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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

In re:	(Hon. Vincent F. Papalia)
PETERSBURG REGENCY, LLC,	Chapter 11
Debtor.	Case No. 15-17169 (TBA)
	Hearing Date: June 23, 2015 @ 10:00 a.m. **Oral Argument: Requested**

REPLY OF LECLAIRRYAN, A PROFESSIONAL CORPORATION TO DEBTOR'S OPPOSITION TO MOTION FOR ENTRY OF AN ORDER DISMISSING CASE PURSUANT TO 11 U.S.C. § 1112(b), AND FOR SANCTIONS, AND RESPONSE TO CROSS-MOTION OF JIM BURT

TO: HONORABLE VINCENT F. PAPALIA
UNITED STATES BANKRUPTCY JUDGE

LeClairRyan, A Professional Corporation ("**LeClairRyan**"), by and through its undersigned counsel, submits this Reply to Petersburg Regency, LLC's (the "**Debtor**") Opposition (the "**Opposition**") to LeClair's Motion For Entry of an Order Dismissing Case Pursuant to 11 U.S.C. § 1112(b), And For Sanctions (the "**Motion**"), and Response to Cross-Motion of Jim Burt (the "**Cross-Motion**") and respectfully states as follows:[1]

REPLY

Despite the Debtor's assertion in its Opposition that LeClairRyan's Motion has taken the Debtor's arguments in favor of dismissal of the Involuntary Bankruptcy "out of context," the fact

[1] Capitalized terms not defined herein shall have the meanings ascribed to them in the Motion.

remains that the Debtor emphatically argued, less than two months before commencing this case, that the Involuntary Bankruptcy served no bankruptcy purpose, stating, among other things, that "the bankruptcy process would add no significant value because the state court systems . . . are aptly equipped to address the appropriate fate of the Arbitration Award," and "[t]o now ask this Bankruptcy Court to be added to the mix creates no added value to the process and only wastes this Court's valuable time and resources." *See McGill Certification, Ex. F*., pp. 15-16.

By filing this case, the Debtor is now treading in the area of judicial estoppel. "Judicial estoppel addresses the incongruity of allowing a party to assert a position in one tribunal and the opposite in another tribunal. If the second tribunal adopted the party's inconsistent position, then at least one court has probably been misled." Edwards v. Aetna Life Ins. Co., 690 F.2d 595, 599 (6th Cir. 1982). Against this backdrop, and given that the Debtor completely ignored and defaulted in the Interpleader Action and then came running into this Court solely to litigate the issues in the Interpleader Action, the Debtor's bad faith in filing this case is apparent.

In an effort to adorn this case with trappings of legitimacy, the Debtor has responded to LeClairRyan's Motion by filing a proposed chapter 11 plan as well as a misguided adversary complaint (the "**Adversary Complaint**") which seeks to avoid various liens and asserts other non-core causes of action against LeClairRyan and others. However, the filing of a plan does not establish that a case was filed in good faith, see, e.g., In re Liberate Technologies, 314 B.R. 206, 217 (Bankr. N.D.Cal. 2004) (citing In re SGL Carbon Corp., 200 F.3d 154, 167-68 (3d Cir. 1999), and, as explained more fully below, neither does the filing of an adversary complaint for the purpose of attempting to rearrange priorities among creditors and asserting causes of action which exist outside of bankruptcy.

As set forth in LeClairRyan's Motion, "[t]wo inquiries are especially relevant to the issue of good faith: '(1) whether the petition serves a valid bankruptcy purpose, and (2) whether the petition is filed merely to obtain a tactical litigation advantage.'" In re Paradigm Elizabeth, LLC, 2015 WL 435067 *3 (Bankr. D.N.J. 2015) (emphasis added) (citing In re 15375 Memorial Corp., 589 F.3d 605, 618 (3d Cir. 2009) (internal quotations omitted). The Debtor has fallen woefully short of addressing both inquiries, and it is thus clear that this case should be dismissed as a bad faith filing.

