No. _____

In the Supreme Court of the United States

PEM ENTITIES LLC, PETITIONER

v.

ERIC M. LEVIN & HOWARD SHAREFF

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

DOUGLAS HALLWARD-DRIEMEIER
Counsel of Record
PATRICK M. ROY
ROPES & GRAY LLP
2099 Pennsylvania Ave., N.W.
Washington, DC 20006
(202) 508-4776
Douglas.Hallward-Driemeier@ropesgray.com

JAMES M. WILTON
GABRIELLE G. HIRZ
ROPES & GRAY LLP
800 Boylston Street
Boston, MA 02199

D. ROSS MARTIN
GREGG M. GALARDI
ROPES & GRAY LLP
1211 Avenue of the Americas
New York, NY 10036

JOHN A. NORTHEN
VICKI L. PARROTT
NORTHEN BLUE LLP
1414 Raleigh Road
Chapel Hill, NC 27515

QUESTION PRESENTED

Whether bankruptcy courts should apply a federal rule of decision (as five circuits have held) or a state law rule of decision (as two circuits have held, expressly acknowledging a split of authority) when deciding to recharacterize a debt claim in bankruptcy as a capital contribution.

PARTIES TO THE PROCEEDINGS BELOW AND RULE 29.6 STATEMENT

The following list provides the names of all parties to the proceedings below:

Petitioner PEM Entities LLC was the appellant in the court of appeals. PEM Entities LLC has no parent corporation and no publicly held company owns 10% or more of its stock.

Respondents Eric M. Levin & Howard Shareff were the appellees in the court of appeals.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Petitioner PEM Entities respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-10a) is unreported. The opinion of the district court (App., *infra*, 11a-17a) is unreported. The opinion of the bankruptcy court (App., *infra*, 18a-40a) is unreported.

JURISDICTION

The judgment of the court of appeals, denying petitioner's motion for rehearing en banc was entered on September 9, 2016. App., *infra*, 41a. This Court has jurisdiction under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 105(a) and 502 of Title 11 of the United States Code are reproduced in full in an appendix hereto. App., *infra*, 42a-49a.

STATEMENT OF THE CASE

Petitioner is the purchaser of a third-party loan taken out by Province Grande Olde Liberty (Debtor) and secured by its principal asset, a real estate development project including a golf course (Olde Liberty Club). The loan was in default and the real estate was in foreclosure at the time the loan was acquired. Debtor did not have sufficient funds to redeem the real estate and was unable to obtain capital contributions to allow it to do so. Absent petitioner's purchase, Debtor's principal asset would have been lost to foreclosure, causing loss of its assets.

While petitioner's loan purchase did not solve Debtor's financial difficulties, it allowed Debtor to continue its business. Although it filed a Chapter 11 bankruptcy proceeding, Debtor successfully confirmed a Chapter 11 plan. In bankruptcy, other creditors sought to recharacterize petitioner's loan as capital, invoking a federal multi-factor test for doing so. As adopted by the Fourth Circuit, the federal rule of decision allowed petitioner's secured, third-party loan to be recharacterized as a capital contribution.

The court of appeals' holding highlights the differences between applying, as the rule of decision, a federal, court-created doctrine of debt recharacterization, as five circuits do, and state law, as two circuits do. Although the law of North Carolina, where Debtor was incorporated and where the loan was made, would rec-

ognize petitioner's loan as a valid and enforceable debt, the bankruptcy court recharacterized the debt as a capital contribution under the Fourth Circuit's federal multi-factor test. The Bankruptcy Code provides no basis to recharacterize petitioner's loan using a federal rule of decision. Petitioner asks this Court to grant a writ of certiorari in order to resolve the circuit split and to establish that state law governs the recharacterization of debt claims as capital contributions in bankruptcy.

The courts of appeals that have considered the proper rule of decision for debt recharacterization have approached the question in very different ways. Two circuits have focused on Bankruptcy Code Section 502, which requires allowance of claims unless the claim is unenforceable under applicable non-bankruptcy law (*i.e.*, state law) or disallowed under any of eight express federal statutory grounds, none of which applies in this case. Other courts, by contrast, have cited Bankruptcy Code Section 105(a) as providing the bankruptcy courts authority to impose debt recharacterization using a federal, court-created test. The courts of appeals apply diametrically opposing rules, based on these competing approaches.

A. Claims Allowance In Bankruptcy

1. In bankruptcy cases creditors file "proofs of claim." 11 U.S.C. 501(a). The proofs of claim establish the various creditors' priority and share of bankruptcy distributions. *E.g.*, 11 U.S.C. 726(a) (setting forth priority in which "property of the estate shall be distributed * * * in payment of claims" in chapter 7), 726(b) ("payment [within each priority] shall be made pro rata among claims").

A proof of claim is deemed "allowed," and therefore valid, "unless objected to." 11 U.S.C. 502(a); Fed. R. Bankr. P. 3001(f) ("prima facie evidence of the validity and amount of the claim"). Thus "claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed." *Travelers Cas. & Sur. Co. of Am.* v. *Pac. Gas & Elec. Co.*, 549 U.S. 443, 452 (2007) (*Travelers*). The bankruptcy court then "shall allow such claim in such amount, except to the extent that—(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unsecured." 11 U.S.C. 502(b)(1).

Section 502(b)(1) means that "any defense to a claim that is available outside of the bankruptcy context is also available in bankruptcy." *Travelers*, 549 U.S. at 450. For example, if the claim is not valid under state law, it will be disallowed, because Section 502(b)(1) "requires bankruptcy courts to consult state law in determining the validity of most claims." *Ibid.* In the remainder of Section 502(b), Congress enacted eight federal statutory grounds for disallowing a claim, none of which is applicable to petitioner's claim. *E.g.*, 11 U.S.C. 502(b)(2) ("unmatured interest"), 502(b)(4) ("for services of an insider * * * [that] exceeds the reasonable value of such services"), 502(b)(6) ("damages resulting from the termination of a lease of real property" in excess of certain periods of rent), 502(b)(7) ("damages resulting from termination of an employment contract" in excess of one year of compensation).

2. After the amounts of claims are determined, they must be placed in priority order. There are categorical

priorities for certain types of claims. Some claims are secured, if they have liens under state or other non-bankruptcy law. 11 U.S.C. 506(a); *e.g.*, *Ohio* v. *Kovacs*, 469 U.S. 274, 285-286 (1985) (O'Connor, J., concurring). After secured claims, Congress has enacted specific priorities for various categories of unsecured claims. 11 U.S.C. 507.

Bankruptcy Code Section 510 specifies three circumstances, besides the above, in which a claim can be subordinated to other identified claims. Section 510(a) makes fully enforceable state law agreements under which one creditor subordinates to another. Section 510(b) subordinates a securities-fraud (and similar) claim to any claim or interest of equal or greater rank with the security that gave rise to the fraud claim. Finally, Section 510(c) provides for case-by-case "equitable subordination" of any claim to any other claim.

B. The Facts Of Petitioner's Case

The debtor in this case is Province Grande Olde Liberty, LLC, a North Carolina limited liability company, which owns real estate located in Franklin County, North Carolina for development of a golf course and homes (Olde Liberty Club). App., *infra*, 20a. Debtor purchased the Olde Liberty Club in 2009. *Id.* at 13a. The purchase was primarily funded by an arms-length new-money $6.465 million secured loan (Paragon Primary Loan) from Paragon Commercial Bank (Paragon Bank). *Ibid.* This loan had a fixed maturity date and payment schedule and was secured by a first lien interest in the Olde Liberty Club. *Id.* at 27a, 30a. Debtor received capital contributions and also obtained $188,000 from Lakebound Fixed Return Fund, LLC (Lakebound). *Id.* at 20a.

Debtor struggled financially and defaulted on the Paragon Primary Loan in 2010. App., *infra*, 20a. Paragon Bank began foreclosure proceedings on the note securing the Paragon Primary Loan in 2011. *Ibid.* Debtor did not have sufficient capital to stop the foreclosure action. *Id.* at 29a. Debtor could not obtain sufficient capital contributions or new third-party loans to do so in what the bankruptcy court found was a "very depressed real estate market." *Id.* at 30a. Instead, "in the aftermath of the worst recession in real estate," several of Debtor's members agreed to form a new limited liability company, PEM Entities LLC (which is the petitioner in this Court) for the purpose of buying the distressed loan from Paragon Bank. *Id.* at 36a. In March 2012, an out-of-court settlement agreement was reached (2012 Settlement Agreement). *Id.* at 20a. The 2012 Settlement Agreement provided that petitioner would purchase the Paragon Primary Loan from Paragon Bank. *Id.* at 21a.

Petitioner purchased the loan for $1.242 million. App., *infra*, 21a. Some of the purchase price came from $300,000 in new capital contributions to petitioner from individuals who were also members of Debtor. The remainder came from two new third-party loans to petitioner—one from Paragon Bank in the amount of $292,000 (Paragon Secondary Loan), and a second from two individuals (D&S) in the amount of $650,000 (D&S Loan). *Id.* at 21a, 23a. The Paragon Primary Loan remained unchanged in its terms and secured by the Olde Liberty Club. *Id.* at 27a, 30a. Both the D&S and Paragon Secondary Loans received additional credit support from mortgages on the Olde Liberty Club. *Id.* at 21a. The bankruptcy court found that the economics of this arms-length consensual workout agreement were

that petitioner purchased the Paragon Primary Loan at "a fair price." *Id.* at 36a. The price that Paragon Bank received was $950,000 in cash and an obligation from PEM to pay another $292,000 over time. *Id.* at 4a. Debtor's primary asset was saved from foreclosure and the Debtor was able to continue its real estate development. *Id.* at 33a.

C. The Bankruptcy Court Proceedings

Debtor's financial difficulties continued and, in March 2013, it filed a voluntary Chapter 11 petition in the United States Bankruptcy Court for the Eastern District of North Carolina. App., *infra*, 19a. Debtor submitted under pains and penalties of perjury its formal bankruptcy schedules, listing the Paragon Primary Loan as a $7 million secured debt. *Id.* at 21a; Fed. R. Bankr. P. 1008 (citing 28 U.S.C. 1746). Debtor's schedules also reported an $188,000 debt to Lakebound resulting from its original purchase of the Olde Liberty Club. App., *infra*, at 19a-20a, 21a.

Respondents Eric Levin and Howard Shareff were investors in Lakebound. App., *infra*, 12a. They filed this adversary proceeding against petitioner seeking to (1) recharacterize petitioner's claim under 11 U.S.C. 105(a); (2) equitably subordinate petitioner's claim pursuant to 11 U.S.C. 510(c); and (3) avoid a pre-petition payment to petitioner as a fraudulent transfer under 11 U.S.C. 544, 548(a)(1), 550, and 551, and the North Carolina Uniform Fraudulent Transfer Act. *Id.* at 19a. On cross-motions for summary judgment, the bankruptcy court granted summary judgment to petitioner on respondents' equitable subordination and fraudulent transfer claims. *Id.* at 39a. It held that, as a matter of law, there was no basis to equitably subordinate peti-

tioner's claim since the loan was purchased for "a fair price" through an arms-length negotiation, and there was no evidence of inequitable conduct. *Id.* at 36a-37a. It also found that respondents lacked standing to pursue fraudulent transfer claims. *Id.* at 37a-38a.

Although the 2012 Settlement Agreement contemplated a sale of the Paragon Primary Loan to petitioner, the bankruptcy court recharacterized petitioner's $7 million secured claim based on a federal rule of debt recharacterization, as required by Fourth Circuit precedent. App., *infra*, 33a; see *Fairchild Dornier GmbH* v. *Official Comm. of Unsecured Creditors (In re Dornier Aviation (N. Am.), Inc.)*, 453 F.3d 225 (4th Cir. 2006) (*Dornier Aviation)*. As applied in the Fourth Circuit, the judicially created, federal rule of debt recharacterization requires consideration of eleven factors (*AutoStyle* Factors) that the Sixth Circuit imported from a prior federal tax decision:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire

capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

App., *infra*, 24a; *Bayer Corp.* v. *MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 749-750 (6th Cir. 2001) (*AutoStyle*) (citing *Roth Steel Tube Co.* v. *Comm'r*, 800 F.2d 625, 630 (6th Cir.1986)); *Dornier Aviation*, 453 F.3d at 233 (citing *AutoStyle*).

