

211 B.R. 849  
(Cite as: 211 B.R. 849)

C

United States District Court,  
M.D. Louisiana.

HANNOVER CORPORATION OF AMERICA,  
Place Vendome Inc., and Place Vendome  
Corporation of America

v.

Donald BECKNER, Michael K. Wolensky, Kutak  
Rock, Tynes Fraser & Roach, Jack G.  
Wheeler, The Home Insurance Company, St. Paul  
Reinsurance Company, Ltd., Zurich  
re (UK, Limited); Compagnie D'Assurances  
Maritimes Aeriennes Et Terrestres,  
Anglo American Insurance Company Limited,  
Aegon Insurance Company (UK Limited),  
Certain Underwriters of Lloyd's, and Evanston  
Insurance Company.

Civil Action No. 96-237.

July 31, 1997.

Chapter 11 debtors-in-possession, acting through their appointed receiver, brought negligence and malpractice claims against their former attorneys and claims against attorneys' professional liability insurers, alleging that attorneys breached duties of reasonable care and responsibility in connection with prepetition Securities and Exchange Commission (SEC) enforcement action brought against debtor-corporations, their officer-shareholder, and another individual, and in connection with individuals' alleged mismanagement, waste, and looting of assets. Defendants filed motions to dismiss. The District Court, Berrigan, J., held that: (1) debtors sufficiently established distinct injury for standing purposes, and (2) debtors' standing was unaffected by in pari delicto-related issues.

Motions to dismiss denied.

West Headnotes

[1] Federal Civil Procedure ⚡1742(1)  
170Ak1742(1) Most Cited Cases

Standard for dismissal articulated in Supreme Court's *Bell v. Hood* decision is inapplicable to motions to dismiss that do not challenge existence of federal cause of action.

[2] Federal Civil Procedure ⚡103.2

170Ak103.2 Most Cited Cases

Party seeking to assert standing has burden of alleging facts demonstrating that standing exists.

[3] Federal Civil Procedure ⚡103.2  
170Ak103.2 Most Cited Cases

Standing must affirmatively appear in the record.

[4] Federal Civil Procedure ⚡1742(1)  
170Ak1742(1) Most Cited Cases

[4] Federal Civil Procedure ⚡1832  
170Ak1832 Most Cited Cases

District court has power to dismiss for lack of subject matter jurisdiction based upon three separate bases: complaint alone, complaint supplemented by undisputed facts in the record, or complaint supplemented by undisputed facts plus the court's resolution of disputed facts.

[5] Federal Civil Procedure ⚡103.2  
170Ak103.2 Most Cited Cases

Determination of standing involves both constitutional limitations on federal court jurisdiction as set forth by Article III and prudential limitations the federal judiciary has imposed upon itself. U.S.C.A. Const. Art. 3, § 2, cl. 2.

[6] Federal Civil Procedure ⚡103.2  
170Ak103.2 Most Cited Cases

Among other requirements of standing, plaintiff must allege that it has suffered some distinct or palpable injury to itself, though this injury may be shared by large class of other possible litigants.

[7] Federal Civil Procedure ⚡103.2  
170Ak103.2 Most Cited Cases

Injury requirement is one of the constitutionally mandated elements of standing. U.S.C.A. Const. Art. 3, § 2, cl. 2.

[8] Bankruptcy ⚡2159.1  
51k2159.1 Most Cited Cases

Chapter 11 debtor-corporations established distinct injury, for standing purposes, in negligence and malpractice action against former attorneys and their professional liability insurers; debtors' alleged damages

included amount of indebtedness occurred, and they further alleged aggravated insolvency and artificial extension of life in their claims that attorney's malpractice caused mismanagement, waste, and looting of debtors' assets.

**[9] Federal Civil Procedure** ↪103.2  
170Ak103.2 Most Cited Cases

Congress cannot waive Article III's injury-in-fact requirement for standing. U.S.C.A. Const. Art. 3, § 2, cl. 2.

**[10] Federal Civil Procedure** ↪103.2  
170Ak103.2 Most Cited Cases

Party's description of its claims is not controlling for purposes of evaluating standing.