The Debtor's stated purpose in filing its case is "to test the validity of claims, the validity of liens, obtain additional assets through litigation, and arrange a fair distribution to all creditors." See *Debtor's Opposition, ¶ 3*. These purposes do not amount to a valid bankruptcy purpose. "[T]he [Bankruptcy] Code's purposes are to preserve going concerns and to maximize the value of the debtor's estate." In re Integrated Telecom Express, Inc., 384 F.3d 108, 128 (3d Cir. 2004) (citations omitted).[2]

As Judge Steckroth recognized in a recent case, "[e]ven if the debtor is not a going concern and the bankruptcy was filed for liquidation purposes, a petition may maximize value for creditors if it adds or preserves value *that would be unavailable to creditors outside of bankruptcy*." In re Paradigm Elizabeth, LLC, 2015 WL 435067 at *3 (emphasis added) (citing In re Integrated Telecom Express, Inc., 384 F.3d at 120).

Here, the Debtor has no ability to maximize the value of any of its assets through a bankruptcy proceeding beyond what would be available to creditors outside of bankruptcy. The only assets the Debtor claims to have are (a) an interest in the $10,230,626.64 in proceeds of the Arbitration Award (the "**Interpleader Fund**") which have been deposited with Petersburg Clerk

[2] As set forth in LeClairRyan's Motion, the Debtor is a defunct New Jersey limited liability company, which is no longer in good standing. The Debtor has not operated as a going concern since the end of 2011.

of Court in the Interpleader Action, (b) and purported causes of action (the "**Prepetition Causes of Action**") against LeClairRyan, Jim Burt and "Garrison" (as defined in the Adversary Complaint), respectively, alleged to have arisen prepetition.

Obviously, the value of the Interpleader Fund cannot be maximized any further, as it a fully liquidated asset. Apart from the fact that the Prepetition Causes of Action appear to have been cooked-up to lend legitimacy to this proceeding and, at least with respect to LeClairRyan, are highly specious if not patently frivolous,[3] the value of the Prepetition Causes of Action is no greater in this Court than in any other court. The value of the Prepetition Causes of Action cannot be maximized by virtue of this bankruptcy proceeding.

Courts have recognized that bankruptcy does not maximize the value of prepetition causes of action by emphasizing that "Chapter 11 relief should not be made available to an entity solely to get an upper hand in litigation against another party, *nor solely to provide an alternate forum for a debtor*." Nothwest Place, Ltd. v. Lawrence E. Cooper (In re Northwest Place, Ltd.),

[3] In its Opposition and in the Adversary Complaint, the Debtor peculiarly fixates on alleged improprieties by LeClairRyan in connection with its alleged "orchestration" of the Involuntary Bankruptcy, and asserts in paragraph 63 of its Opposition that "LeClairRyan faces liability for actual and punitive damages pursuant to, inter alia, Section 303(i)(2) of the Bankruptcy Code." Apart from the fact any such issues should have been raised in the Involuntary Bankruptcy, and cannot now be adjudicated by this Court or any other court, the Debtor neglects to inform the Court that the Involuntary Bankruptcy was dismissed on the consent of all petitioners and the Debtor. See *Supplemental Certification of Douglas J. McGill, Esq. (the "Supplemental McGill Cert."), Exhibit A*. Section 303(i)(2) does not allow for the imposition of any liability where an involuntary petition is dismissed on consent. See *11 U.S.C. § 303(i).*

The Debtor also premises causes of action against LeClairRyan on the Debtor's knowingly false statement that "[a]s far as Debtor was aware [at the time the Involuntary Bankruptcy was filed] on February 3, 2014 (sic), LeClairRyan was still Debtor's counsel with respect to the Insurance Litigation." See *Opposition, ¶ 25*. The reality, however, is that following the filing of the Interpleader Action on December 30, 2015 naming both LeClairRyan and the Debtor as defendants, LeClairRyan terminated its representation of the Debtor via a January 6, 2015 email to Debtor's New Jersey counsel and the Debtor's principal, Mr. Harmon, which email stated in pertinent part:

> Given that the Arbitrator has entered the Award in favor of Petersburg, and given that arbitration between Selective and Petersburg Regency is now completed, the Firm's engagement under the terms of the August 9, 2013 Engagement is now complete. **Please accept this email as formal notice that the Firm's representation of Petersburg Regency has ended**. (Bob, I have to make this clear, because as Gerry noted, the filing of the interpleader action has created a conflict and we cannot represent Petersburg Regency in the face of this conflict).

