions are not resolvable on a motion to dismiss.

As for damages, Defendant's main argument is that Plaintiff pleads a theory of deepening insolvency not recognized by either Connecticut or Delaware law.[78] Plaintiff argues that it did not plead a cause of action based on deepening insolvency, that Connecticut courts take a "flexible approach" to damages, and that damages need not be known with certainty to meet the pleading standard.

Once again, I agree with Plaintiff. Plaintiff is not basing its cause of action on a theory of deepening insolvency. And, Plaintiff is not required to plead a precise calculation of damages.[79] The Complaint alleges that Debtors incurred losses from the fraudulent scheme

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[77] Reply 10 (citing *Doe v. Saint Francis Hosp. & Med. Ctr.*, 309 Conn. 146, 178, (2013) (citing Restatement (Second) of Torts § 448)).

[78] To reiterate, Delaware law is not appliable.

[79] Reply 28 (citing *Chapman Lumber, Inc. v. Tager*, 288 Conn. 69, 87–88 (2008).

which drove Debtors into financial ruin. Accepting the allegations as true, Defendant's conduct plausibly contributed to the fraudulent scheme and thus the resulting injuries, and thereby the damages element is satisfied for motion to dismiss purposes. As Plaintiff has adequately pled the elements of causation and damages, I will not grant the motion to dismiss on those grounds.

I will, however, require that Plaintiff amend the Complaint to draw the "straight line" Defendant seeks. The Investor Trust was authorized to bring the claims of each Plan Debtor. Some may have claims; some may not. But, the claims did not morph into some kind of consolidated "super claim" when they became Investor Trust Assets. While the Complaint specifically avers BTT's actions in certain regards, BTT is entitled to know which of its clients (i.e., which Plan Debtor) is suing it for malpractice, the transaction(s) associated with that Plan Debtor as well as the harm that the Plan Debtor suffered. Accordingly, Counts I and II are dismissed with leave to amend.

B. The Affirmative Defense of in Pari Delicto Raises Factual Issues Not Resolvable on a Motion to Dismiss

Defendant asserts that the doctrine of *in pari delicto* bars Plaintiff from recovering damages caused by Plan Debtors' principal—DiMenna. The doctrine is an affirmative defense, so while it can be decided on a motion to dismiss in certain circumstances, if factual issues exist, such a motion must be denied.

In *Allegheny Health*,[80] Judge Ambro observed that *in pari delicto* is a "murky area of the law. It is an ill-defined group of doctrines that prevents courts from becoming involved in

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[80] *Off. Comm. of Unsecured Creditors of Allegheny Health, Educ. & Rsch. Found. v. PricewaterhouseCoopers, LLP*, No. 07-1397, 2008 WL 3895559, at *5 (3d Cir. July 1, 2008), *certified question answered*, 605 Pa. 269 (2010).

disputes in which the adverse parties are equally at fault."[81] He explained:

> In *Cenco, Inc. v. Seidman & Seidman,* 686 F.2d 449, 453-54 (7th Cir.1982) (Posner, J.) the Court characterized *in pari delicto* as a set of doctrines that embodies the general principle that a plaintiff who is as at fault as the defendant may not recover. In contract actions, the principle manifests itself as the doctrine that a promisor will not be held liable for a breach of contract if the promisee prevented the promisor's performance. In negligence actions, it is the doctrine of contributory negligence (now superseded in some instances by comparative negligence). In fraud actions, it is the principle that a person may only recover as a victim of fraud if he actually relied on the alleged misrepresentation, something a participant in the fraud cannot prove. In other words, *in pari delicto* is not so much a stand-alone doctrine as multiple doctrines that embody a common principle and often apply in similar ways across various causes of action.

Judge Ambro provides a helpful two-step analytical framework for the analysis. First, can the agent's acts (DiMenna) be imputed to the principal (Plan Debtors)? Second, if so, can the particular defendant be shielded from liability by the doctrine? For example, is the defendant an innocent third party? an alleged co-conspirator? or merely accused of negligence? did the defendant act in good faith? In *Allegheny Health*, Judge Ambro posited several scenarios and noted that state courts come out differently on the issue.[82] In applying this framework, a court applies the same state law that governs the affirmative cause of action.[83] So, once again, Connecticut law applies.