**[11] Bankruptcy** ↪2159.1  
51k2159.1 Most Cited Cases

In negligence and malpractice action brought by Chapter 11 debtor-corporations, acting through their court-appointed receiver, against debtors' former attorneys and their professional liability insurers, defendants failed to establish that debtors lacked standing due to their alleged participation in the underlying fraud; cases relied upon by defendants did not establish universal principle of in pari delicto relevant to standing that existed irrespective of relevant applicable law, and receiver's prepetition appointment freed debtors from sting of in pari delicto.

\*850 Frederick R. Tulley, John Ashley Moore, Taylor, Porter, Brooks and Phillips, Baton Rouge, LA, David John Messina, Taylor, Porter, Brooks and Phillips, New Orleans, LA, for Plaintiff.

Robert B. Bieck, Jr., Jones, Walker, Waechter, Poitevent, Carrere & Denegre, New Orleans, LA, Gary G. McKenzie, Monroe & Lemann, Baton Rouge, LA, John R. Keogh, Keogh, Cox & Wilson, Ltd., Baton Rouge, LA, Christopher D. Matchett, Matchett, Verbois, Futrell & Henchy, Baton Rouge, LA, William E. Wright, Jr., Deutsch, Kerrigan & Stiles, New Orleans, LA, Mark Benjamin Holton, Corroero, Fishman, Haygood, Phelps, Weiss, Walmsley & Casteix, New Orleans, LA, Patrick F. McGrew, New Orleans, LA, for Defendant.

ORDER AND REASONS

BERRIGAN, District Judge.

This matter is before the Court on motions to dismiss filed by DonaLd L. Beckner ("Beckner") and The

Home Insurance Company ("Home Insurance"). Having considered the record, the parties' arguments, and the applicable law, the Court denies the motions.

I. BACKGROUND

A. HISTORY

The plaintiffs in this matter, Hannover Corporation of America, Place Vendome, Inc., and Place Vendome Corporation of America ("plaintiffs" or "the plaintiff corporations"), are acting through their appointed receiver, William Hays, Jr.

Hays was appointed a Federal Court Receiver by order of Judge Livaudais, U.S. District Judge, Eastern District of Louisiana, on July 29, 1992. The appointment was contained in the judge's order granting summary judgment and imposing a permanent injunction and other equitable relief in *SEC v. Sam Recile, et al.*, Civil Action 91-1422.

The proceeding before Judge Livaudais involved an SEC enforcement action brought against the plaintiff corporations, Sam Recile, and Virgie Rae Phillips. Recile and Phillips formed and controlled the plaintiff corporations for the purpose of developing a shopping mall in Louisiana--Place Vendome Mall. While Phillips was the president and sole stockholder of the plaintiff corporations, Recile was in charge of major decisions concerning the Place Vendome project, including raising funds to develop the mall. Recile and others associated with him and the plaintiff corporations solicited funds from investors by selling "pre-acquisition investment units," which were written instruments in the form of letter agreements. The agreements were issued by the plaintiff corporations, along with notes, and promised returns, or "bonuses," as Recile called them, of 100 percent or more over periods as short as six months.

\*851 Because no registration statement was filed with the SEC with respect to the solicitation of funds, the SEC brought an enforcement action against the plaintiff corporations, Recile, and Phillips. Defendant Donald L. Beckner, d/b/a Donald L. Beckner and Associates, was engaged by the plaintiff corporations, Recile, and Phillips around April 1991 to defend against this SEC lawsuit. Beckner appeared in the litigation as counsel of record until withdrawing on June 22, 1992.

On about July 29, 1992, Judge Livaudais granted the SEC's summary judgment motion and permanently enjoined the defendants from, among other things, violating federal securities laws. The order treated the different defendants with different degrees of severity.

Phillips was ordered to disgorge approximately

\$609,809 plus prejudgment interest, while Recile was ordered to disgorge approximately \$15,149,538 plus prejudgment interest. On February 2, 1994, Judge Livaudais entered a final judgment in the enforcement action against the corporations, Recile and Phillips. Hays' appointment as receiver has not been terminated.

The corporations subsequently became debtors-in-possession pursuant to a liquidating plan of reorganization in a substantively consolidated chapter 11 bankruptcy proceeding filed September 23, 1992 in U.S. Bankruptcy Court for the Middle District of Louisiana. In this proceeding, before Bankruptcy Judge Brown, Hays has acted as administrator of the debtors-in possession. [FN1]

[FN1. Judge Brown approved Hays' appointment as manager and administrator of the debtors in the bankruptcy action in a December 13, 1992 order.

