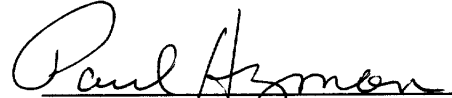




ORDERED in the Southern District of Florida on February 27, 2017.


Paul G. Hyman, Jr., Judge
United States Bankruptcy Court

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA
WEST PALM BEACH DIVISION
www.flsb.uscourts.gov

In re:

CHAPTER 11

PALM BEACH FINANCE PARTNERS, L.P.,
PALM BEACH FINANCE II, L.P.,

Case No. 09-36379-PGH
Case No. 09-36396-PGH
(Jointly Administered)

Debtors.

**FINDINGS OF FACT AND CONCLUSIONS OF LAW APPROVING
LIQUIDATING TRUSTEE’S MOTION TO APPROVE DISTRIBUTION SCHEME
PURSUANT TO 11 U.S.C. § 510(b) AND BANKRUPTCY RULE 9019 [ECF No. 3135]**

This matter came before the Court for hearing on January 31, 2017 (“*Hearing*”), to consider the *Liquidating Trustee’s Motion to Approve Distribution Scheme Pursuant to 11 U.S.C. § 510(b) and Bankruptcy Rule 9019 (“Distribution Motion”)*¹ [ECF No. 3135]. The Court, having considered the Motion, (ii) the Joinder of MIO Partners, Inc. attached to the Distribution Motion, (iii) the proffer of evidence offered and accepted by the Court without

¹ Unless otherwise defined or modified herein, all capitalized terms used in this Order shall have the meanings ascribed to them in the Motion.

objection from any party; and having found that due and proper notice has been given to all creditors and parties in interest in this case with respect to the Distribution Motion and Hearing; and after due deliberation and good and sufficient cause having been shown; and otherwise being fully advised in the premises, the Court hereby makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure (“*Bankruptcy Rules*”) and Rule 52(a) of the Federal Rules of Civil Procedure.²

BACKGROUND

A. On November 30, 2009, the Debtors filed voluntary Chapter 11 petitions in the United States Bankruptcy Court for the Southern District of Florida (“*Florida Bankruptcy Court*”). By subsequent Order of this Court, the cases are jointly administered.

B. On January 29, 2010, the United States Trustee appointed the Liquidating Trustee as Chapter 11 trustee in both of the Debtors’ estates. [ECF No. 107].

C. On October 21, 2010, this Court entered its Order Confirming Second Amended Joint Plan of Liquidation [ECF No. 444], creating the Liquidating Trusts, appointing the Liquidating Trustee as Liquidating Trustee and appointing Geoffrey Varga as Trust Monitor.

JURISDICTION AND VENUE

D. Venue of this case is proper and continues to be proper in this District pursuant to 11 U.S.C. §§ 1408 and 1409.

E. Approval of the Distribution Motion is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A,O), and this Court has jurisdiction to enter a final order with respect thereto.

F. The Court takes judicial notice of the docket in this Chapter 11 case maintained by the Clerk of the Bankruptcy Court, including without limitation, all pleadings and other

² Where appropriate, findings of fact shall constitute conclusions of law and conclusions of law shall constitute findings of fact. See *In re American Family Enterprises*, 256 B.R. 377, 385, n.2 (Bankr. D.N.J. 2000); *In re Antar*, 122 B.R. 788, 789 (Bankr. S.D. Fla. 1990).

documents filed, evidence and arguments made, proffered, presented or adduced at the hearings held before the Court and all orders entered during the pendency of this case.

FINDINGS OF FACT

The Mediation

G. On October 20, 2016, the Court entered its *Order Granting Liquidating Trustee's Motion for Judicial Settlement Conference or in the Alternative for Mediation on 510(b) Issues* [ECF No. 3065].