In applying those factors, the bankruptcy court looked to petitioner's 2012 purchase of the Paragon Primary Loan and its post-purchase administration of the loan, and not to the terms and circumstances of the Paragon Primary Loan itself. App., *infra*, 24a-32a. The court did not consider the fixed maturity date, required payments, third-party nature of the loan and first-lien security given for the loan as controlling the debt recharacterization analysis. *Ibid.* Instead, the bankruptcy court focused on the discounted price petitioner paid for the distressed loan, petitioner's failure to enforce the original loan terms prior to bankruptcy, Debtor's poor financial position at the time of the loan purchase, petitioner's insider status resulting from having multiple members with a stake in both petitioner and Debtor, the fact that petitioner made additional capital contributions to Debtor, and the inability of Debtor to obtain outside financing at the time the loan was purchased. *Ibid.*

D. Proceedings On Appeal

The District Court affirmed, finding that the bankruptcy court had correctly applied the federal rule of decision laid out by the Fourth Circuit in *Dornier Aviation.* App., *infra*, 17a.

Petitioner appealed to the Fourth Circuit, which

also affirmed. App., *infra*, 10a. In finding that the bankruptcy court had properly applied the precedent set in *Dornier Aviation*, the court of appeals reasoned that "broad recharacterization power is integral to the consistent application of the Bankruptcy Code." *Id.* at 8a (quoting *Dornier Aviation*, 453 F.3d at 233).

Petitioner moved for rehearing en banc, requesting that, in light of the circuit split established by *Lothian Oil* and *Fitness Holdings*, the Fourth Circuit reconsider its prior panel holding in *Dornier Aviation* that a federal rule of decision applied to debt recharacterization. See *Grossman* v. *Lothian Oil Inc. (In re Lothian Oil Inc.)*, 650 F.3d 539 (5th Cir. 2011) (*Lothian Oil*), cert. denied sub. nom., *Lothian Cassidy, LLC* v. *Lothian Oil Inc.*, 132 S. Ct. 1573 (2012); *Official Comm. of Unsecured Creditors* v. *Hancock Park Capital II, L.P.* (*In re Fitness Holdings Int'l, Inc.*), 714 F.3d 1141 (9th Cir. 2013) (*Fitness Holdings*). The Fourth Circuit denied rehearing. App., *infra*, 41a.

REASONS FOR GRANTING THE PETITION

The court of appeals' decision is the most recent case in an acknowledged and well-developed circuit split concerning whether a state law or federal rule of decision applies to debt recharacterization in bankruptcy. The minority view (two out of seven courts of appeals) holds that a state law rule of decision applies because, under the statutory scheme of the Bankruptcy Code, bankruptcy courts determine the allowance of claims under state law. The majority view relies on the bankruptcy courts' powers under Bankruptcy Code Section 105(a).

This petition is an ideal vehicle for this Court to address this important question. The court of appeals'

decision rested solely on debt recharacterization. Specifically, the bankruptcy court rejected respondents' claims under both equitable subordination and fraudulent transfer law on the basis that petitioner had not engaged in any bad faith conduct and that the relevant transactions were done on an arms-length basis. Respondent never challenged these holdings on appeal. Whether the rule of decision is supplied by state or federal law is outcome determinative here. While the court of appeals found it could recharacterize petitioner's debt claim resulting from its purchase of a third-party arms-length loan, North Carolina law would not do so.

The Fourth Circuit's decision not only upset petitioner's legitimate expectations regarding the treatment of its claim in this case, but more broadly increases the chances of business failures because it discourages lending by those most knowledgeable of the risks and most likely to extend credit to distressed companies.

I. THERE IS A WELL-DEVELOPED CIRCUIT CONFLICT REGARDING WHETHER STATE LAW OR FEDERAL LAW PROVIDES THE RULE OF DECISION FOR BANKRUPTCY COURTS RECHARACTERIZING CLAIMS AS CAPITAL CONTRIBUTIONS

A. Several Courts Of Appeals Have Adopted A Federal Rule Of Decision

A number of the courts of appeals have held that a federal rule of decision governs debt recharacterization, following the Sixth Circuit's reasoning in *Bayer Corp.* v. *MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 749-750 (2001). *Autostyle* found authority for federal courts to create a rule for debt recharacteriza-

tion under Section 105(a) of the Bankruptcy Code, which gives bankruptcy judges the authority to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Code. *Id.* at 748 (quoting 11 U.S.C. 105(a)). The Sixth Circuit looked to a federal tax case that established a standard to determine whether or not an advance from a parent corporation to subsidiary should be recharacterized as a capital contribution for purposes of determining whether, when the advance was later written off for uncollectibility, such write-off was fully or only partially deductible in computing income tax liability. *Id.* at 749-750 (citing *Roth Steel Tube Co.* v. *Comm'r*, 800 F.2d 625, 630 (6th Cir. 1986)). Under the 11-factor test imported by *AutoStyle*, the bankruptcy court considers:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Ibid. No single factor is determinative; rather the inquiry turns on whether the transaction reflects an

arms-length negotiation. *Id.* at 750.

Since then, three circuit courts have followed the Sixth Circuit's lead, applying variants of the *AutoStyle* federal rule of decision. See *Sender* v. *Bronze Grp., Ltd. (In re Hedged-Investments Assocs., Inc.)*, 380 F.3d 1292, 1298 (10th Cir. 2004) (noting that "[t]he Sixth Circuit recently applied such a multi-factor test from the tax cases to a bankruptcy recharacterization inquiry like the one now before us [in *AutoStyle*]. We now do the same."); *Cohen* v. *KB Mezzanine Fund II, LP (In re SubMicron Sys. Corp.)*, 432 F.3d 448, 455-456 (3d Cir. 2006) (describing that both the seven-factor test applied by a bankruptcy court and the *AutoStyle* multi-factor test "devolve to an overarching inquiry * * * whether the parties called an instrument one thing when in fact they intended it as something else"); *Fairchild Dornier GmbH* v. *Official Comm. of Unsecured Creditors (In re Dornier Aviation (N. Am.), Inc.)*, 453 F.3d 225, 233-234 (4th Cir. 2006) (quoting *AutoStyle*, 269 F.3d at 749-750); see also *Redmond* v. *Jenkins* (*In re Alternate Fuels, Inc.*), 789 F.3d 1139, 1146-1149 (10th Cir. 2015).

The Eleventh Circuit, which first addressed the issue long before *AutoStyle*, has a different formulation, but also applies a federal rule of decision. See *In re N & D Properties, Inc.*, 799 F.2d 726, 733 (1986). Under the Eleventh Circuit's two-pronged test, shareholder loans may be deemed capital contributions "where the trustee proves initial under-capitalization or where the trustee proves that the loans were made when no other disinterested lender would have extended credit." *Ibid.*

B. More Recent Decisions Have Adopted A State Law Rule Of Decision

In 2011, the Fifth Circuit concluded that debt recharacterization under the Bankruptcy Code, if appropriate at all, must be based on state law. *Grossman* v. *Lothian Oil Inc. (In re Lothian Oil Inc.)*, 650 F.3d 539 (2011), cert. denied sub. nom., *Lothian Cassidy, LLC* v. *Lothian Oil Inc.*, 132 S. Ct. 1573 (2012). *Lothian Oil* grounded its holding in Bankruptcy Code Section 502(b), which mandates that all claims "are deemed allowed" unless the bankruptcy court determines a claim is unenforceable under state law or the eight enumerated federal exceptions described above. *Id.* at 543 (citing *Butner* v. *United States*, 440 U.S. 48, 54 (1979)). In rejecting a court-created federal test for recharacterization, the Fifth Circuit explained that, "[t]aken together, *Butner* and § 502(b) support the bankruptcy courts' authority to recharacterize claims," but only pursuant to applicable state law. *Ibid.* If a claim for debt is disallowed under state law, because "state law classifies the interest as equity rather than debt, then implementing state law as envisioned in *Butner* requires different treatment than simply disallowing the claim," *i.e.*, by "recharacterizing the claim as an equity interest." *Ibid.* In light of that analysis, the Fifth Circuit observed that "resort to § 105(a) is unnecessary," which is, moreover, consistent with precedent reflecting "a cautious view of § 105(a)." *Ibid.* In *Lothian Oil*, the Fifth Circuit went on to apply Texas law, finding that because Texas had adopted the federal multifactor test as its state law rule and would not recognize the claim as debt, recharacterization was appropriate. *Id.* at 544.

Two years later, the Ninth Circuit followed the Fifth Circuit's lead, applying state law to determine whether to recharacterize debt. See *Official Comm. of Unsecured Creditors* v. *Hancock Park Capital II, L.P. (In re Fitness Holdings Int'l, Inc.)*, 714 F.3d 1141 (2013). Noting the split of authority created by *Lothian Oil*, the Ninth Circuit found that the Fifth Circuit's reasoning was more consistent with this Court's opinions requiring courts to determine whether a claim is allowed by reference to state law. *Id.* at 1148. The Ninth Circuit relied on this Court's decision in *Travelers* for the proposition that "courts may not rely on § 105(a) and federal common law rules 'of their own creation' to determine whether recharacterization is warranted." *Id.* at 1148-1149 (citing *Travelers Cas. & Sur. Co. of Am.* v. *Pac. Gas & Elec. Co.*, 549 U.S. 443, 451 (2007)). The Ninth Circuit remanded the case so that the debt obligation could be analyzed under a state law test. *Id.* at 1150. See *In re Fitness Holdings Int'l, Inc.*, No. 14-cv-1059 (C.D. Cal. Oct. 9, 2014), slip op. (applying California law on remand and holding claim not subject to recharacterization).

As noted above, the Fourth Circuit refused to grant rehearing en banc to reconsider its application of a federal rule of decision in light of the new Fifth and Ninth Circuit cases holding that debt recharacterization must apply a state law standard. Only this Court can provide a uniform approach to this important question.

II. A Federal Rule Of Decision For Debt Recharacterization Is Inconsistent With The Statutory Scheme And This Court's Jurisprudence

The Constitution grants Congress the power to enact "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const. art. I, § 8, cl. 4. Early rulings by this Court confirmed that the Constitution did not intend to preempt all state laws in this domain, but only laws in direct conflict with federal statutes. *Sturges* v. *Crowninshield*, 17 U.S. 122, 195 (1819); *Ogden* v. *Saunders*, 25 U.S. 213, 264 (1827); *Hanover Nat'l Bank* v. *Moyses*, 186 U.S. 181, 190 (1902); *Stellwagen* v. *Clum*, 245 U.S. 605, 613 (1918). Accordingly, the Bankruptcy Code does not "displace traditional state regulation" in the absence of a "clear and manifest" statutory intent permitting it to do so. *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 544 (1994) (citation omitted); see also *Kelly* v. *Robinson*, 479 U.S. 36, 52 (1986). In the absence of such intent, it ruled, the "Bankruptcy Code will be construed to adopt, rather than to displace, pre-existing state law." *BFP*, 511 U.S. at 544-545. And so it has long been held that one of the most fundamental rules in bankruptcy is that state law rules of decision apply to determining the validity and amount of claims, except where Congress adds specific federal rules of decision. *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 161 (1946) (*Vanston Bondholders*); see also *id.* at 170 (Frankfurter, J., concurring). This gives rise to the phenomenon that in bankruptcy there are some state law rules of decision and other federal rules of decision, *Travelers Cas. & Sur. Co. of Am.* v. *Pac. Gas & Elec. Co.*, 549 U.S. 443, 452-453 (2007), because the "uniformity" of bankruptcy

laws is not intended to "wip[e] out the differences among the [fifty] States in their laws governing commercial transactions," *Vanston Bondholders*, 329 U.S. at 172 (Frankfurter, J., concurring). Instead it allows "existing obligations of a debtor [to be] treated alike by the bankruptcy administration throughout the country regardless of the State in which the bankruptcy court sits." *Ibid.* The core of the debt recharacterization disagreement among the courts of appeals is whether (a) the doctrine is part of some general power of "bankruptcy administration" or (b) the "existing obligations of the debtor" based on the law of "the [fifty] States." *Ibid.*

A. State Law Is The Principal Rule Of Decision For Determination Of Claims, And There Is No Specific Federal Rule For Debt Recharacterization

Statutes are construed as a whole, including taking into account their structure. See, *e.g.*, *Kmart Corp.* v. *Cartier*, *Inc.*, 486 U.S. 281, 291 (1981); *Travelers*, 549 U.S. at 449-450. Determination of whether a creditor's claim is denied in bankruptcy occurs under Section 502(b), and the structure of the Bankruptcy Code and that provision is telling.[1] The statute first gives the bankruptcy court authority to disallow claims unen-

[1] Several courts acknowledge that debt recharacterization is a type of claim objection regardless of the rule of decision they apply. See *In re Insilco Techs., Inc.*, 480 F.3d 212, 217 (3d Cir. 2007); *Official Comm. of Unsecured Creditors of Russell Cave C*o. v. *Gen. Elec. Capital Corp.* (*In re Russell Cave Co.)*, 107 F. App'x 449, 451 (6th Cir. 2004); *FCC* v. *Airadigm Commc'ns*, *Inc.* (*In re Airadigm Commc'ns, Inc.)*, 616 F.3d 642, 659 (7th Cir. 2010).

forceable under "any agreement or applicable law." 11 U.S.C. 502(b)(1). That first clause of Section 502(b) refers to applicable *non-bankruptcy* law, which is generally state law. *Travelers*, 549 U.S. at 450.