#### B. PROCEEDING BEFORE THIS COURT

In the litigation before this Court, the plaintiff corporations have brought negligence and malpractice claims against their attorneys, including Beckner (Count Four of Plaintiffs' Second Amended Complaint) and claims against the attorneys' professional liability insurers, including Home Insurance (Count Five of Plaintiffs' Second Amended Complaint). The plaintiff corporations allege that Beckner breached an attorney's duty of reasonable care and professional responsibility. The alleged breaches include preferring the interests of Sam Recile over the interests of the corporations, failing to advise the corporations that Recile was violating securities laws and the injunctions in the SEC action by continuing to solicit and raise investor funds, failing to advise the corporations that Recile was looting and mismanaging the corporations' assets, and failing to properly advise the corporations on steps that could be taken to protect the debtors' assets from looting, mismanagement and waste. The plaintiff corporations also allege that their attorneys breached their duty of reasonable care and professional responsibility by drafting and presenting pleadings in the SEC action which failed to disclose ongoing violations of the law and injunctions, and which understated the amount of money raised by the corporations and the debt incurred. The plaintiff corporations further allege breaches due to the attorneys' drafting of letters to investors. These letters allegedly sought the investors' acceptance of less than the full amount of the debt owed to them on the assumption that the money for these payments would come from third party loans to the project, without

making reasonable inquiry into the viability of these loans and without first determining whether Recile was continuing to promise investors double-their-money plus interest.

#### C. THE MOTIONS

Defendants Donald L. Beckner and The Home Insurance Company have each filed motions to dismiss. Both of these motions simply adopt the grounds and arguments made in the motion to dismiss filed by Kutak Rock, et al. (Rec.Doc. 104) ("Kutak's motion").\*852 [FN2] The Kutak Rock defendants ("Kutak") are not named in the first three counts of the complaint, which only involve Beckner, and which seek to void transfers made to Beckner pursuant to the bankruptcy code. (See Second Amended Complaint.) Accordingly, the motion before the Court does not address those claims.

[FN2. The Kutak Rock defendants have reached a settlement with the plaintiff corporations and have been dismissed from this matter.

Kutak's motion sought dismissal of claims related to negligence and malpractice pursuant to Federal Rule of Civil Procedure 12(b)(6). Kutak argued that the plaintiff corporations lack standing to sue their attorneys for negligence based upon two grounds:

1) "[A] corporate debtor has no standing to assert a claim for damages that are nothing more than the unpaid obligations of the debtor to investors." (Kutak's Memo. at 2).

2) A plaintiff corporation cannot recover damages from fraud which the corporation was aware of and in which it participated. (Kutak's Memo. at 3).

Movants refer to their second argument as their *in pari delicto doctrine* argument. (E.g., Kutak's Reply Memo. at 3 n. 1). The Court will similarly refer to this argument as the *in pari delicto* argument.

Before addressing the merits of these arguments, the Court notes the procedural history behind these motions. On February 15, 1994, Kutak filed a motion to dismiss while this matter was before Bankruptcy Judge Brown. This motion raised Constitutional standing as well as *in pari delicto* arguments similar to the ones presented in the motions now before the Court. (See Bankruptcy Proceeding Record p. 67). Judge Brown denied the motion on March 22, 1994. Kutak moved Judge Polozola to grant an appeal of

Judge Brown's ruling, but that motion was denied on November 3, 1994. [FN3] Kutak argued that this Court should evaluate the pending motion unaffected by Judge Brown's prior decision because of significant legal and factual developments. Legally, Kutak claims that Hirsch v. Arthur Andersen & Co., 72 F.3d 1085 (2nd Cir.1995) and Terlecky v. Hurd (In re Dublin Sec., Inc.), 197 B.R. 66 (S.D. Ohio 1996) are precedential and decisive. (See e.g., Kutak's Reply Memo. at 2). Factually, Kutak cites certain answers to interrogatories and deposition testimony of Receiver Hays which they consider to constitute significant factual developments.

The Court is unpersuaded that any "significant" legal or factual developments have occurred since Judge Brown's ruling. For reasons set forth further in the analysis that follows, the Court rejects the assertion that the Second Circuit and district court cases are precedential or decisive to this matter; the Court also does not consider the evidence Kutak cites to substantially bear upon Beckner and Home Insurance's motions.