H. On October 27, 2016, the Liquidating Trustee noticed all parties in interest in the PBFP and PBF II estates that a mediation of matters associated with 11 U.S.C. § 510(b) that may impact the creditors of PBFP and Palm Beach Finance II, L.P. (the “§ 510(b) Issues”) would occur on November 15, 2016 and November 16, 2016, with Harley E. Riedel, Esq. serving as mediator (the “*Mediator*”) [ECF No. 3067]. Parties in interest were invited to attend the mediation either in person or by phone.

I. On November 15, 2016, the Liquidating Trustee participated in a mediation (“*Mediation*”) conducted by Harley E. Riedel (“*Mediator*”) that addressed the impact of 11 U.S.C. § 510(b) on Limited Partner (“*LP*”) claims in the estates of PBFP and PBF II (“*510(b) Issues*”).

J. MIO Partners, Inc. (“*MIO*”) and Skybell Select LP (“*Sky Bell*”) attended the Mediation as creditors or equity interest holders of Palm Beach Finance Partners, L.P. (“*PBFP*”).

K. MIO is the fund manager for Compass Special Situations Fund, LP (“*CSSF*”), Special Situations Investment Fund, L.P. (“*SSIF*”), McKinsey Master Retirement Trust (“*MMRT*”), and Security Benefit Life Insurance Company Variable Annuity Account IX

(“*SBLIC*,” and together with CSSF, SSIF and MMRT, the “*MIO Entities*”). MIO is a creditor of the PBFP estate with over \$27 million of allowed claims [ECF No. 2746]. Skybell holds over \$2 million of allowed equity interests against the PBFP estate.

L. As evidenced by its Joinder MIO agrees to the distribution scheme described in the Motion which resulted from the Mediation.

M. Sky Bell did not file a Joinder to the Motion. However, the Court was advised at the Hearing that Sky Bell and the Trustee agreed on the form of an agreed order (“*Sky Bell Order*”) granting *Sky Bell’s Motion for (I) Leave to File a Proof of Claim After the Bar Date and Deeming Such Proof of Claim to be Timely Filed (“Sky Bell’s Motion”)* [ECF No. 3103] on the terms set forth therein and as modified by the Court. The Sky Bell Order has been entered simultaneously with this Order. Sky Bell announced at the Hearing its support for the granting of the Distribution Motion.

The Waterfall Distribution Scheme

N. The distribution scheme divides the LPs into 4 categories for distribution purposes only:

a. **Category A**: LPs who (i) filed proofs of claim and (ii) made prepetition redemption requests or (iii) have unsecured claims allowed pursuant to Court Order will share in the distributions based on 100% of their allowed claim amounts. LPs in this category are treated with the highest priority in the proposed distribution scheme, because they took actions in the prepetition period that are most consistent with the caselaw referenced below in which a limited partner’s claim was not subordinated.

b. **Category B**: LPs who (i) filed proofs of claim and (ii) did not make prepetition redemption requests will share in the distributions based on 65% of their allowed claim amounts. The LPs in category B are treated with the second highest priority in the proposed distribution scheme, because their diligence in filing proofs of claim indicates an intent to be treated as unsecured creditors and receive a distribution from this estate and to not have their interests subordinated.

c. **Category C**: LPs who (i) did not file proofs of claim but (ii) made prepetition redemption requests will share in the distributions based on 30% of their allowed claim amounts. LPs in category C are treated less favorably than LPs in Categories A and B, because they failed to file proofs of claim. However, the fact that such LPs made redemption requests indicates an intent to be treated as an unsecured creditor.

d. **Category D**: Equity interest holders who (i) did not file proofs of interest and (ii) did not make prepetition redemption demands will share in the distributions based on 15% of their allowed amounts. LPs in category D are treated the least favorably because they failed to take action to assert an unsecured claim.

CONCLUSIONS OF LAW

For the reasons set forth below, the Court finds that the Distribution Motion meets the requirements for approval under 11 U.S.C. § 510(b) and Fed. R. Bankr. P. 9019.

A. 11 U.S.C. § 510(b)

1. When determining the applicability of 11 U.S.C. § 510(b) to the limited partner claims at issue in this case, we begin, as we must, with the language of the statute.