See *Supplemental McGill Cert., Exhibit B (emphasis added).*

73 B.R. 978, 982 (Bankr. N.D.Ga. 1987) (emphasis added); see also In re HBA East, Inc., 87 B.R. 248, 260 (Bankr. E.D.N.Y. 1988); see also Little Creek Development Co. v. Commonwealth Mortgage Co. (In the Matter of Little Creek Development Co.), 779 F.2d 1068, 1074 (5th Cir. 1986) (analyzing a bad faith filing question and stating, "If the circumstances surrounding [the debtor's] filing demonstrate that the goals of the bankruptcy laws cannot be fulfilled by permitting [the debtor] to stave off foreclosure by Commonwealth, then it makes no difference whether [the debtor] had, or has, a cause of action for damages against Commonwealth in state court"). This is especially so here, where the Prepetition Causes of Action, which generally allege breach of contract, negligence/professional malpractice and usury, are all non-core claims that cannot be finally adjudicated by this Court in any event. See, e.g., Joseph DelGreco & Co., Inc. v. DLA Piper (US) (In re Joseph DelGreco & Co., Inc.), 2011 WL 350281 *3 (S.D.N.Y. 2011) (stating that a debtor's claim for prepetition legal malpractice is a non-core claim); DHP Holdings II Corp. v. The Home Depot, Inc. (In re DHP Holdings II Corp.), 435 B.R. 264, 271-72 (Bankr. D.Del. 2010) (finding that debtor's claim for prepetition breach of contract is non-core); Stipetich v. First Mount Vernon Industrial Loan Ass'n (In re Stipetich), 294 B.R. 635, 649 (Bankr. W.D.Pa. 2003) (debtor's usury claim was non-core).

It is true that the Debtor, in furtherance of its stated intention to use this case to avoid liens and to "arrange a fair distribution to all creditors," has asserted various lien avoidance and equitable subordination causes of action (the "**Chapter 5 Causes of Action**") in its Adversary Complaint. However, the assertion of these Chapter 5 Causes of Action does not establish that the instant case was filed in good faith. As the United States Court of Appeals for the Third Circuit recognized in Integrated Telecom Express, Inc.,

> Although the Bankruptcy Code contains many provisions that have the effect of redistributing value from one interest group to another, these redistributions are

> not the Code's purpose. Instead, the purposes of the Code are to preserve going concerns and to maximize the value of the debtor's estate.
>
> . . .
>
> To be filed in good faith, a petition must do more than merely invoke some distributional mechanism in the Bankruptcy Code. It must seek to create or preserve some value that would otherwise be lost – not merely distributed to a different stakeholder – outside of bankruptcy. This threshold inquiry is particularly sensitive where, as here, the petition seeks to distribute value directly from a creditor to a company's shareholders.

384 F.3d 108, 128-29 (3d Cir. 2004) (citations omitted); see also In re Dewey Commercial Investors, L.P., 503 B.R. 643, 650 (Bankr. E.D.Pa. 2013) (stating, "The fact that a petition desires to invoke the Code's distributional mechanisms to distribute estate assets to a different party is not a valid bankruptcy purpose").

The Third Circuit put a finer point on this principle in In re 15375 Memorial Corp., stating:

> Moreover, an orderly distribution of assets, standing along, is not a valid bankruptcy purpose. [In re Integrated Telecom Express, Inc., 384 F.3d at] 126. "Antecedent to any such distribution is an inquiry [into] whether the petition [was] filed in good faith, *i.e.*, whether [it] served a valid bankruptcy purpose." *Id.* In other words, the creation of a central forum to adjudicate claims against the Debtors is not enough to satisfy the good faith inquiry – the Debtors must show that bankruptcy has some "hope of maximizing the value of the [Debtors' estates]." *Id.*

589 F.3d at 622.

Thus, courts will dismiss a bankruptcy petition where the sole or real purpose of the filing is to avoid liens, particularly if avoidance will benefit the debtor's insiders. See, e.g., In re Humcor, Inc., 2010 WL 1641531 (W.D.Wash. 2010) (affirming bankruptcy court's dismissal of a petition for having been filed in bad faith where the only purpose to the filing was to avoid a lien for the benefit of the debtor's controlling shareholder).