After a general rule of disallowance based on state law, the remaining clauses of Section 502(b) provide additional federal grounds for disallowance that Congress has enacted. 11 U.S.C. 502(b)(2)-(9). Thus Congress knows how to draft federal rules for claims disallowance. Some of these statutory federal rules for claims disallowance even concern claims of insiders of bankrupt debtors, such as Sections 502(b)(4) and 502(b)(7). None of these provisions, however, would justify disallowing petitioner's claim and recharacterizing it as a capital contribution under a federal test. Indeed, the bankruptcy court specifically rejected respondents' causes of action for fraudulent conveyance and under the statutory provision allowing for equitable subordination of insider debt. App., *infra*, 34a-38a. Respondents furthermore did not challenge those findings on appeal, so they have waived those arguments. *Id.* at 2a, 10a, 11a, 17a.

Thus the most basic structure and text of the Bankruptcy Code's provisions regarding creditors' claims focus on state law rules of decision. They provide no support for a separate federal common law of debt recharacterization, and provide no support for recharacterizing the debt at issue here.

B. The Decision Below Is Inconsistent With This Court's Precedent That The "Basic Federal Rule" Is That State Law Determines Allowance Of Claims In Bankruptcy

This Court has repeatedly held that, where Con-

gress has not explicitly spoken, relying on state law rules of decision to determine the validity of claims in bankruptcy is equitable and ensures uniform treatment in state and federal courts, preserving creditors' expectations as to their rights, and granting them neither boon nor bane as a result of bankruptcy.

The earliest in the line of cases is *Vanston Bondholders*, in which the majority and concurring opinions agreed that the initial question regarding claims that arise prior to the bankruptcy is whether they are valid under state law. 329 U.S. 156. The majority explained that "[w]hat claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Id.* at 161. In his concurrence, Justice Frankfurter noted this rule was consistent with the Constitution because the authorization for Congress to adopt uniform federal bankruptcy laws was not intended to "wip[e] out the differences among the [fifty] States in their laws governing commercial transactions." *Id.* at 172-173.

The Court addressed a similar issue in *Butner* v. *United States*, which addressed the propriety of applying a federal rule of decision to determine whether to allow mortgagees secured claims for rents and profits based on federal judges' "perception of the demands of equity." 440 U.S. 48, 55 (1979). *Butner* held that "undefined considerations of equity provide no basis for adoption of a uniform federal rule affording mortgagees an automatic interest in the rents as soon as the mortgagor is declared bankrupt." *Id.* at 56. In so holding, the Court found that except for certain explicit statuto-

ry provisions, "Congress has * * * left the determination of property rights in the assets of a bankrupt's estate to state law." *Id.* at 54. It further found that applying a state law rule of decision prevented the inequity that would result if the bankruptcy court granted a "mortgagee rights that are not his as a matter of state law." *Id.* at 56.

More recently, relying on *Vanston Bondholders* and *Butner*, the Court held that a state law burden of proof applied in determining the validity of a state tax claim in bankruptcy. See *Raleigh* v. *Illinois Dep't of Revenue*, 530 U.S. 15, 22 (2000). *Raleigh* reasoned that because there was no statute specifically altering the state law burden of proof, state law provided the rule of decision and "[b]ankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides." *Id.* at 24-25. *Raleigh* also questioned the equity in applying a different burden of proof; the Court concluded that "equal treatment of comparable creditors in and out of bankruptcy" was itself a compelling equitable justification for the bankruptcy court to follow state law. *Id.* at 25.

In *Travelers*, the Court applied its analysis from *Vanston Bondholders*, *Butner*, and *Raleigh* to the statutory language of Section 502(b). 549 U.S. at 452. *Travelers* considered a judicially created federal rule denying attorneys' fees as part of the allowable amount of unsecured claims of creditors in bankruptcy, without regard to whether the creditor had an enforceable claim for those fees under state law. *Id.* at 447. The Court noted that the structure of 502(b) presumes a

claim shall be allowed if enforceable according to state law, unless it fits within one of the congressionally-created exceptions in 502(b)(2) through (9). *Id.* at 449-450. Because the lower court did not find the claim to be unenforceable under state law and none of the limited exceptions applied, the Court refused to disallow the claim. The Court explained that "claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed." *Id.* at 451-453.

C. The Decision Below Is Inconsistent With This Court's Direction That Bankruptcy Code Section 105(a) May Be Used Only In Furtherence Of Express Statutory Grants Of Authority

Without specific statutory authority for a federal rule of decision for debt recharacterization, the Third, Fourth, Sixth and Tenth Circuits have justified an independent federal rule of debt recharacterization based on Section 105(a). However, this Court has held that Section 105(a) is not a source of substantive federal bankruptcy law. In *Norwest Bank Worthington* v. *Ahlers*, the Court rejected a bankruptcy court's use of "a variety of 'equitable arguments'" and "equitable powers" to create an additional ground to justify confirmation of a chapter 11 plan of reorganization that was otherwise precluded by the statute. 485 U.S. 197, 206-207 (1988). "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Id.* at 206.

Therefore Section 105(a) cannot be the font of authority for a federal rule of decision for debt recharac-

terization. This would be tantamount to creating an additional ground to justify claim disallowance, just the result that *Norwest Bank* disapproves.

III. THE CHOICE OF A STATE OR FEDERAL RULE OF DECISION IS SIGNIFICANT TO BANKRUPTCY AND COMMERCIAL LAW, AND THIS CASE PRESENTS AN APPROPRIATE VEHICLE TO RESOLVE THE CIRCUIT CONFLICT

A. In This Case, The Rule of Decision For Debt Recharacterization Is Outcome Determinative

This case is an exceptionally good vehicle to resolve the circuit conflict, because it combines two critical qualities to present a clean, legal question for this Court.

First, there are no alternative grounds of decision. See, *e.g.*, *The Monrosa* v. *Carbon Black Export, Inc.*, 359 U.S. 180, 182-184 (1959) (dismissing the writ of certiorari as improvidently granted despite a circuit split because alternative grounds for relief existed). Indeed, the bankruptcy court held that where petitioners purchased the Paragon Primary Loan in good faith and at an arms-length price, it had to reject respondents' other causes of action and could only hold in favor of respondents on debt-recharacterization grounds. As described above, respondents sought debt recharacterization in addition to the statutory remedy of equitable subordination, because the latter requires bad faith and/or misconduct. The bankruptcy court's affirmative findings mean that equitable subordination could not apply. Similarly, the bankruptcy court rejected a fraudulent conveyance claim. Respondents did not challenge these holdings on appeal. The only claim that

now lies with respect to these respondents is a debt recharacterization claim.

Second, the difference between a federal and state rule of decision is outcome determinative in this case. See, *e.g.*, *United States* v. *Sommerville*, 324 F.2d 712 (3d Cir. 1963), cert. denied, 376 U.S. 909 (1964) (denying certiorari where the concurring opinion found that the rule of decision was not outcome determinative). States have long confronted the issue of the enforceability of advances by corporate insiders as debt. They have developed their own tests for adjudicating disputes based on traditional state law domains, such as contract, corporate and fraudulent-conveyance law. See, *e.g.*, *Marciano* v. *Nakash*, 535 A.2d 400, 405 (Del. 1987); *Obre* v. *Alban Tractor Co.*, 179 A.2d 861, 864 (Md. 1962); *Albert Richards Co.* v. *The Mayfair*, 191 N.E. 430, 433 (Mass. 1934); *Gilman* v. *F.O. Bailey Carriage Co.*, 141 A. 321, 323 (Me. 1928); *Lynes* v. *Helm*, 168 P.3d 651, 655 (Mont. 2007); *Royal Oak Realty Trust* v. *Mordita Realty Trust*, 777 A.2d 860, 864 (N.H. 2001); *Kalt* v. *Ritman*, 50 A.D.3d 469 (N.Y. 2008); *Fischer* v. *Streeter Milling Co.*, 234 N.W. 392, 394 (N.D. 1930); *Tanzi* v. *Fiberglass Swimming Pools, Inc.*, 414 A.2d 484, 490 (R.I. 1980); *Belcher* v. *Webb*, 29 P.2d 702, 704 (Wash. 1934); *Campbell* v. *Hutchinson Lumber Co.*, 145 S.E. 160 (W. Va. 1928); *In re Mader's Store for Men, Inc.*, 254 N.W.2d 171, 189 (Wis. 1977).

In some States, the rule of decision has become the same as the *AutoStyle* Factors, and such cases would not be appropriate for review. See, *e.g.*, *Grossman* v. *Lothian Oil Inc. (In re Lothian Oil Inc.)*, 650 F.3d 539, 544 (5th Cir. 2011), cert. denied sub. nom., *Lothian Cassidy, LLC* v. *Lothian Oil Inc.*, 132 S. Ct. 1573 (2012).

However, the relevant State here—North Carolina, where the bankruptcy case was filed, Debtor was formed, and the loan was made—has developed its own jurisprudence regarding the enforceability of advances as debt. North Carolina recognizes that "[t]he concept and elements of a 'loan' are well understood in both the popular and legal usage of the term." *Kessing* v. *Nat'l Mortgage Corp.*, 180 S.E.2d 823, 827 (N.C. 1971) (determining "loan" for purposes of usury statute). A loan is "a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which he borrows." *Ibid.* Adhering to this focus, North Carolina does not look to a multi-factor test like *AutoStyle* does. *AutoStyle*, for example, looks to whether there is a stated interest rate. Under North Carolina law, by contrast, the presence of interest does not matter—"a loan has been made upon 'the delivery by one party and the receipt by the other party of a given sum of money, on an agreement, express or implied, to repay the sum lent, *with or without interest*.'" *Ibid.* (emphasis added).

Recent North Carolina cases confirm that North Carolina does not follow the *AutoStyle* Factors. In *Cross* v. *Capital Transaction Group, Inc.*, the North Carolina Court of Appeals held that an obligation denominated as an "investment" gave rise to a "creditor" obligation (so that certain protections arose under workers compensation law). 661 S.E.2d 778, 783 (N.C. App. 2008). It reasoned that "the character of a transaction is not automatically changed * * * if we construe the agreement as requiring repayment * * * only in the event that their operations should prove successful. A loan is no less a loan because its repayment is made contingent." *Ibid.* (citations and quotations marks omi-

tted); see also *Bogovich* v. *Embassy Club of Sedgefield, Inc.*, 712 S.E.2d 257, 268 (N.C. App. 2011) (denying enforcement of a claim by an insider for advances, finding that, although the funds were used for corporate purposes, there were no instruments evidencing the debt, no fixed interest rate or payment schedule, and corporate approval was not received, but without considering the availability of third-party loans, the capitalization of the corporation, or the use of the advances to acquire capital assets, which are key factors under the federal multi-factor tests); *Bluebird Corp.* v. *Aubin*, No. 04 CvS 02563, 2006 WL 4511542 (N.C. Super. Dec. 5, 2006) (upholding insider real estate loan as a valid obligation but denying enforcement of claims for services, looking only to whether funds were loaned and services performed, not *AutoStyle* Factors), aff'd, 188 N.C. App. 671 (2008). On the facts of this case (involving the arms-length purchase of a third-party, new-money mortgage loan originally used to purchase capital assets for Debtor), a North Carolina court would undoubtedly reject recharacterization.

B. Resolving This Issue Is Vitally Important To Provide Certainty To Small Businesses

Debt recharacterization is not an obscure and rare bankruptcy doctrine. The rule does not just matter during the bankruptcy case—it matters when a party is deciding whether to make the loan before bankruptcy, with the intention to rescue the business and avoid bankruptcy. Many businesses struggle at some point, and they require infusions of cash to survive and later prosper. Additional uncertainty regarding repayment of a loan if bankruptcy ensues will discourage parties from making loans to rescue a struggling operation, as

well as the purchase of distressed debt by a party more inclined to work with the company to restructure its finances, and make business turnarounds less likely at the outset.

During "a very depressed real estate market" "in the aftermath of the worst recession in real estate," petitioner purchased the Paragon Primary Loan that was in default. App., *infra*, 30a, 36a. Petitioner's intervention allowed Debtor to stop foreclosure proceedings, and substituted in place of the foregoing creditor a party who supported a viable Chapter 11 plan.