2. Section 510(b) of the Bankruptcy Code provides:

For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b).

B. Application of 11 U.S.C. 510(b) to Limited Partner Redemption Requests

3. The language of § 510(b) refers to claims arising from “rescission.” However, the LP claims at issue in this case are claims arising from *redemption* requests the Debtors failed to honor before the Petition Date. At least two courts have noted a distinction between a “rescission-based claim, which [is] subject to §510(b) subordination, [and] a claim based on redemption of ownership interests, which *might* not be.”³ As noted by the *SeaQuest* court: “Rescission” is defined as “[a] party’s unilateral unmaking of a contract for a legally sufficient reason, such as the other party’s material breach, or a judgment rescinding the contract; voidance.”⁴ Redemption, on the other hand, has been referred to as a conversion of equity to debt.⁵

4. The Court in *Seaquest* referenced the distinction between claims arising from rescission and redemption as follows:

The policy rationales underlying § 510(b) support the result in the circuit court cases because those claimants bargained for an equity position in the debtors *and*

³ *In re Orange Cnty. Nursery Inc.*, 479 B.R. 863, 867 (Bankr. C.D. Cal. 2012) (emphasis in original) *reversed and remanded* other grounds 523 B.R. 692 (C.D. Cal. 2014) (discussing *SeaQuest*, 579 F.3d at 423, which allowed for subordination because the transaction was for rescission, rather than for redemption).

⁴ *In re SeaQuest Diving, LP*, 579 F.3d 411, 419 (5th Cir. 2009)). (quoting BLACK’S LAW DICTIONARY 1332 (8th ed. 2004) (emphasis added)).

⁵ *See id.* at 423 (citing *In re Am. Wagering, Inc.*, 493 F.3d 1067, 1073 (C.D. Cal. 2007)).

never converted that equity into debt pre-petition. A claimant who held equity on the petition date or was promised equity has assumed the risk of enterprise insolvency in exchange for the upside potential of equity ownership. By redeeming equity for debt before the bankruptcy filing, the claimant can convert from the “risk/return position of an equity investor” to a “fixed, pre-petition debt due and owing” the claimant as a creditor.

In re Seaquest Diving, 579 F.3d at 423 (emphasis added)

5. Here it can be argued that the LPs that made timely, pre-bankruptcy redemption requests were “deemed to have retired” their interests upon the date of demand, and that the inability or failure of PBFP to pay the demands, does not change the identity of the LPs making such demands as creditors. Section 8.4 of the LP Agreement makes clear that withdrawals are “effective on the last day of each calendar quarter after allocations of Allocable Net Profits or Allocable Net Losses and the Performance Allocation (if any) as of such date.” See Section 8.4 of the LP Agreement. In many instances the redemptions were noticed before the end of the quarter, and the end of the quarter occurred before the Petition Date. Arguably, therefore, many redemptions may have become “effective.” However, the identity of the claimants is not as relevant to an analysis of 11 U.S.C. § 510(b) as the existence of some nexus to the purchase or sale of a security.⁶

6. The phrase “arising from” in § 510(b) is universally acknowledged by courts to be ambiguous.⁷ However, the majority of courts (including this Court), interpreting this phrase have

⁶ See *In re NAL Fin. Group, Inc.*, 237 B.R. 225 (Bankr. S.D. Fla. 1999). In *NAL*, this Court adopted “the broader reading of § 510(b),” holding that Section 510(b) applies so long as “the purchase or sale [is] part of the causal link although the injury may flow from a subsequent event.” In *NAL*, this Court found that the cause of action would not have accrued, and the creditor “would not have incurred any damages if [the creditor] did not purchase the [security] in the first place[. Thus,] the purchase is a causal link.” In so-holding, this Court adopted a ‘but for’ test. Here, the LP claims would not have accrued but for the purchase.