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[81] *Id.*

[82] "We are unsure whether the three causes of action presented here-professional negligence, breach of contract, and aiding and abetting a breach of fiduciary duty-are subject to *in pari delicto* in the same way." *Allegheny Health,* 2008 WL 3895559 at *5.

[83] *See, e.g., id.* at *6 (certifying questions to the Pennsylvania Supreme Court: "1. What is the proper test under Pennsylvania law for determining whether an agent's fraud should be imputed to the principal when it is an allegedly non-innocent third-party that seeks to invoke the law of imputation in order to shield itself from liability? 2. Does the doctrine of *in pari delicto* prevent a corporation from recovering against its accountants for breach of contract, professional negligence, or aiding and abetting a breach of fiduciary duty, if those accountants conspired with officers of the corporation to misstate the corporation's finances to the corporation's ultimate detriment?").

Here, while the parties appear to agree that Connecticut recognizes some form of *in pari delicto* doctrine, they disagree on when Connecticut courts will impute the agent's knowledge to the principal and when an "adverse interest" exception to the doctrine applies. Under the adverse interest exception, "knowledge of an agent will not ordinarily be imputed to his principal where the agent is acting adversely to the latter's interest."[84] This is because Connecticut courts presume that an agent will be loyal to his principal and faithfully report to the principal all of the agent's knowledge.[85] Connecticut courts have identified three circumstances in which the presumption can be rebutted: "(1) where it is not the duty of the agent to disclose; (2) when the agent is acting adversely to the principal, whether for the interest of himself or a third party; and (3) where the agent is acting in fraud of his principal."[86] As the court explains:

> In the second and third situations, by contrast, the agent's duty to communicate to his principal is clear, but his loyalty to the principal is cast very much in doubt. When an agent, by his self-serving conduct, so abandons his principal's interests as to act adversely to those interests, or worse, to act in fraud of his principal, it can fairly be said "that, pro tanto, the agency really cease[s]." Id. When that occurs, the *Resnik* Court declared, "'the principal is not bound by the acts or declarations of the agent unless it be proved that he had at the time actual notice of them, or having received notice of them, failed to disavow what was assumed to be said and done in his behalf.'" *Id.*, at 43–44, 122 A. 910 quoting *American Surety Co. v. Pauly*, 170 U.S. 133, 156, 18 S.Ct. 552, 42 L.Ed. 977 (1898). Thus, though a "party [who] knowingly receives and retains a benefit from the transaction which is tainted with fraud . . . cannot claim that benefit and disavow knowledge of the fraud[,] ... a party [who] receives no benefit from the transaction, . . . will not be charged with knowledge of the fraud." *Mutual Assurance Co. v. Norwich Savings Society*, *supra*, 128 Conn. at 513–14, 24 A.2d 477.
> 10*211. Under these authorities, when a corporate officer or agent engages in fraudulent conduct for the distinctly private purpose of lining his own pockets at his corporation's expense, it is unlawful, as well as illogical, to impute the agent's guilty knowledge or disloyal, predatory conduct to his corporate principal. Unless the agent's

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[84] *Reider v. Arthur Andersen, LLP*, 784 A.2d 464, 469 (Super. Ct. 2001), *as corrected* (Dec. 7, 2001).

[85] *Id.* at 470.

[86] *Id.*

activity in pursuit of that scheme somehow benefits the corporation, the corporation cannot be made responsible for the agent's fraud.[87]

In its Opening Brief, Defendant argues that DiMenna's actions can be imputed to Plaintiff. The argument goes: DiMenna's conduct was undertaken in his capacity as principal of Plan Debtors, was for the benefit of Plan Debtors, and thus, DiMenna's conduct should be imputed to Plan Debtors (presumably all of them). Defendant argues that Plan Debtors benefitted from DiMenna's conduct because his conduct "kept funds available in order to perpetuate the operations and to prop up the cash negative companies."[88] Defendant makes no comment with respect to the cash-flow positive Plan Debtors whose funds were stripped from them.

In its Answering Brief, Plaintiff argues that DiMenna's actions cannot be imputed to Debtors—not even the cash-strapped Debtors who received funds from the scheme—because an artificial extension of corporate life does not benefit a corporation.[89] Plaintiff argues that DiMenna's fraudulent conduct was self-serving (whether to satisfy financial concerns, ego or otherwise) and ultimately led to the collapse of all Plan Debtors. Plaintiff further argues that DiMenna was both acting adversely to the interests of his principals and in fraud of them.[90]

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[87] *Reider*, 784 A.2d at 470

[88] Opening Brief 37.