As with all investments, many succeed, but some fail. When an investment is made in a troubled company, failure is even more likely, and bankruptcy a distinct possibility. These forms of insider support for a troubled company are therefore often challenged after-the-fact on the same grounds as here: equitable subordination, fraudulent conveyance and debt recharacterization. This Court should resolve the acknowledged conflict among the courts of appeals, and eliminate the uncertainty that currently exists in commercial law on these important questions.

The importance of, and tension created by, insider loans and loan purchases is a long-running dynamic in bankruptcy law. For over 140 years this Court has recognized the importance of insider loans to the chances of survival of struggling companies. In 1875, this Court refused to endorse "any rule" preventing an insider from loaning money "in good faith, and honestly to assist it in its business in an hour of extreme embarrassment" and obtaining a reasonable security interest. *Twin-Lick Oil Co.* v. *Marbury*, 91 U.S. 587, 588-589 (1875). It reasoned that such a rule "would deprive [the

corporation] of the aid of those most interested in giving aid judiciously, and best qualified to judge of the necessity of that aid, and of the extent to which it may safely be given," while "afford[ing] little protection to the corporation against actual fraud or oppression." *Id* at 589.

Indeed, even the circuit courts that have adopted the *AutoStyle* federal rule of decision have acknowledged that "[i]n many cases, an insider will be the only party willing to make a loan to a struggling business" and therefore had to caution that courts should not "discourage good-faith loans." *Fairchild Dornier GmbH* v. *Official Comm. of Unsecured Creditors (In re Dornier Aviation (N. Am.), Inc.)*, 453 F.3d 225, 234 (4th Cir. 2006). "[O]wners may often be the only party willing to make a loan to a struggling business, and needlessly punishing their efforts" is not "desirable as a social policy." *Redmond* v. *Jenkins* (*In re Alternate Fuels, Inc.*), 789 F.3d 1139, 1153 (10th Cir. 2015) (internal citation and quotation marks omitted). "[I]nsiders are the persons most interested in restoring and reviving the debtor, and such bona fide efforts should be viewed with approval." *Bayer Corp.* v. *MascoTech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 745 (6th Cir. 2001).

Yet the federal rule applied by the court of appeals raises precisely this concern. Because Debtor did end up in a bankruptcy court in the Fourth Circuit, petitioner's loan was recharacterized as a capital contribution, even though it would have been honored under North Carolina law, where all the relevant events took place.

Applying the *AutoStyle* test will discourage similar efforts in the future to rescue troubled companies. As many commentators have observed, if insiders are unsure whether the courts will honor their claims, they will be less likely to pursue the sort of efficient value-producing action taken by petitioner in this case. See, *e.g.*, Georgette Chapman Poindexter, *Dequity: The Blurring of Debt and Equity in Securitized Real Estate Financing*, 2 Berkeley Bus. L.J. 233, 261 n.99 (2005) (the ambiguity of recharacterization produces risk aversion for investors); Hilary A. Goehausen, *You Said You Were Going to Do What to My Loan? The Inequitable Doctrine of Recharacterization*, 4 DePaul Bus. & Com. L.J. 117, 141 (2005) (noting "far-reaching implications for start-up companies and small and medium-sized companies that seek funding from the all-American Bank down on Main Street"); Michael R. Tucker, *Debt Recharacterization During an Economic Trough: Trashing Historical Tests to Avoid Discouraging Insider Lending*, 71 Ohio St. L.J. 187, 209-221 (2010) (criticizing various factors under the federal multi-factor tests as unsuitable for determining the true nature of a transaction as debt or equity).

CONCLUSION

This Court should grant the petition and issue a writ of certiorari to resolve the substantial uncertainty that currently exists regarding the appropriate rule of decision for recharacterizing debt as capital contributions in bankruptcy proceedings.

Respectfully submitted,

DOUGLAS HALLWARD-DRIEMEIER
JAMES M. WILTON
D. ROSS MARTIN
GREGG M. GALARDI
GABRIELLE G. HIRZ
PATRICK M. ROY
ROPES & GRAY LLP

JOHN A. NORTHEN
VICKI L. PARROTT
NORTHEN BLUE LLP

Counsel for Petitioner

OCTOBER 2016

APPENDIX

APPENDIX A

UNPUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 15-1669

IN RE PROVINCE GRANDE OLDE LIBERTY, LLC, a/k/a Silver Deer Olde Liberty AA Lots, LLC,
Debtor.

PEM ENTITIES LLC,
Appellant

v.

PROVINCE GRANDE OLDE LIBERTY, LLC, Defendant, and ERIC M. LEVIN, and HOWARD SHAREFF,
Creditors- Appellees.

Appeal from the United States District Court for the Eastern District of North Carolina, at Raleigh. James C. Dever III, Chief District Judge. (5:14-cv-00889-D; 8:13-01563; 8:13-00122)

Argued: May 10, 2016
Decided: August 12, 2016

Before GREGORY, Chief Judge, TRAXLER, Circuit Judge, and Joseph F. ANDERSON, Jr., Senior United

States District Judge for the District of South Carolina, sitting by designation.

Affirmed by unpublished per curiam opinion.

ARGUED: John Arlington Northen, NORTHEN BLUE, LLP, Chapel Hill, North Carolina, for Appellant. James C. White, LAW OFFICE OF JAMES C. WHITE, P.C., Chapel Hill, North Carolina, for Appellees. **ON BRIEF:** Vicki L. Parrott, John Paul H. Cournoyer, NORTHEN BLUE, LLP, Chapel Hill, North Carolina, for Appellant. Michelle M. Walker, LAW OFFICE OF JAMES C. WHITE, P.C., Chapel Hill, North Carolina, for Appellees.

PER CURIAM:

PEM Entities, LLC ("PEM") appeals the district court's order affirming the bankruptcy court's grant of summary judgment in favor of Eric M. Levin and Howard Shareff ("Appellees"). Specifically, PEM contests the bankruptcy court's recharacterization of certain debt into equity. For the following reasons, we affirm the decision of the district court.

I.

This case arises out of several North Carolina real estate investments involving Howard Jacobsen ("Howard"). Lakebound Fixed Return Fund, LLC ("Lakebound") is a company formed to invest in real estate and provide a fixed, high-yield return to its investors. Lakebound is managed by Howard. Appellees invested $500,000.00 each into Lakebound. Province Grande Olde Liberty, LLC ("Debtor") is an entity formed by Howard for the purpose of acquiring the Olde Liberty

Golf and Country Club ("Golf Club"), a golf and residential real estate development in Franklin County, North Carolina. Debtor's membership included Howard, his parents-Stanley and Rhonda Jacobsen-and Robert B. Conaty.

To finance the acquisition of the Golf Club, Debtor obtained $188,000.00 from Lakebound and borrowed $6,465,000.00 from Paragon Commercial Bank ("Paragon"). The transfer of $188,000.00 from Lakebound to Debtor is the subject of ongoing litigation in North Carolina state court and provides a basis for Appellees claims in the underlying bankruptcy proceeding. Specifically, Appellees contend that this transfer was a misappropriation of Lakebound's funds. The $6,465,000.00 loan from Paragon was an arms-length transaction evidenced by a promissory note and secured by a deed of trust on the Golf Club property.

In 2010, Debtor defaulted on the Paragon loan. The following year, Paragon initiated foreclosure proceedings on the real estate security. In an effort to resolve the loans to Debtor and other entities, Howard, Debtor, and several other related entities entered into a settlement agreement with Paragon. Under that agreement, Paragon agreed to sell its $6,465,000.00 loan to a new company, PEM, for the discounted price of $1,242,000.00. PEM is a Delaware company, owned by Stanley Jacobsen - Howard's father, Robert B. Conaty, and an entity owned by trusts established by Stanley Jacobsen for the benefit of his grandchildren ("the Trust").

Importantly, PEM's members did not negotiate the settlement agreement. Rather, Debtor's principals, including Howard Jacobsen, negotiated the agreement

that purported to be "in settlement of the Loan." Paragon understood that Debtor's principals had the authority to bind PEM. Further, the settlement agreement bound Paragon to sell the loan to PEM for a fixed price and even included an outline of the financing of the loan's purchase. PEM, however, was not a signor of the settlement agreement.

To fund the loan purchase provision of the settlement agreement, PEM used both equity contributions from its members as well as outside debt. Stanley Jacobsen contributed $130,000.00, Conaty contributed $100,000.00, and the Trust contributed $70,000.00. Together, these three contributions totaled $300,000.00.

PEM relied on financing to assemble the remainder of purchase price. Two individuals, Joseph Deglomini and Joseph Simone (collectively "D&S"), loaned PEM $650,000.00. Additionally, Paragon agreed to loan PEM the final $292,000.00, interest free, needed to complete the settlement. Both loans were secured by Golf Club real estate owned not by PEM, but by Debtor. Finally, PEM agreed to subordinate its position in the security to the loans from both D&S and Paragon.

After the completion of the settlement agreement, Debtor sold some of its property for $462,146.15. From those funds, Debtor paid $240,120.00 directly to Paragon and D&S in partial payment of the loans those entities made to PEM. Debtor transferred $202,087.71 to PEM. Shortly thereafter, PEM "re-advanced" $50,000.00 to Debtor for miscellaneous operating expenses. At no time did PEM or Debtor maintain any ledger or account of the Paragon loan. Several other cash transfers went between Debtor and PEM and

Howard sometimes called "loans" and other times "readvances."

Debtor filed its bankruptcy petition on March 11, 2013. In that filing, it listed PEM's claim at $7,000,000, including the principal from the Paragon loan and accrued interest. Additionally, it listed Appellees as creditors with unknown and disputed claims. Appellees filed claims in the Debtor's bankruptcy proceeding in the amount of $500,000.00 each. They made claims for equitable subordination and recharacterization and also statutory claims for avoidance and recovery of allegedly fraudulent transfers. The parties moved for summary judgment on all claims.

The bankruptcy court granted summary judgment in favor of Appellees on their equitable claim of recharacterization. Specifically, the bankruptcy court concluded that the PEM's loan purchase was, in effect, a settlement and satisfaction of the Paragon loan. The court recharacterized the $300,000.00 portion of the $1,242,000.00 paid by PEM pursuant to the settlement agreement from a debt owed it by Debtor into an equity investment in Debtor. Thus, the court rendered PEM's $7,000,000.00 claim void.

PEM appealed the bankruptcy court's order to the United States District Court for the Eastern District of North Carolina. In its *de novo* review, the district court found the bankruptcy court correctly applied the law and affirmed its judgment. PEM timely filed its Notice of Appeal to this Court.

II.

A.

Recharacterization is well within the broad powers afforded a bankruptcy court. In re: Official Committee of Unsecured Creditors for Dornier Aviation (North America), Inc., 453 F.3d 225 (2006). The Bankruptcy Code establishes a scheme in which contributions to capital receive a lower priority than loans because their nature is that of a fund contributed to meet the obligations of a business and which should be repaid only after all other obligations have been satisfied. Id. at 231. Thus, adjudication under the Bankruptcy Code often requires a determination of whether a particular obligation is debt or equity. Id. When that question is in dispute, the bankruptcy court must make this determination in order to effectuate the priority scheme. Id.

In determining whether or not to recharacterize a claim, a bankruptcy court should apply the eleven factors adopted by this Court in Dornier:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to

> the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Id. at 233 (quoting Bayer Corp. v. Masco Tech, Inc. (In re AutoStyle Plastics, Inc.), 269 F.3d 726, 747-48 (6th Cir. 2001)). None of these eleven factors are themselves dipositive. Id. at 234. Rather, their significance varies depending upon the circumstance. Id.

B.

In this case, the bankruptcy court weighed each of the Dornier factors in analyzing the settlement agreement. The court found that all of them weighed in favor of recharacterization. The court emphasized several facts in drawing its conclusion: (1) the naming of the settlement agreement and the fact that it was entered into "in settlement of the loan"; (2) the fact that Debtor's principals negotiated the settlement agreement and note purchase on behalf of PEM; (3) the failure of both Debtor and PEM to observe any formalities such as payment schedules, actual interest payments or even a ledger; (4) Debtor's total reliance on money from PEM to meet expenses and its inability to obtain any other financing; (5) the identity of interests between Debtor and PEM; and (6) that approximately $900,000.00 of the $1,242,000.00 was funded by the pledge of security owned by Debtor. These facts adequately support the bankruptcy court's decision.

PEM contends that the bankruptcy court misapplied the Dornier factors by applying them to the wrong transaction. PEM argues that the bankruptcy court should have limited its analysis to the inception of

the Paragon debt rather than to the later settlement agreement. Thus, according to PEM, we should apply the Dornier factors to the situation at the time Paragon made the loan to Debtor. We find this argument unpersuasive.