⁷ See e.g. *In re Telegroup, Inc.*, 281 F.3d 133, 138 (3d Cir. 2002) (“We conclude that the phrase “arising from” is ambiguous”); *In re SeaQuest Diving, LP*, 579 F.3d 411, 418 (5th Cir. 2009); *Rombro v. Dufayne (In re Med Diversified, Inc.)*, 461 F.3d 251, 255 (2d Cir. 2006); *In re Geneva Steel Co.*, 281 F.3d 1173, 1178-79 (10th Cir. 2002); *Pensco Trust Co. v. Tristar Esperanza Properties, LLC (In re Tristar Esperanza Properties, LLC)*, 488 B.R. 394, 402 (9th Cir. 2015) (“What constitutes ‘arising from’ has been considered and found ambiguous by the Second, Third, Fifth, Ninth and Tenth Circuits. No circuit has taken a contrary view.”).

adopted a so-called “but-for” test determining that only *some* nexus or causal relationship between the claim and the purchase of the securities must exist to invoke mandatory subordination. The nexus required is not limited to claims involving the purchase itself.⁸

7. However, the most recent circuit level decision analyzing the meaning of “arising from” in § 510(b) is *Pensco Trust Co. v. Tristar Esperanza Properties, LLC (In re Tristar Esperanza Properties, LLC)*, 782 F.3d 492 (9th Cir. 2015).⁹ In *Tristar*, the Ninth Circuit acknowledged that at least one bankruptcy court has held that the status of the claim on the date of the petition controls the subordination question.¹⁰ In *MarketXT*, the court reasoned “It is black letter law that claims are analyzed as of the date of the filing of a petition, not as of a hypothetical date in the past.”¹¹ Because the creditor held a judgment based on notes issued following the creditor's exercise of the liquidation preference of its preferred stock, it was a creditor on the date of the petition and thus its claim was not subject to subordination.¹² Various

⁸ See e.g., *In re Telegroup, Inc.*, 281 F.3d 133, 138 and 143 (“The claim would not exist but for claimants' purchase of debtor's stock”); *In re NAL Fin. Group, Inc.* 237 B.R. 225, 234 (Bankr. S.D. Fla. 1999) (J. Hyman) (“Interbank would not have these causes of action against NALF had the parties not entered into these agreements.”).

⁹ A recent decision of a bankruptcy court in the Southern District of New York has criticized *Tristar* as being inconsistent with the law in the Second Circuit which contemplates only 2 rationales for mandatory subordination under § 510(b): either the claimant (1) took on the risk and return expectations of a shareholder rather than a creditor; or (2) seeks to recover a contribution to the equity pool relied upon by creditors in deciding whether to extend credit to the debtor. See *In re Lehman Bros, Inc.* – B.R. --, 2015 WL 6163438 at *39 (Bankr. S.D.N.Y. Oct. 8, 2015) citing *In re Med Diversified, Inc.* 461 F.3d 251, 256 (2d Cir. 2006) and *KIT Digital, Inc. v. Invigor Group Ltd. (In re KIT Digital, Inc.)*, 497 B.R. 170, 183 (Bankr. S.D.N.Y. 2013).

¹⁰ See *In re MarketXT Holdings Corp.*, 361 B.R. 369, 389 (Bankr. S.D.N.Y. 2007).

¹¹ *Id.* (citing 5 Lawrence P. King et al., COLLIER ON BANKRUPTCY ¶ 506.04 (15th ed. rev. 2006)).

¹² *Id.* at 389–90.

other courts have followed similar reasoning in refusing to subordinate certain creditors' claims even though their debt instruments or judgments derived from an equity interest.¹³

8. These cases suggest that to be subject to subordination, the claimant must, at the very least, enjoy the rights and privileges of equity ownership on the date of the bankruptcy petition. *See Mobile Tool Int'l*, 306 B.R. at 782. However, the Ninth Circuit rejected that principle in *In re Betacom of Phoenix, Inc.*, 240 F.3d 823 (9th Cir. 2001), holding that a claimant who bargained for an equity position was subject to subordination, even though he never enjoyed the benefits of equity ownership. *Betacom*, 240 F.3d at 829–30.