[89] *See Reider*, 784 A.2d at 471 ("[T]he Court is persuaded that the only 'benefit' derived from the artificial prolongation of First Connecticut's corporate existence inured to its owner-looters, Robert and Helen Chain. The company itself derived no benefit from its continuing service as their private piggy bank.").

[90] Plaintiff also argues that even if DiMenna's conduct can be imputed to the Plan Debtors, it should not be imputed to the Investor Trust because its beneficiaries were not benefitted by DiMenna's conduct. The argument is unavailing; it is well established in the Third Circuit that a trustee stands in the shoes of the debtor with respect to claims coming into the estate under § 541 of the Bankruptcy Code, and any actions it brings on such claims are subject to the same defenses the debtor would have faced as of the commencement of the case. *See Off. Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356–57 (3d Cir. 2001) ("We thus agree with the analysis of the Tenth Circuit in *In re: Hedged-Investments Assocs., Inc.*, 84 F.3d 1281 (10th Cir.1996), which employed section 541 in applying

Defendant's reply merely repeats its earlier position.

As shown by the above discussion, questions of fact clearly exist which preclude dismissal of the State Law Actions. At the very least, Defendant's argument suffers from the same deficiency as does Plaintiff's—it lumps all Plan Debtors together. Whether the cash-starved Plan Debtors can be said to have benefitted from DiMenna's actions may be an open question. But, Defendants do not even address how it could be that the cash-flow positive Plan Debtors benefitted.

In pari delicto is an affirmative defense and thus Defendant has the burden of proof on this issue. I will not grant the Motion to Dismiss on these grounds.

C. Failure to State a Cause of Action for Constructive Fraudulent Transfer

Finally, Defendant contends that Plaintiff has not satisfied the pleading standard regarding constructive fraudulent transfers under § 548(a)(1)(B) under either Rule 9(b) or 12(b)(6). Defendant asserts that "The Trust's complaint is entirely devoid of any fact supporting the contention of fraud by BTT" and does not identify "any circumstances even hinting fraud by BTT" or any fact to suggest BTT was not owed the money it was paid.[91] Defendant concludes that "The Trust's own averments do not support the bald contention of fraud."[92] Plaintiff asserts that the correct standard by which to gauge claims of constructive fraud is Rule 8(a)(2).

A plaintiff pleading constructive fraud, as opposed to actual fraud, does not need to meet the heightened standard of Rule 9(b).[93] Constructive fraud is just that—a statutory

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the *in pari delicto* doctrine to bar a bankruptcy trustee's suit against a third-party.").

[91] Reply Brief 38–39.

[92] *Id.*

[93] *In re Pillowtex Corp.*, 427 B.R. 301, 310 (Bankr. D. Del. 2010) ("As noted by my colleague, Judge

construct—which in no way depends upon any fraudulent conduct by a defendant. Defendant's request that it be apprised of facts supporting a contention of fraud are irrelevant to this cause of action. Accordingly, I will not dismiss Count IV for failure to state a cause of action.[94]

Conclusion

An order will enter consistent with the above rulings.

Dated: June 10, 2021

Laurie Selber Silverstein
United States Bankruptcy Judge

Gross, in *Mervyn's*, courts in this district have held that claims of constructive fraud (i.e., fraudulent transfers) are evaluated using Rule 8(a)(2).")

[94] Any ground for dismissal not addressed herein is denied.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: SEABOARD HOTEL MEMBER ASSOCIATES, LLC, et al., Post-Effective Date Plan Debtors.	Chapter 11 Case No. 15-12510 (LSS) (Jointly Administered)
NCA INVESTORS LIQUIDATING TRUST, Plaintiff, v. BERKOWITZ, TRAGER & TRAGER, LLC, Defendant.	Adv. No. 19-50257 **Re: Docket No. 16**

ORDER

For the reasons set forth in my Memorandum of even date,

IT IS HEREBY ORDERED that:

1. Defendant Berkowitz, Trager & Trager, LLC's Motion to Dismiss Plaintiff's Complaint [D.I. 16] is **GRANTED, without prejudice,** as to Counts I and II.
2. Plaintiff has leave to amend the Complaint within 30 days of the entry of this Order.

Laurie Selber Silverstein
United States Bankruptcy Judge

Dated: June 10, 2021