The bankruptcy court's broad recharacterization power is "integral to the consistent application of the Bankruptcy Code." Dornier, 453 F.3d at 233. "A bankruptcy court's equitable powers have long included the ability to look beyond form to substance." Id. at 233. The recharacterization decision itself rests on the "substance of the transaction" involved. Id. at 232 (emphasis in original).

Here, the settlement agreement is the "substance of the transaction" because it was the basis of the note purchase and gave rise the PEM's claims. The settlement agreement was negotiated and executed by Paragon and Debtor's principals. While PEM notes that it was neither a party to nor a signor of the settlement agreement, Paragon believed Debtor's principals had the authority to bind PEM. Further, the settlement agreement specifically obligated Paragon to sell the loan to PEM. Indeed, the settlement agreement specifically outlined the sources of PEM's funding. It even obligated Paragon to loan PEM $292,000.00. Clearly, PEM knew of, participated in, and consented to those terms. While PEM itself may not have been obligated by the settlement agreement, the settlement agreement certainly obligated Paragon towards PEM.

Thus, the bankruptcy court properly "looked beyond form" to determine that the "substance of the transaction" was in fact the settlement agreement in which Debtor used PEM as an extension of itself to

complete what was, in effect, a satisfaction of the Paragon loan. Moreover, the bankruptcy court's application of the Dornier factors adequately supported its recharacterization decision.

C.

PEM challenges several of the bankruptcy court's factual findings. Findings of fact by a bankruptcy court in proceedings within its full jurisdiction are reviewable only for clear error. In re Johnson, 960 F.2d 396, 399 (4th Cir. 1992). Under this standard, we will not reverse a bankruptcy court's factual finding that is supported by the evidence unless that finding is clearly wrong. In re ESA Envtl. Specialists, Inc., 709 F.3d 388, 399 (4th Cir. 2013). We will conclude that a finding is clearly erroneous only if, after reviewing the record, we are left with "a firm and definite conviction that a mistake has been committed." Klein v. PepsiCo, Inc., 845 F.2d 76, 79 (4th Cir. 1988) (citation omitted).

Of the six errors claimed by PEM, none rise to the level of clear error. First, PEM challenges the court's alleged mischaracterization of both the $300,000.00 contribution by the members of PEM and the relief requested by Appellees. The bankruptcy court recharacterized the $300,000.00 portion of the $1,242,000.00 settlement of the $7,000,000.00 claim or in other words, exactly the relief sought by Appellees. The court made a detailed explanation of all the intricate moving parts of this complex dispute. To the extent the court failed to clearly explain each moving piece, it was not due to any mistaken fact, but rather to the unwieldy jargon associated with this type of litigation.

Next, PEM contends the court was in error by stating that Stanley Jacobsen was the sole member of

PEM at the time of the settlement agreement. This fact appears to be incorrect as the evidence, discussed above, is that the members of PEM were Stanley Jacobsen, Robert B. Conaty, and the Trust. However, this minor mistake does not rise to the level of clear error. First, the court made this mistake in its recitation of undisputed facts. Secondly, the court obviously understood that PEM's membership included all three members at all relevant times. In its analysis of the first Dornier factor, the court specifically noted that these three members were responsible for the $300,000.00.

PEM's four other claims of errors merely reargue the proper application of the Dornier factors. None constitute clear error.

III.

For the foregoing reasons, the judgment of the district court is **AFFIRMED**.

AFFIRMED

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NORTH
CAROLINA
WESTERN DIVISION

NO. 5:14-CV-889-D

IN RE PROVINCE GRANDE OLDE LIBERTY,
LLC, et al.,

PEM ENTITIES LLC, Appellant,

v.

ERIC M. LEVIN, and HOWARD SHAREFF,
Appellees.

ORDER

In this appeal from the United States Bankruptcy Court for the Eastern District of North Carolina, PEM Entities, LLC ("PEM" or "appellant") contends that the bankruptcy court erred in granting summary judgment to Eric M. Levin and Howard Shareff ("appellees"). Essentially, PEM contends that the bankruptcy court erroneously applied In re Official Committee of Unsecured Creditors for Dornier Aviation (North America). Inc., 453 F.3d 225 (4th Cir. 2006), in recharacterizing PEM's debt as equity. As explained below, the court affirms the bankruptcy court's judgment.

I.

Because the underlying motion for summary judgment involved a core matter, the bankruptcy court possessed the constitutional authority to enter a final

judgment on the motion, and this court has jurisdiction over the appeal. See, e.g., 28 U.S.C. § 158(a); Exec. Benefits Ins. Agency v. Arkison, 134 S. Ct. 2165, 2170-75 (2014); Stern v. Marshall, 131 S. Ct. 2594, 2619-20 (2011). The parties also consented to the bankruptcy court's resolution of their dispute. See Wellness Int'l Network, Ltd. v. Sharif, No. 13-935, 2015 WL 2456619, at *9, *13 (U.S. May 26,2015).

This court reviews a bankruptcy court's conclusions of law de novo and reviews its findings of fact for clear error. See, e.g., Sartinv. Macik, 535 F.3d 284, 287 (4th Cir. 2008); In re White, 487 F.3d 199, 204 (4th Cir. 2007); In re Duncan, 448 F.3d 725, 728 (4th Cir. 2006). The court reviews de novo an order granting a motion for summary judgment. See, e.g., Scott v. Harris, 550 U.S. 372, 378-80 (2007); Celotex Corp. v. Catrett, 477 U.S. 317, 322-24 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986); Matsushita Elee. Indus. Co. v. Zenith Radio Corp.,475 U.S. 574, 585-87 (1986); Nader v. Blair, 549 F.3d 953, 958 (4th Cir. 2008).

Eric Levin and Howard Shareff invested $1,000,000 in Lakebound Fixed Return Fund, LLC ("Lakebound"). See Levin Decl. [D.E. 13-11] ¶¶3-5; Shareff Decl. [D.E. 13-12] ¶¶ 3-7. Lakebound was supposed to invest in real estate and provide a fixed return to its investors. Lakebound did not perform as expected, and individuals and entities associated with Lakebound (including Levin and Shareff) are litigating in North Carolina Business Court. Two defendants in the state-court action are CILP Acquisition, LLC ("CILP") and Province Grande Olde Liberty, LLC ("Province Grande"). Province Grande also is the debtor in the underlying Chapter 11 bankruptcy in this court. See Chapter 11

Voluntary Petition, In re Providence Grande Olde Liberty, LLC, 13- 1563-8-SWH (Bankr. E.D.N.C. Mar. 11, 2013), [D.E. 1].

Levin and Shareff allege that Province Grande misappropriated $188,000 from Lakebound in order to close Province Grande's 2009 purchase of certain land out of a foreclosure sale. See [D.E. 12-2] ¶¶ 18-20, 24; Levin Decl. [D.E. 13-11] ¶¶ 7-8; Shareff Decl. [D.E. 13-12] ¶¶ 8-9. Province Grande admits receiving the $188,000, but contends that Lakebound lent it those funds. [D.E. 13-1] ¶ 24. Levin and Shareff respond that the alleged loan from Lakebound to Province Grande violated Lakebound's Operating Agreement, that no documentation supports Province Grande's contention concerning a loan, and that Province Grande converted the $ 188,000. See [D.E. 12-2] ¶¶ 24-26; Levin Decl. [D.E. 13-11] ¶¶ 4-8; Levin Decl., Ex. A [D.E. 13-11] 3-34; Shareff Decl. [D.E. 13-12] ¶¶ 5-9. Notably, the bankruptcy court found that Province Grande used that $188,000, plus a $6,465,000 loan from Paragon Commercial Bank ("Paragon") secured by a deed of trust, to purchase the land out of foreclosure. See [D.E. 1-2] 3; PEM 30(b)(6) Dep. [D.E. 13-7] 15; [D.E. 13-6] 1; cf [D.E. 13-13] 167.

The dispute at issue in this appeal concerns the settlement of Province Grande's $6,465,000 debt to Paragon. Specifically, in late 2011, Paragon began foreclosure proceedings against Province Grande. In addition, Paragon sought to recover from Howard Jacobson and Richard Wolf, who had personally guaranteed the $6,465,000 loan. See [D.E. 12-2] ¶¶ 30-33; [D.E. 13-1] ¶¶ 30-33. On March 2, 2012, Province Grande, Jacobson, Wolf, CILP, and Paragon entered into a settlement

agreement resolving the $6,465,000 debt and resolving a loan from Paragon to CILP that secured other portions of the land. See Paragon 30(b)(6) Dep. [D.E. 13-5] 20; [D.E. 13-6] 22-45 ("Settlement Agreement").

PEM is a Delaware limited liability company that Stanley Jacobson, Howard Jacobson's father, and Eric Martins formed on December 6, 2011. See PEM 30(b)(6) Dep. [D.E. 13-7] 35-36, 52. Stanley Jacobson is an "insider" of Province Grande under 11 U.S.C. § 101(31). [D.E. 20] 7; [D.E. 13-8] 13.[1] According to Levin

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[1] 11 U.S.C. § 101(31) states:

> The term "insider" includes-
> (A) if the debtor is an individual-
> (i) relative of the debtor or of a general partner of the debtor;
> (ii) partnership in which the debtor is a general partner;
> (iii) general partner of the debtor; or
> (iv) corporation of which the debtor is a director, officer, or person in control;
> (B) if the debtor is a corporation-
> (i) director of the debtor;
> (ii) officer of the debtor;
> (iii) person in control of the debtor;
> (iv) partnership in which the debtor is a general partner;
> (v) general partner of the debtor; or
> (vi) relative of a general partner, director, officer, or person in control of the debtor;
> (C) if the debtor is a partnership-
> (i) general partner in the debtor;
> (ii) relative of a general partner in, general partner of, or person in control of the debtor;
> (iii) partnership in which the debtor is a general partner;
> (iv) general partner of the debtor; or
> (v) person in control of the debtor;
> (D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;

and Shareff, Stanley Jacobson ostensibly created PEM to acquire the $6,450,000 bank notes from Paragon, but Jacobson really created PEM to strip equity from Province Grande and prevent payment to Levin and Shareff, who are Province Grande creditors. In support of their argument, Levin and Shareff note that PEM is not a party to the Settlement Agreement. Nevertheless, PEM agreed to purchase the Paragon loan of approximately $6,465,000 for the steeply discounted price of $1,242,000. See [D.E. 13-6] 25. Moreover, Paragon negotiated this purchase with Howard Jacobson and Wolf, and never met or negotiated with any PEM representatives. See PEM 30(b)(6) Dep. [D.E. 13-7] 52; Paragon 30(b)(6) Dep. [D.E. 13-5] 36-37.

In order to fund the $1,242,000 purchase, Province Grande pledged two deeds of trust against its land for PEM's benefit. The first deed of trust for $292,000 secured a zero-percent loan from Paragon to PEM that PEM, in turn, used to finance PEM's discounted purchase of the Paragon loan. See [D.E. 13-6] 25, 46. Province Grande also executed a second deed of trust, pledging other property to secure a $650,000 loan that PEM, in turn, used to purchase the Paragon debt. See Paragon 30(b)(6) Dep. [D.E. 13-5] 49; PEM 30(b)(6) Dep. [D.E. 13-7] 80; [D.E. 13-6] 55. PEM contributed the remaining $300,000 to fund the purchase of the Paragon debt, and it is this contribution that Levin and Shareff seek to have recharacterized as equity. [D.E. 1-2] 6.

(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and

(F) managing agent of the debtor.

11U.S.C. § 101(31).

On March 11, 2013, Province Grande filed its bankruptcy petition. See Chapter 11 Voluntary Petition, In re Providence Grande Olde Liberty, LLC, 13-1563-8-SWH (Bankr. E.D.N.C. Mar. 11, 2013), [D.E. 1]. Province Grande listed PEM's claim as a secured claim of $7,000,000. See id. at 5; Amended Schedules at 1,4, In re Providence Grande Olde Liberty, LLC,13-1563-8-SWH (Bankr. E.D.N.C. May 17, 2013), [D.E. 72-1]. Province Grande listed Levin and Shareff as creditors with unknown and disputed claims. Chapter 11 Voluntary Petition at 4-5, In re Providence Grande Olde Liberty, LLC,13-1563-8-SWH (Bankr. E.D.N.C. Mar. 11, 2013), [D.E. 1].