9. Given the uncertainty surrounding the application of § 510(b), especially in the context of the complex facts at issue in this case, the Liquidating Trustee asserts that implementation of the proposed distribution scheme is appropriate and in the best interests of the estate and its creditors. This Court agrees.

C. BANKRUPTCY RULE 9019

10. Although the Mediation was attended by certain LPs, it was not attended by all LPs, and therefore it cannot be said that any settlement reached between the Liquidating Trustee and the LPs at Mediation, by itself, binds other LPs that were not present at the Mediation. However, all LPs were provided notice of the Mediation and had ample opportunity to attend. While not an exact fit, the Court finds that analysis of the agreed upon Distribution Scheme, through the lens of Bankruptcy Rule 9019 lends further support to this Court's approval of the Distribution Motion.

¹³ *See, e.g., In re Cybersight LLC*, No. 02–11033, Civ. A. 04–112 JJF, 2004 WL 2713098, at *4 (D. Del. Nov. 17, 2004); *In re Swift Instruments, Inc.*, No. NC–11–1426–DHSA, 2012 WL 762833, at *7–8 (9th Cir. BAP Mar. 8, 2012); *In re Mobile Tool Int'l, Inc.*, 306 B.R. 778, 782 (Bankr. D. Del. 2004).

11. Rule 9019 provides in relevant part that “[o]n motion ... and after a hearing on notice to creditors; the debtor ... and to such other entities as the Court may designate, the Court may approve a compromise or settlement.”

12. The standard for judicial approval of settlements pursuant to Fed. R. Bankr. P. 9019 is well settled in the Eleventh Circuit. In passing on proposed settlements, the Court must determine whether a proposed settlement is fair and equitable. *In re Chira*, 367 B.R. 888, 896 (Bankr. S.D. Fla. 2007); *In re Air Safety Int’l, L.C.*, 336 B.R. 843, 852 (S.D. Fla. 2005). The Court must evaluate whether the compromise falls below the “lowest point in the range of reasonableness.” *In re S&I Investments*, 421 B.R. 569, 583 (Bankr. S.D. Fla. 2009); *In re BiCoastal Corp.*, 164 B.R. 1009, 1016 (Bankr. M.D. Fla. 1993); *In re Arrow Air, Inc.*, 85 B.R. 886, 890 (Bankr. S.D. Fla. 1988). The decision to approve a settlement is within the sound discretion of the court and will not be disturbed or modified on appeal unless approval or disapproval is an abuse of discretion. *See id.*

13. In making this determination, the Court is required to examine the four factors enumerated by the Eleventh Circuit in *Justice Oaks*¹⁴: (a) the probability of success in litigation; (b) the difficulties, if any, to be encountered as a matter of collection; (c) the complexity of the litigation involved and the expense, inconvenience, and delay necessarily attending it; and (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

14. The Court has examined the factors espoused in *Justice Oaks*, and finds that the settlement described in the Distribution Motion meets the standards for approval set forth by the

¹⁴ *In re Justice Oaks II, Ltd.*, 898 F.2d 1544, 1549 (11th Cir. 1990) (“*Justice Oaks*”).

Eleventh Circuit and, therefore, approval of the mediated Distribution Scheme is proper pursuant to Federal Rule of Bankruptcy Procedure 9019.

15. The Court specifically finds that the mediated Distribution Scheme is (i) fair and reasonable, (ii) falls within the range of possible litigation outcomes, and (iii) is in the best interests of the estate because settlement (a) precludes any risks associated with litigation and collection in this matter, and (b) increases the dividend available to LPs that may otherwise receive no distributions.

16. In making this determination, the Court has expressly considered (i) the probability of success in the litigation, (ii) the difficulties, if any, to be encountered in the matter of collection (iii) the complexity of the litigation involved, and the expense, inconveniences and delay necessarily attending it, and (iv) the paramount interest of the creditors and proper deference to their reasonable views in the premises.