[FN3. Bankruptcy reference was withdrawn regarding this non-core proceeding on February 1, 1995 and the matter was assigned the Judge Polozola of the Middle District of Louisiana. After Judge Polozola recused himself, this matter was referred to this Court on October 12, 1995.

The Court considers the present motions bound by Judge Brown's prior rulings; nonetheless, it addresses the merits of the motions. Among other reasons, the Court does so due to three considerations: 1) this order is consistent with Judge Brown's ruling; 2) Beckner and Home Insurance, not the Kutak defendants, are now the moving parties; and 3) Judge Brown was able to resolve the motions before him without any written reasons. (See Bankruptcy Proceeding Record p. 90 (denying Kutak's motion for reasons orally assigned)).

To the extent that Judge Brown's ruling affects the matters raised in the present motions, the Court considers this order to set forth additional and alternative bases for denial of the motions.

## II. DISCUSSION

### A. STANDARD OF REVIEW

Plaintiffs contend that the Court should evaluate the standing issue based upon the \*853 standard of whether a plausible foundation exists for their claims. In support of this argument, plaintiffs cite Williamson v. Tucker, 645 F.2d 404 (5th Cir.1981), cert. denied, 454 U.S. 897, 102 S.Ct. 396, 70 L.Ed.2d 212 (1981).

Plaintiffs state:

The court in Williamson found that under the standard of Bell v. Hood, 327 U.S. 678, 66 S.Ct. 773, 90 L.Ed. 939 ([1946]), a claim cannot be dismissed for lack of subject matter jurisdiction to dismiss under the standard of whether the plaintiff's claim "has no plausible foundation" or is "clearly foreclosed by a prior Supreme Court decision." 645 F.2d at 416.

(Pls.' Memo. at 4).

[1] Plaintiffs fail to point out, however, that the Williamson court applied the Bell v. Hood standard because the challenge to jurisdiction was also a challenge to the existence of a federal cause of action. Williamson, 645 F.2d at 415. [FN4] The Bell v. Hood standard is inapplicable to motions to dismiss that do not challenge the existence of a federal cause of action. Id. As the Williamson court explicitly stated, "Conversely, a jurisdictional attack which does not implicate the merits of any federal cause of action is not bound by the strict Bell v. Hood standard." Williamson, 645 F.2d at 415 fn. 9. This matter does not involve a federal cause of action; accordingly, the Court rejects plaintiffs' suggestion that Bell v. Hood as interpreted by Williamson applies.

[FN4. Williamson involved a federal cause of action based upon the Securities Act of 1933 and the Securities Exchange Act of 1934.

[2][3][4] The party seeking to assert standing has the burden of alleging facts demonstrating that standing exists. FW/PBS, Inc. v. Dallas, 493 U.S. 215, 231, 110 S.Ct. 596, 607-608, 107 L.Ed.2d 603 (1990). Standing must affirmatively appear in the record. Id. A district court has the power to dismiss for lack of subject matter jurisdiction based upon three separate bases: "(1) the complaint alone; (2) the complaint supplemented by undisputed facts in the record; or (3) the complaint supplemented by undisputed facts plus the court's resolution of disputed facts." Williamson, 645 F.2d at 413.

Movants seek dismissal based upon the allegations of the Complaint and the record facts developed outside the Complaint. Movants also have stated that no resolution of disputed facts is necessary to decide this motion. The Court finds it possible to resolve the motions in favor of the plaintiffs based upon either the complaint alone or upon the complaint supplemented by undisputed facts evidenced in the record.

### B. GROUND ONE: INJURY

Kutak summarizes its first grounds for dismissal in the heading to that section: "Because the damages alleged were sustained, if at all, by investors, the plaintiff corporations lack standing to pursue those claims." (Kutak's Memo. at 12). Kutak primarily puts forth two cases to support this legal principal: Hirsch v. Arthur Andersen & Co., 72 F.3d 1085 (2nd Cir.1995) and Terlecky v. Hurd (In re Dublin Sec., Inc.), 197 B.R. 66 (S.D. Ohio 1996). Kutak has stated that this argument is a jurisdictional challenge and "is not based upon the alleged absence of an element of the negligence/malpractice cause of action." (Kutak's Reply Memo. at 3).