The bankruptcy court had to decide, inter alia, how to analyze the Paragon loan and the relationship between Province Grande and PEM. The bankruptcy court examined PEM's "acquisition" of the $6,450,000 Paragon loan for $1,242,000. The bankruptcy court focused on whether the acquisition, in substance, was Province Grande's satisfaction of the notes to Paragon. Tellingly, an insider of Province Grande formed PEM, and PEM funded three quarters of the purchase price with loans that Province Grande's property secured. Moreover, Province Grande's principals (not PEM's principals) negotiated the transaction with Paragon as part of a settlement agreement involving Province Grande and Paragon. See [D.E. 1-2] 7.

The bankruptcy court thoroughly analyzed the eleven factors described in Dornier Aviation in deciding whether to recharacterize PEM's $7,000,000 claim. See id. 6-14.[2] The bankruptcy court concluded that it could

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[2] A bankruptcy court may consider the following factors in determining whether to recharacterize a claim:

recharacterize PEM's $300,000 contribution towards the $1,242,000 settlement as an equity contribution that allowed Province Grande to satisfy its debt to Paragon. See id. 13-14.

This court has reviewed the record and the relevant cases and concludes that the bankruptcy court acted within its discretion under Dornier Aviation. See Dornier Aviation, 453 F.3d at 231-33. Furthermore, the court agrees with Levin and Shareff that the bankruptcy court's conclusions are correct.

II.

In sum, the judgment of the bankruptcy court is AFFIRMED.

SO ORDERED. This 1st day of June 2015.

JAMES C. DEVER III
Chief United States District Judge

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Dornier Aviation, 453 F.3d at 233.

APPENDIX C

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
RALEIGH DIVISION

Case No. 13-01563-8-ATS

Chapter 11

IN RE PROVINCE GRANDE OLDE LIBERTY, LLC, Debtor.

Adversary Proceeding

No. 13-00122-8-ATS

ERIC M. LEVIN, and HOWARD SHAREFF, Plaintiffs,

v.

PEM ENTITIES LLC, AND PROVINCE GRANDE OLDE LIBERTY, LLC, Defendants.

ORDER

Pending before the Court is the Plaintiffs' Motion tor Summary Judgment, the Brief in Support of Plaintiffs' Motion for Summary Judgment and the Supplement to the Motion for Summary Judgment filed by the Eric M. Levin and Howard Shareff (the "Plaintiffs") on September 15, 2014, the Response of PEM Entities, LLC to Plaintiffs' Motion for Summary Judgment filled by PEM Entities, LLC ("PEM") on October 9, 2014, and the Response in Opposition to Motion for Summary Judgment filed by Province Grande Olde Liberty, LLC (the "Debtor") on October 9, 2014. The Court conducted a hearing in Greenville, North Carolina on November 3, 2014, to consider these matters.

PROCEDURAL HISTORY

On March 11, 2013, the Debtor filed a petition for relief under Chapter 11 of the United States Bankruptcy Code (the "Code") and is a debtor in possession. The Plaintiffs filed the Complaint in this adversary proceeding on July 25, 2013 in which they asserted claims of equitable subordination and recharacterization of the claim of PEM, pursuant to 11 U.S.C. §§ 105(a) and 510(c). The Complaint also includes a cause of action for avoidance and recovery of alleged fraudulent transfer pursuant to 11 U.S.C. §§ 544, 548(a)(1), 550, 551, and the North Carolina Uniform Fraudulent Transfer Act, N.C. Gen. Stat. § 39-23.1 et seq; N.C. Gen. Stat. § 44A-4(g).

On September 15, 2014, the Plaintiffs moved the Court pursuant to Rule 56 of the Federal Rules of Civil Procedure, as made applicable by Rule 7056 of the Federal Rules of Bankruptcy Procedure, for summary judgment on the ground that there are no genuine issues as to any material facts. The Plaintiffs state they are entitled to a judgment as a matter of law on their claims for recharacterization of PEM's debt to equity, equitable subordination of PEM's debt and the claim for recovery of fraudulent transfers from the Debtor to PEM. PEM moves the Court to enter summary judgment in favor of PEM on all claims asserted by the Plaintiffs. The Plaintiffs, PEM, and the Debtor take the position that there are no genuine issues of material fact and this matter is ripe for decision.

UNDISPUTED FACTS

Howard Jacobson, the principal of the Debtor, formed Lakebound Fixed Return Fund, LLC ("Lakebound"). The Plaintiffs invested one million dollars into Lakebound. The Debtor obtained funds from Lake-

bound in the amount of $188,000.00 in order to close the purchase of the Debtor's principal asset.

As of the date of the petition, the Debtor's principal asset consisted of developed and undeveloped land, divided into lots, in the Olde Liberty Golf and Country Club (the "Olde Liberty Club"), a golf and single-family home development project in Franklin County, North Carolina. In order to purchase the Olde Liberty Club, the Debtor borrowed $6,465,000.00 from Paragon Commercial Bank ("Paragon" and the "Debtor's Paragon Loan"). The Debtor also obtained $188,000.00 from Lakebound for the remainder of the purchase price (the "Lakebound Funds"). In 2010, the Debtor defaulted on the Debtor's Paragon Loan. In 2011, Paragon began foreclosure proceedings on the note securing the Debtor's Paragon Loan.

On March 2, 2012, the Debtor, Howard Jacobson, Richard Wolf, CLIPS Acquisition, LLC ("CLIPS") and Paragon entered into a settlement agreement resolving the Debtor's Paragon Loan and a loan from Paragon to CLIPS, an entity which is also controlled by Howard Jacobson (the "Settlement Agreement"). The loan from Paragon to CLIPS was also secured by a number of lots of the Olde Liberty Club, the Debtor's principal asset.

The defendant PEM, is a Delaware limited liability company that was formed in December 2011 by Stanley Jacobson, Howard Jacobson's father. Stanley Jacobson was the sole member of PEM at the time of the execution of the Settlement Agreement. Stanley Jacobson and PEM are insiders of the Debtor pursuant to 11 U.S.C. § 101(31). The members of the Debtor include, but are not limited to Howard Jacobson as AJHRLT Holdings, LLC, Robert B. Conaty, Stanley and Rhoda

Jacobson, Richard Wolfe and several others. Under the Settlement Agreement, Paragon would transfer to PEM the Debtor's Paragon Loan, which was in the principal amount of $6,465,000.00, for the discounted price of $1,242,000.00. In order to fund the settlement of the Debtor's Paragon Loan, PEM borrowed $292,000.00 from Paragon ("PEM's Paragon Loan"). The settlement of the Debtor's Paragon Loan was funded by two deeds of trust pledged by the Debtor against its principal asset, Olde Liberty Club, for the benefit of PEM. The first deed of trust, in the amount of $292,000.00 for PEM's Paragon loan, secures a zero-percent loan from Paragon to PEM (the "First Deed of Trust"). The Debtor also entered into a second deed of trust, pledging additional property in Olde Liberty Club to secure an additional loan for funds that PEM used to settle the Debtor's Paragon Loan. The second deed of trust states that PEM is indebted to Joseph Deglomini ("Deglomini") and Joseph Simone ("Simone") in the amount of $650,000.00 (the "Deglomini-Simone Deed of Trust"). Deglomini and Simone required the Debtor to pledge a number of lots in the Debtor's principal asset, the Olde Liberty Club, and required subordination of the Debtor's Paragon Loan as a condition of Deglomini and Simone making the $650,000.00 loan.

PEM's claim for the purchase of the Debtor's Paragon Loan was designated by the Debtor in the Debtor's schedules as a secured claim in the amount of $7,000,000.00. The Debtor's schedules also reflect that Lakebound has a general unsecured claim in the amount of $188,000.00 for the Lakebound Funds. On July 3, 2013, each Plaintiff filed a claim in the Debtor's bankruptcy proceeding in the amount of $500,000.00.

DISCUSSION

The Plaintiffs and the Defendants have all moved for summary judgment and are in agreement that no genuine issue of material facts exist in this case. "[S]ummary judgment is proper if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett,* 477 U.S. 317, 322 (1986) (internal quotations omitted). In making this determination, conflicts are resolved by viewing all facts and all reasonable inferences in the light most favorable to the non-moving party. *United States v. Diebold, Inc.,* 369 U.S. 654, 655 (1962). "Only disputes between the parties over facts that might affect the outcome of the case properly preclude the entry of summary judgment." *Nationwide Mut. Ins. Co. v. McMahon*, 365 F. Supp. 2d 671, 674 (M.D.N.C. 2005) (citing *Anderson v. Liberty Lobby, Inc.* 477 U.S. 242, 247-48 (1986)). Accordingly, the court must examine "both the materiality and the genuineness of the alleged fact issues" in ruling on this motion. *Id.* (citing *Faircloth v. United States*, 837 F. Supp. 123, 125 (E.D.N.C. 1993)).

The Fourth Circuit has recognized the affirmative obligation of the "trial judge to prevent 'factually unsupported claims and defenses' from proceeding to trial." *Felty v. Gres-Humphreys Co.*, 818 F.2d 1126, 1128 (4th Cir. 1987) (citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S. Ct. 2548, 2553, 91 L.Ed. 2d 265 (1986)). "[T]here is no issue for trial unless there is sufficient evidence favoring the non-moving party for a jury to return a verdict for that party . . . If the evidence is

merely colorable . . . or is not significantly probative, summary judgment may be granted." *Glover v. Lockheed Corp.*, 772 F. Supp. 898, 904 (D. S.C. 1991) (quoting *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986)).

I. The Recharacterization of PEM's Claim from a Debt to an Equity Contribution.

PEM contributed $300,000.00 to fund the purchase of the Debtor's Paragon Loan (the "PEM Contribution"). The Plaintiffs contend that this PEM Contribution should be recharacterized from a debt in the Debtor's bankruptcy case to an equity contribution. The $300,000.00 was contributed by several entities including: Stanley Jacobson in the amount of $130,000.00 as a capital contribution; Robert B. Conaty in the amount of $100,000.00 as a capital contribution; and a $70,000.00 capital contribution from AIHL. AIHL is a trust established for the benefit of Stanley Jacobson's grandchildren. Stanley's middle son, Andrew Jacobson, is the trustee of the trusts that owns AIHL. *Stanley L. Jacobson Affidavit*, ¶17. AIHL was not at any time a member of the Debtor.

This Court has the authority to recharacterize a claim from a debt to an equity contribution when an analysis of the circumstances reveals that the contribution is more appropriately an equity contribution. A bankruptcy court's equitable powers have long included the ability to look beyond form to substance. *In re Official Committee of Unsecured Creditors for Dornier Aviation(North America), Inc.*, 453 F.3d 225, 231(4th Cir.2006); See *Pepper v. Litton*, 308 U. S. 295, 305; 60 S.Ct. 238, 84 L.Ed.281(1939). Further, "the Courts exercise of this power to recharacterize is essential to the

implementation of the Code's mandate that creditors have a higher priority in bankruptcy than those with an equity interest." *Dornier Aviation*, 453 F.3d at 233.

According to the Fourth Circuit in *Dornier Aviation*, this Court should look to certain enumerated factors to determine whether the Court should recharacterize debt to equity. These factors include: (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments. *Id.* at 233.

The first *Dornier Aviation* factor, which considers the names given to the instruments evidencing the indebtedness, supports a holding that the PEM Contribution is an equity contribution. The instrument evidencing the debt in this matter is the Settlement Agreement. The Settlement Agreement was signed by CLIPS, Howard A. Jacobson, Richard E. Wolf, Paragon, and the Debtor. Significantly, the Settlement Agreement explicitly stated that all terms, including that the transfer of the Debtor's Paragon Loan to PEM, are made "in settlement of the Loan." *Paragon Depo.*, Exh. 4, at Section 3.2(a). Richard Wolf was man-

aging member of CLIPS, which was an entity involved along with the Debtor in the development of the Olde Liberty Club. *It is undisputed that PEM was never a party to this Settlement Agreement.* PEM preferred the Debtor's principals to negotiate the settlement. Stanley Jacobson requested that Howard Jacobson and Richard Wolfe negotiate the Settlement Agreement. *Stanley L. Jacobson Affidavit,* ¶14. Stanley Jacobson further requested that Howard Jacobson and Richard Wolfe not disclose to PEM and keep confidential that he was to be the driving force behind PEM's purchase of the Debtor's Paragon Loan. *Id* at ¶14. The Settlement Agreement, which by its terms allowed for the purchase of the Debtor's Paragon Loan, was executed only by equity owners of the Debtor, Howard Jacobson, and Richard E. Wolf.