The Debtor clearly filed this case solely to bring the Adversary Complaint in an improper attempt to rearrange priorities among its creditors through the lien avoidance and other distributional mechanisms of the Bankruptcy Code, for the ultimate benefit of the Debtor's insiders, Mr. and Mrs. Harmon. The Court should not overlook the fact that the Debtor has scheduled Mr. and Mrs. Harmon as having an unsecured claim in the approximate amount of $12,000,000, see *Debtor's Schedule F – Creditors Holding Unsecured Nonpriority Claims [Docket No. 1],* and that any success which the Debtor might have in avoiding liens for the benefit of its estate would inure to the substantial benefit of Mr. and Mrs. Harmon.

An almost identical tactic was rejected as a bad faith chapter 11 filing in In re Northwest Place, Ltd., 73 B.R. at 978, a case cited by the Third Circuit in In re Integrated Telecom Express, Inc. In that case, a single asset debtor filed a chapter 11 petition for the sole purpose of seeking to avoid an alleged fraudulent transfer. Notwithstanding the fact that the debtor in Northwest Place, like the Debtor here, had filed a plan, as well as an adversary complaint to avoid the transfer and/or equitably subordinate the claim at issue, the court dismissed the case as a bad faith filing, stating:

> The real purpose of the filing of this case was to bring the 11 – count adversary complaint to set aside the transfer to the Coopers. The counts based upon state law may be asserted in the appropriate state court forum. The counts based on the Bankruptcy Code are an attempt to misuse those provisions.
>
> . . .
>
> It is quite apparent to the Court that the only thing the Debtor wants to reorganize is its relationship with the Coopers by converting them back into equity holders. The Court will not permit the Debtor to litigate those issues in this forum.

73 B.R. at 982.

For all of the foregoing reasons, this case does not serve any valid bankruptcy purpose. Moreover, the filing of this case amounts to an improper litigation tactic to pressure creditors to settle their claims against the Debtor. The Debtor admits as much by stating in its Opposition that it has been negotiating with creditors "in an effort to resolve the distribution of . . . [the Interpleader Fund]. See *Debtor's Opposition,* ¶¶ *5-6*. The use of chapter 11 to pressure creditors into settling claims was emphatically rejected by the Third Circuit in In re SGL Carbon Corp., 200 F.3d at 167 (holding that petition was not filed in good faith where the debtor's sole purpose was "to put pressure on [a claimant] to accept the company's settlement terms").

The Debtor's effort to leverage creditors through this bankruptcy proceeding is particularly egregious given the fact that the Debtor completely ignored and defaulted in the Interpleader Action, despite having been served and despite having actual notice of the Interpleader Action. Despite its failure to participate in the Interpleader Action, once the Final Order was entered in the Interpleader Action, the Debtor came to this Court in an effort to obtain relief from that Final Order.

Nothing about this case involves a valid bankruptcy purpose, and everything about this case amounts to an improper litigation tactic. For all of the foregoing reasons, the Debtor's case should be dismissed.[4]

[4] LeClairRyan supports the Cross-Motion to the extent that it seeks relief adjunct to the relief sought by LeClairRyan's Motion, *i.e.*, a structured dismissal based on the Debtor's bad faith filing.

CONCLUSION

WHEREFORE, LeClairRyan, A Professional Corporation respectfully requests the entry of an order: (i) granting the Motion; (ii) dismissing the Petition with prejudice; and (iii) granting and appropriate award of sanctions and such other and further relief as may be just.

WEBBER MCGILL LLC
Attorneys for LeClair Ryan,
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By: */s/ Douglas J. McGill*
Douglas J. McGill

Dated: June 19, 2015
Whippany, New Jersey