Probability of success in litigation

17. The Liquidating Trustee could assert that all LP claims should be subordinated pursuant to 11 U.S.C. § 510(b). However, litigation between the estates and the LPs if the Liquidating Trustee were to seek subordination of all LP claims is not just a risk, but an inevitability as a result of the diametrically opposed interests of certain LPs and unsecured creditors. However, protracted litigation is not in the best interest of the estates and its creditors and therefore the proposed distribution scheme favorably resolves this matter for all LP creditors, as it represents a distribution scheme that is not only logical but designed to elicit the most equitable distribution for all the LPs. The settlement treats all similarly situated parties, with similar facts and positions, in the same way.

18. There are litigation risks both on proving the elements of 11 U.S.C. § 510(b) and the interplay between the Bankruptcy Code, the application of the partnership agreements, Delaware statutory law and the application of relevant case law. Accordingly, this factor weighs in favor of approval of the Distribution Motion.

The difficulties, if any, to be encountered in the matter of collection

19. As a result of the unique nature of the relief requested herein, collectability is not a significant issue that militates one way or another with respect to the relief requested.

Complexity of litigation and attendant expense, inconvenience and delay

20. This is a meaningful consideration that militates in favor of approval of the Distribution Scheme.

21. Although the LP claims described in the Motion could arguably be covered within the scope of 11 U.S.C. § 510(b), as noted above, there are counter-arguments as to why § 510(b) should not apply. To the extent the matter is disputed, any litigation of specific LP claims in relation to § 510(b) would potentially require the retention of experts and fact discovery before a trial could take place. Coupled with the legal hurdles outlined above, the result of these efforts will be substantial fees of professionals that would significantly diminish the net amounts available to all parties in interest.

22. The distribution scheme addresses these concerns. The LPs would avoid litigating fact specific claims, with the attendant expense and delay of litigation being nullified.

Paramount interests of the creditors

23. The proposed distribution scheme represents an appropriate resolution of the § 510(b) Issues, which have significant legal concerns, gives certainty to the Liquidating Trusts and avoids the risk, expense and delay attendant with litigation. As such, the proposed

distribution scheme is in the paramount interest of the Liquidating Trusts and their stakeholders and is approved.

CONCLUSION

In light of the uncertainties, delay and costs associated with continued litigation over the application of 11 U.S.C. § 510(b) on LP claims, approval of the Distribution Motion is fair, reasonable, and in the best interest of the estates and all creditors, and falls well above the lowest point of reasonableness.

Accordingly, based on the foregoing, it is

ORDERED and ADJUDGED as follows:

1. The Distribution Motion is **GRANTED**.
2. The Distribution Scheme is **APPROVED** in its entirety.
3. The Distribution Scheme qualifies as an adversary proceeding or settlement of a potential adversary proceeding. Therefore, this Order is both a Final Judgment and Final Order.
4. The entry of this Order shall be simultaneous with, and is conditioned upon, the entry of the Agreed Order on Motion for (I) Leave to File a Proof of Claim After the Bar Date and (II) Deeming Such Proof of Claim to be Timely Filed (the “*Sky Bell Order*”). This Order and the Sky Bell Order shall become final simultaneously. In the event that an objection is lodged to the Allowed Claim of Sky Bell, the finality and effectiveness of this Order shall be stayed until such time as the objection is fully and finally adjudicated. If the objection is sustained, this Order shall not become final until a further Court hearing on the merits of the Distribution Motion after notice to Sky Bell.

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5. The Court retains jurisdiction with respect to all matters arising from or related to the implementation of this Order.

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Submitted By:

Peter D. Russin, Esquire
Florida Bar No. 765902
prussin@melandrussin.com
MELAND RUSSIN & BUDWICK, P.A.
Counsel for Liquidating Trustee
3200 Southeast Financial Center
200 South Biscayne Boulevard
Miami, Florida 33131
Telephone: (305) 358-6363
Telefax: (305) 358-1221

Copies Furnished To:

Peter D. Russin, Esquire, is directed to serve copies of this Order on all parties in interest and to file a Certificate of Service.