In addition, this Court looks beyond the form or names given to the instrument evidencing the indebtedness to the substance of the transaction and its terms, as instructed by the court in *Dornier Aviation.* 453 F.3d at 231. The terms of the Settlement Agreement stated that the agreement was made "in settlement of the Loan," which refers to the Debtor's Paragon Loan and deed of trust held by Paragon in the original amount of $6,465,000.00. As stated, PEM was not a party to the Settlement Agreement, and the focus of the Settlement Agreement was to settle the Debtor's Paragon Loan with the Debtor and its insider guarantors Richard Wolf and Howard Jacobson. This Settlement Agreement was not intended as an assignment of the Debtor's Paragon Loan to PEM. Even though PEM was not a signer to the Settlement Agreement, PEM, as a third party, purchased the $6,465,000.00 Debtor's Paragon Loan for $1,242,000.00. The additional monies

acquired by PEM came from PEM's Paragon Loan in the amount of $292,000.00 and $650,000.00 loaned to PEM by Deglomini and Simone secured by the Deglomini-Simone Deed of Trust *on portions of the Debtor's Olde Liberty Club property. The Debtor's Paragon Loan was subordinated to the Deglomini-Simone Deed of Trust and the PEM Paragon Loan.* Monies to repay these loans owed to PEM came from money generated by the sales of the Debtor's Old Liberty Club real estate. *Paragon Depo*, Exh. 4 at 4, Exh. 6; PEM Depo. Vol. 1 at 48:23-49:8.

In effect, Stanley Jacobson, Robert Conaty, and AIHL purchased the Debtor's Paragon Loan, consisting of a $6,465,000.00 note and deed of trust, for a true equity investment total of $300,000.00. The Debtor pledged sufficient collateral for PEM's Paragon Loan of $292,000.00, and the Deglomini and Simone loan of $650,000.00, but pledged nothing for the $300,000.00 truly invested by Stanley Jacobson, Richard Conaty, and AIHL.

The Debtor's Chapter 11 Plan, in the above captioned bankruptcy case, provided that the Debtor would surrender all property owned by the Debtor, except for 35 lots in Old Liberty Club, in exchange for a reduction in balance on the note held by PEM for the purchase of the Debtor's Paragon Loan. This reduction would reduce the balance of the Debt for the purchase of the Debtor's Paragon Loan from $6,450,000.00 to $3,000,000.00. Therefore, when PEM, which is controlled by the Debtor's insiders, voted in favor of the Debtor's Chapter 11 Plan treatment of PEM, PEM received what amounted to an approximately 300% increase in real estate value on the Old Liberty Club

property. The 300% increase in value occurred from the date of the execution of the Settlement Agreement of March 2, 2012, to the date of the filing of the original Chapter 11 Plan on June 10, 2013. After thorough examination of the substance and terms of the Settlement Agreement, the recharacterization of the debt in question to an equity contribution is supported by the first factor enumerated by *Dornier Aviation* as a matter of law.

The second *Dornier Aviation* factor considers the presence or absence of a fixed maturity date and schedule of payments. The third *Dornier Aviation* factor considers the presence or absence of a fixed rate of interest and interest payments. The fourth *Dornier Aviation* factor considers the source of payments. The Debtor's Paragon Loan in the amount of $6,465,000.00 did have as its original terms a payment of $30,000.00 per year with all principal and interest due on or before February 28, 2017. However, after the Settlement Agreement was executed, there is absolutely no evidence that any new terms of payment or maturity were negotiated or put in writing by the Debtor and PEM. It is uncontroverted that all of the Debtor's revenue was received directly by PEM. *See PEM Depo.* Vol. 1 at 82:8-20. In spite of receiving all of the Debtor's revenue, PEM admitted that no ledger or accounting journal is maintained in regard to the $6,465,000.00 note. *PEM Depo.* Vol. 2 at 14:6-21,23:9-12. Further, Stanley Jacobson, the sole member of PEM had no knowledge of any terms of repayment of the $6,465,000.00 note for the purchase of the Debtor's Paragon Loan. *PEM Depo.* Vol. 1 at 81:17-23. PEM admitted that it expects no regular payments because Debtor has no source for such payments. *PEM Depo.* Vol. 1 at 84:3-8. No evi-

dence of a fixed maturity date was presented. No schedule of repayments of the principal balance nor evidence of interest or interest repayment was provided. These undisputed facts provide further evidence to this Court that a recharacterization is appropriate as a matter of law.

Particularly relevant in this matter is the fifth *Dornier Aviation* factor which examines the adequacy or inadequacy of capitalization. It is uncontroverted that the Debtor has no adequate capitalization. The only monies that the Debtor receives to operate are payments from PEM to the Debtor from the sale of the lots in the Old Liberty Club. See *PEM Depo.* Vol. 2, Exh 17. As evidenced by PEM's admission mentioned above, the Debtor has no source with which to make payments on its debts. Further, the Debtor's monthly operating reports show the Debtor holds no cash and relies on capital contributions from members to pay the Debtor's quarterly fees. In 2011, with the foreclosure of the Debtor's Paragon Debt nearing, Howard Jacobson and Richard Wolf approached Stanley Jacobson in an effort to solicit additional capital contributions. *Stanley Jacobson Affidavit* ¶4, *Richard E. Wolf Affidavit*, ¶44, *Howard Jacobson Affidavit*, ¶10. Those efforts to have members of the Debtor contribute additional capital were unsuccessful. Instead of making an additional capital contribution to pay off the Debtor's Paragon Loan at the discounted amount, Stanley Jacobson began his efforts to purchase the note and deed of trust for the Debtor's Paragon Loan. Rather than continuing to solicit capital contributions for the Debtor or solicit other potential investors, Stanley Jacobson focused his efforts on soliciting capital contributions for participation in a new entity, PEM. *Howard Jacobson Affidavit*, ¶24;

Stanley L. Jacobson Affidavit, ¶18. After the capital contributions were solicited for PEM, Stanley Jacobson directed PEM to purchase the note from Paragon for the Debtor's Paragon Loan. The Debtor did not have enough capital to prevent foreclosure and could not raise adequate capital contributions from its members. An application of the fifth *Dornier Aviation* factor further supports recharacterization of this debt to equity as the under capitalization of the Debtor is evident as a matter of law.

The formation of PEM and its members for the purposes of purchasing the Debtor's Paragon Loan is examined in an application of the sixth *Dornier Aviation* factor. This factor scrutinizes the identity of interest between the creditor and stockholders. All but one of the current members of PEM are members who were added as a result of the capital contributions are insiders of the Debtor pursuant to 11 U.S.C. § 101(31). The members of PEM who are also insiders of the Debtor are: Stanley and Rhoda Jacobson, Robert B. Conaty, A&M, LLC, Ron Serbin, and Howard Jacobson. *See Debtor's Petition; Responses of PEM Entities, LLC to Plaintiffs ' First Set of Interrogatories* at 6. Further, during the negotiation of the Settlement Agreement, Paragon's representatives dealt solely with principals of the Debtor, Howard Jacobson and Richard Wolf. *PEM Depo.* Vol. 1 at 52:1-3. An examination of the identity of interest in the creditor and stockholder relationship supports the holding of the Court that the $300,000.00 debt should be recharacterized as equity as a matter of law.

The seventh *Dornier Aviation* factor seeks discovery of the security, if any, for advances made. It is un-

disputed that any and all advances made by PEM to the Debtor, continue to be secured by the note and deed of trust assigned to PEM by Paragon pursuant to the Settlement Agreement. Most significant are the contributions of capital being made by PEM to the Debtor to fund operating expenses. This Court holds that contributions of capital for operating expenses should not receive preferential treatment above other creditors and therefore recharacterization of this debt to equity is proper as a matter of law.

The corporation's ability to obtain financing from outside lending institutions is taken into consideration by the eighth *Dornier Aviation* factor. No evidence was presented to this Court that the Debtor had any ability to obtain financing from outside lending institutions. This inability to obtain financing may have been caused by two foreclosure proceedings initiated by Paragon and a very depressed real estate market. Nonetheless, it is undisputed that the Debtor could not obtain financing and therefore recharacterization of the $300,000.00 from debt to equity is appropriate as a matter of law.

Dornier Aviation factor nine and ten pertain to the advances made to the Debtor. The ninth factor regards the extent to which the advances were subordinated to the claims of outside creditors. In this case, there is absolutely no evidence presented to the Court that the $300,000.00 PEM Contribution by Stanley Jacobson, Robert Conaty and AIHL trust were subordinated to other creditors. To the contrary, PEM maintained a first lien on the real property of Olde Liberty Club by virtue of the note and deed of trust assigned to PEM from Paragon for Debtor's loan. In addition, the tenth *Dornier Aviation* factor considers the extent to which

the advances were used to acquire capital assets. In this case, there is no evidence that the $300,000.00 PEM Contribution was used by the Debtor to purchase additional capital assets, but was rather used to settle the Debtor's Paragon Loan that was in default with Paragon for a deep discount. Accordingly, the ninth and tenth factors regarding advances made to the Debtor supports the Court's holding that a recharacterization of the debt to equity is appropriate.

The final factor examined by the court in *Dornier Aviation* discerns whether there is a presence or absence of a sinking fund to provide repayments for the debt in question. In the present matter, no evidence was presented nor mention made of a sinking fund to fund repayments by the Debtor to PEM for the purchase of the Debtor's Paragon Loan. The absence of a sinking fund gives rise to support the fact the Debtor was undercapitalized and had no set terms of repayment. Such uncontroverted facts support a holding that the $300,000.00 PEM Contribution was an equity infusion by equity members of the Debtor rather than a loan to be repaid by the Debtor to PEM.

Counsel for PEM argued that this transaction was nothing more than insider owners of the Debtor trying to salvage the property from foreclosure by purchasing the note of the Debtor's Paragon Loan that was in default. The Court in *Dornier Aviation* found it important to note that, "a claimant's insider status and a debtor's undercapitalization alone will normally be insufficient to support the recharacterization of a claim." As in the present matter, however, the court stated, "when other factors indicate that the transaction is not a loan at all, recharacterization is appropriate." *In re Official Com-*

mittee of Unsecured Creditors for Dornier Aviation(North America), Inc., 453 F.3d 225, 234(4th Cir.2006).

All of the factors in *Dornier Aviation* support a holding of recharacterization of the debt as an equity contribution. The transaction as a whole was more consistent with an equity contribution than that of a loan from a creditor. PEM was NOT a party or signer of the Settlement Agreement with Paragon which required it to hold the Debtor's Paragon Loan. Further, PEM, through Stanley Jacobson and Robert Conaty, did not make a separate loan to the Debtor. Instead, the purchase of the Debtor's Paragon Loan was negotiated as opposed to having the note for the Debtor's Paragon Loan marked paid and satisfied. Had either of the them desired to make a loan to the Debtor, Stanley Jacobson, and Robert Conaty could have contributed money to the Debtor without the need for PEM. To adjust for these capital contributions, they could have adjusted the capital accounts. Instead, Stanley Jacobson and Robert Conaty chose to negotiate the purchase of the Debtor's Paragon Loan in the form of a $6,465,000.00 note for the purchase price of $1,242,000.00. In effect, Stanley Jacobson, Robert Conaty, and AIHL purchased a $6,465,000.00 note and deed of trust for the Debtor's Paragon Loan for a true equity investment total $300,000.00. The Debtor pledged sufficient collateral for the PEM's Paragon Loan, and the Deglomini-Simone Loan, but pledged nothing for the $300,000.00 PEM Contribution. The result of this transaction was that PEM and its owners would have the opportunity of realizing a 300% a return on their investment over a period of less than two years. Further, PEM would have a controlling vote in the confirmation of the Debt-

or's Chapter 11 Plan. In accordance with the factors enumerated in *Dornier Aviation*, this Court holds that the PEM Contribution in the purchase of the Debtor's Paragon Loan in the amount of $300,000.00 is an equity contribution and is therefore recharacterized as such.

The Debtor used PEM as an extension of itself, used its property to secure PEM's debt and used money collected by PEM for payment on the Paragon Loan for the Debtor's ordinary business expenses. The Debtor, through Richard Wolf and Howard Jacobson, negotiated the satisfaction of the Debtor's Paragon Loan, and the $300,000.00 PEM Contribution for the purchase of the Debtor's Paragon Loan. These actions are, as a matter of law, an equity contribution made to keep the Debtor from losing its sole asset in foreclosure. Accordingly, this special relationship between PEM and the Debtor as well as PEM's interest in the Debtor's survival, support finding that the alleged debt was in fact an equity contribution. There are no genuine issues of material fact with regard to Plaintiffs' claim that the $300,000.00 PEM Contribution was an equity contribution to the Debtor. Plaintiff is entitled to judgment against the Defendants to recharacterize the $300,000.00 portion of the $1,242,000.00 as equity. The $7,000,000.00 claim of PEM is void.