[5][6][7] Thus, Kutak's first grounds rests upon the injury requirement of standing. The determination of standing involves both Constitutional limitations on federal court jurisdiction as set forth by Article III and prudential limitations the federal judiciary has imposed upon itself. Gladstone, Realtors v. Village of Bellwood, 441 U.S. 91, 99, 99 S.Ct. 1601, 1607-1608, 60 L.Ed.2d 66 (1979). Among other requirements of standing, the plaintiff must allege that it has suffered some distinct or palpable injury to itself, though this injury may be shared by a large class of other possible litigants. Warth v. Seldin, 422 U.S. 490, 501, 95 S.Ct. 2197, 2206, 45 L.Ed.2d 343 (1975). This injury requirement is one of the Constitutionally mandated elements of \*854 standing. Id., 422 U.S. at 500-502, 95 S.Ct. at 2206-2207.

[8][9][10] The Court rejects defendants' argument that any damages could have been sustained only by the defrauded investors. Specifically, the Court notes that the aggravation of insolvency or prolonging the life of an insolvent business has been considered to constitute injury to the corporation. Schacht v. Brown, 711 F.2d 1343, 1347-48 (7th Cir.1983), cert. denied, 464 U.S. 1002, 104 S.Ct. 508, 509, 78 L.Ed.2d 698 (1983). As movants have noted, the plaintiff corporations' alleged damages include the amount of indebtedness incurred.

Plaintiffs have further alleged aggravation of insolvency and artificial extension of life in their claims that Beckner's malpractice caused mismanagement, waste, and looting of their assets.

Movants acknowledge this "apparently contradictory authority," but argue that the Court should disregard Schacht and instead follow Hirsch and Terlecky--cases which movants characterize as "controlling precedent." This Court, however, declines to read the Second Circuit opinion and district court opinion as more than persuasive authority. Furthermore, the Court is unconvinced that Hirsch and Terlecky, even if they were controlling, would establish that plaintiffs in this matter lack standing due to lack of distinct injury.

1. Hirsch v. Arthur Andersen & Co., 72 F.3d 1085 (2nd Cir.1995)

Hirsch involved a suit by a chapter 11 trustee against the debtors' accountants and law firms for breach of contract and fiduciary duty, negligence, negligent misrepresentation, fraud, and RICO violations arising from a Ponzi scheme. Arthur Andersen and Company, one of the debtors' accountants, had played the lead role in preparing false and misleading private placement memoranda ("PPMs") through which the Ponzi schemes were carried forward.

The district court dismissed the charges against the accountants and law firms due to lack of standing. Upon appeal, the Second Circuit looked at two issues regarding standing: 1) whether the trustee had standing to bring suit regarding the distribution of misleading PPMs to investors; and 2) whether the trustee had standing to bring suit regarding the provision of deficient professional services directly to the debtors. Hirsch, 72 F.3d at 1092.

With respect to the distribution of misleading PPMs to investors, the Second Circuit noted that the investors had a cause of action under Connecticut law and that class actions were being prosecuted by the defrauded investors. The court concluded that the trustee did not have standing to sue regarding the distribution of the misleading PPMs. Plaintiffs' citations to standing generally arise from this section. However, this holding did not include the claims predicated upon professional malpractice alleged to have injured the debtors.

While the Hirsch court found that the trustee did not have standing to sue for the PPMs because those claims belonged to investors, it *separately* considered the issue of whether the trustee had standing to sue for professional malpractice--"There remain for consideration, however, the claims that are predicated upon professional malpractice alleged to have injured the Debtors." Hirsch, 72 F.3d at 1094. The Second Circuit found that the trustee could not bring such claims; however, this finding was not based upon lack of distinct injury, but upon an *in pari delicto*-type analysis. Hirsch, 72 F.3d at 1094-1095. After conceding that some independent financial injury to the Debtors might be established, the court stated,

In any event, we are persuaded that the [Shearson Lehman Hutton v. ] Wagoner], 944 F.2d 114 (2d Cir.1991)] rule should be applied here, and that [the trustee] is precluded from asserting the professional malpractice claims alleged in the Complaint because of the Debtors' collaboration with the defendants-appellees in promulgating and promoting the Colonial Ponzi schemes.