As to the Plaintiffs' standing to bring this adversary proceeding, this court ordered that the adversary proceeding, "*Bolton, et. al., vs Jacobson, et. al.* A. P. No. 13-00046-8-ATS, be heard by the North Carolina Business Court by virtue of that certain order entered on May 17, 2013, requiring mandatory abstention of the Bankruptcy Court from hearing that case. Whether or not the Plaintiffs are entitled to a claim in the Debtor's

case and to the relief set forth in this Order Granting Summary Judgment, will be determined in the trial of "*Bolton, et. al., vs Jacobson, et. al.*" in the North Carolina Business Court. Therefore, whether or not the Plaintiffs are entitled to the benefit of the $300,000.00 PEM Contribution being recharacterized as equity, depends on the outcome of this state business court litigation.[1]

II. No Grounds Exist for the Equitable Subordination of Pem's Claim in the Debtor's Bankruptcy Proceeding to that of the Plaintiffs.

In addition to the claim for recharacterization of the debt, the Plaintiffs allege that PEM's claim in the Debtor's bankruptcy proceeding should be equitably subordinated to that of the Plaintiffs. The Plaintiffs alleged that PEM engaged in inequitable conduct stating that PEM's purchase of the Debtor's Paragon Loan was not an arm's length transaction as PEM was an insider of the Debtor pursuant to 11 U.S.C. § 101(31). Further, the Plaintiffs contended that the purchase of the Debtor's Paragon Loan was structured in a way to prevent distribution of the assets of the Debtor's bankruptcy estate to legitimate creditors.

It is well established that "[t]he courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act." *In re FCX, Inc.*, 60 B.R. 405, 409 (E.D.N.C. 1986) (quoting *Young* v. *Higbee Co.*, 324 U.S. 204 (1945)). Pursuant to

[1] Hearings on the Debtor's pending Objection to Claim Number 5 of Eric of Levin and Objection to Claim Number 6 of Howard Shareff have been continued until North Carolina Business Court litigation in *Bolton, et. al., vs Jacobson, et. al.* A. P. No. 13-00046-8-ATS is resolved.

these equitable powers, "the bankruptcy court has the power to shift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate." *Id.* (quoting *Pepper v. Litton*, 308 U.S. 295 (1939)). "Therefore, the bankruptcy court has the ability to deviate from the rules of priority and distribution set forth in the Code in the interest of justice and equity." *Id.*

Section 510 of the united states the Code provides that:

> [A]fter notice and a hearing, the court may--
>
> > (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or
> >
> > (2) order that any lien securing such a subordinated claim be transferred to the estate.
>
> 11 U.S.C. § 510(c).

The Bankruptcy Court may only equitably subordinate a claim, absent Congressional authorization, because of the fraudulent nature of a claim or bad faith or improper conduct of a claimant. *In re FCX, Inc.*, 60 B.R. 405, 410 (E.D.N.C. 1986); *In re Westgate-California Corp.*, 642 F.2d 1174, 1177-1178 (9th Cir. 1981); *In re Columbia Ribbon Company*, 117 F.2d 999, 1002 (3d Cir.1941); *See also* 11 U.S.C. § 510©. The fundamental aim of equitable subordination "is to undo or to offset any inequity in the claim position of a creditor that will produce injustice or unfairness to other credi-

tors in terms of the bankruptcy results." *In re Kansas City Journal-Post Co.*, 144 F.2d 791, 800 (8th Cir.1944), quoted *In re Westgate-California Corp.*, 642 F.2d at 1177. Therefore, "a claim will not be subordinated unless it is shown that the claimant has acted inequitably in the course of his relationship with the debtor and that those actions have harmed the debtor or his other creditors in some way." *In re Westgage-California Corp.*, 642 F.2d at 1178; quoting *In re Ahlswede*, 516 F.2d 784, 788 (9th Cir. 1975). Pursuant to the undisputed facts presented to the Court, there is insufficient evidence from which this Court could find there was misconduct or inequitable conduct on the part of PEM. There is no evidence that the negotiation with Paragon for the settlement of the $6,465,000.00 Debtor's Paragon Loan was anything but an arms length transaction between the Debtor's insiders and Paragon, for the benefit of PEM. According to his affidavit, Stanley Jacobson believed the Olde Liberty Club property to have a value of no more than $1,200,000.00. *Stanley Jacobson Affidavit*, ¶11. The Settlement Agreement provided that PEM, at the direction of Stanley Jacobson, would purchase the Debtor's Paragon Loan for $1,242,000.00 which would have been a fair price according to Stanley Jacobson's estimation. The negotiations for PEM's purchase of the Debtor's Paragon Loan occurred in the aftermath of the worst recession in real estate in 2008. Further, the Olde Liberty Club property had twice been subjected to foreclosure proceedings by Paragon.

The Court's holding that PEM's contribution should be recharacterized from a debt to an equity contribution has no bearing on the determination of whether equitable subordination is appropriate. *Dorni-*

er Aviation, 453 F.3d at 232. The court in *Dornier Aviation* explains that a "bankruptcy court's recharacterization decision rests on the *substance of the transaction* . . . its equitable subordination decision rests on its assessment of the *creditor's behavior*." *Id.* This Court holds that there has been no factual evidence that rises to the level of misconduct or inequitable conduct as a matter of law. The Court holds that an equitable subordination of PEM'S claim is not appropriate. Therefore, summary judgment is granted in favor of the Defendants.

III. The Plaintiffs Lack Standing to Assert or Recover Damages for a Claim of Fraudulent Transfer.

Lastly, the Plaintiffs argue that they are entitled to summary judgment with regard to the claim that the Debtor engaged in fraudulent transfers. The Plaintiffs allege that the Debtor transferred $202,087.71 to PEM on account of the debt for the PEM's Paragon Loan three months prior to the Debtor's filing its petition for relief under Chapter 11 of the Code. The Plaintiffs also ask that this Court set aside or mark as satisfied the deeds of the First Deed of Trust of Paragon purchased by PEM and the Deglomini Deeds of Trust as they were results of the fraudulent transfer.

This Court has held that, "once a bankruptcy case is filed, all fraudulent transfer claims relating to a transfer made by the debtor, and the rights to recover damages or to avoid liens in connection with such claims, are property of the estate." *In re Midsouth Golf, LLC. (Fairfield Harbour Property Owners Association, Inc. v. Midsouth Golf, LLC et al.)* AP No: 14-00012-8-RDD at 3 (Bankr. E.D.N.C. Nov. 20, 2014)

(quoting *In re Ontos, Inc. (Morley v. Ontos, Inc., et al)*, 478 F.3d 427, 431-32 (1st Cir. 2007)). The Fourth Circuit held that fraudulent conveyance actions are property of the estate which vest in the debtor in possession or trustee such that an individual creditor lacks standing to pursue such a claim. *Nation American Ins. Co. v. Ruppert Landscaping Co., Inc.*, 187 F.3d 439 (4th Cir. 1999); *Steyr-Daimler-Puch of America Corp. v. Pappas*, 852 F.2d 132 (4th Cir. 1988); See *Poth v. Russey*, 99 Fed. Appx. 446 (4th Cir. 2004). The Bankruptcy Court in *Ivester v. Miller* also held, and the District Court affirmed, that individual creditors lack standing to pursue state law fraudulent transfer actions and that these cases should be dismissed, on the grounds that the actions are property of the estate. *Ivester v. Miller*, 398 BR. 408, 429-430 (M.D.N.C. 2008). Therefore, the Court holds that the Plaintiffs, as individual creditors, lack standing to pursue the claim for recovery of a fraudulent transfer. This cause of action lies solely with the Trustee or Debtor in Possession, not with individual creditors. Further, the Court refuses to set aside the valid First Deed of Trust securing PEM's Paragon loan and the Deglomini-Simone deeds of trust. These parties are not named defendants in the adversary proceeding. Therefore, summary judgment is granted in favor of the Defendants.

CONCLUSION

As to the Plaintiffs' motion for summary judgment requesting that the $300,000 PEM contribution be recharacterized as an equity contribution by Stanley Jacobson, Richard B. Conaty, and AIHL, summary judgment for Plaintiffs is **GRANTED**.

As to the Plaintiffs' claim that the PEM Contribution should be equitably subordinated to that of the Plaintifls the Court holds that there was not sufficient evidence of misconduct or inequitable conduct on the part of the Defendants, as a matter of law. Therefore, summary judgment is DENIED for Plaintiffs but GRANTED for Defendants. Further, Plaintiffs' claim with regard to equitable subordination is DISMISSED with prejudice.

As to Plaintiffs claim for relief to recover for the alleged fraudulent transfers made by the Debtor for the benefit of PEM, the Plaintiffs do not have standing to bring an action for fraudulent transfers under 11 U.S.C. §§544, 548. Therefore, summary judgment is DENIED and the Plaintifls' claim for relief is DISMISSED with prejudice.

As to Plaintiffs' request that this Court set aside the Paragon First Deed of Trust and the Deglomini-Simone Deed of Trust, the Court holds that the aforementioned deeds of trust are valid deeds of trust. Further, Paragon, Deglomini, and Simone are not party defendants to this action.

Therefore, summary judgment is DENIED and the Plaintiffs' claim for relief is DISMISSED with prejudice.

Finally, as to the Plaintiffs' prayer for relief that this Court award Plaintiffs' their costs and reasonable attorneys' fees, this Court finds no basis for such an award. The Plaintiffs and Defendant will each be taxed with their respective fees and costs.

SO ORDERED.

SIGNED this 5 day of December, 2014.

/s/ Randy D. Doub
Randy D. Doub
United States Bankruptcy Judge

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APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 15-1669 (5:14-cv-00889-D)
(8:13-01563)
(8:13-00122)

FILED: SEPTEMBER 9, 2016

IN RE PROVINCE GRANDE OLDE LIBERTY, LLC, a/k/a Silver Deer Olde Liberty AA Lots, LLC, Debtor.

PEM ENTITIES LLC, Appellant,

v.

PROVINCE GRANDE OLDE LIBERTY, LLC, Defendant,

and

ERIC M. LEVIN, and HOWARD SHAREFF, Creditors- Appellees.

ORDER

The petition for rehearing en banc was circulated to the full court. No judge requested a poll under Fed. R. App. P. 35. The court denies the petition for rehearing en banc.

For the Court

/s/ Patricia S. Connor, Clerk

APPENDIX E

11 U.S.C. § 105(a)

§ 105. Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

* * * * *

APPENDIX F

11 U.S.C. § 502

§ 502. Allowance of claims or interests

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under section 523(a)(5) of this title;

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds—

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of—

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates;

(8) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an

employment tax on wages, salaries, or commissions earned from the debtor; or

(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide, and except that in a case under chapter 13, a claim of a governmental unit for a tax with respect to a return filed under section 1308 shall be timely if the claim is filed on or before the date that is 60 days after the date on which such return was filed as required.

(c) There shall be estimated for purpose of allowance under this section—

(1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case; or

(2) any right to payment arising from a right to an equitable remedy for breach of performance.

(d) Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title.

(e)(1) Notwithstanding subsections (a), (b), and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that—

(A) such creditor's claim against the estate is disallowed;

(B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or

(C) such entity asserts a right of subrogation to the rights of such creditor under section 509 of this title.

(2) A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.

(f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(g)(1) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unex-

pired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(2) A claim for damages calculated in accordance with section 562 shall be allowed under subsection (a), (b), or (c), or disallowed under subsection (d) or (e), as if such claim had arisen before the date of the filing of the petition.

(h) A claim arising from the recovery of property under section 522, 550, or 553 of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(8) of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(j) A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case. Reconsideration of a claim under this subsection does not affect the validity of any payment or transfer from the estate made to a holder of an allowed claim on account of such allowed claim that is not reconsidered, but if a reconsidered claim is allowed and is of the same class as such holder's claim, such holder may not re-

ceive any additional payment or transfer from the estate on account of such holder's allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder. This subsection does not alter or modify the trustee's right to recover from a creditor any excess payment or transfer made to such creditor.

(k)(1) The court, on the motion of the debtor and after a hearing, may reduce a claim filed under this section based in whole on an unsecured consumer debt by not more than 20 percent of the claim, if—

(A) the claim was filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment schedule proposed on behalf of the debtor by an approved nonprofit budget and credit counseling agency described in section 111;

(B) the offer of the debtor under subparagraph (A)—

(i) was made at least 60 days before the date of the filing of the petition; and

(ii) provided for payment of at least 60 percent of the amount of the debt over a period not to exceed the repayment period of the loan, or a reasonable extension thereof; and

(C) no part of the debt under the alternative repayment schedule is nondischargeable.

(2) The debtor shall have the burden of proving, by clear and convincing evidence, that—

(A) the creditor unreasonably refused to consider the debtor's proposal; and

(B) the proposed alternative repayment schedule was made prior to expiration of the 60-day period specified in paragraph (1)(B)(i).