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NEWS & DEVELOPMENTS

Grant of Summary Judgment Affirmed Because Appellant Did Not Demonstrate that Debtor was Left with Unreasonably Small Capital

On September 30, 2014, the United States District Court for the District of Delaware entered an order affirming the Delaware Bankruptcy Court's grant of summary judgment to a defendant/appellee on a plaintiff/appellant's claims to avoid and recover two equity distributions totaling $55 million as constructively fraudulent transfers. *Whyte v. Ritchie SH Hldgs. LLC, et al (In re: SemCrude, L.P.)*, Civ. Nos. 13-1375 & 13-1376 (D. Del. Sept. 30, 2014). The issues on appeal included the bankruptcy court's conclusion that the appellant had not demonstrated that the debtor was left with unreasonably small capital after the distributions at issue.

The debtor provided goods and services related to the transportation, storage, and distribution of oil and gas products. At the time of the distributions at issue, the debtor also was party to credit facilities and had actual bank loans and lines of credit. Between July 2007 and February 2008, the debtor increased its borrowings under such facilities from about $800 million to $1.7 billion. In July 2008, the lenders declared the debtor to be in default, and the debtor thereafter filed for bankruptcy.

The Delaware District Court relied heavily on the Third Circuit decision in *Moody v. Security Pacific Business Credit, Inc.*, 971 F.2d 1056 (3d Cir. 1992). Quoting liberally from *Moody*, the District Court noted that the concept of unreasonably small capital denotes "a financial condition short of equitable insolvency" and refers to an "inability to generate sufficient profits to sustain operations. The test looks to a period of time before the entity's inability to pay debts as they become due (a separate "insolvency" test under federal and state law). In assessing the debtor's capital, the test assumes "reasonable foreseeability" and it is proper for the court to consider the availability of credit. The reasonableness of projections is determined by an objective standard "anchored in the company's actual performance," but the court must recognize that "businesses fail for all sorts of reasons, and . . . fraudulent [conveyance] laws are not a panacea for all such failures." Moreover, there must be a causal connection between the transfers at issue and the likelihood of the debtor's business failure. In this regard, a "debtor's later failure, alone, is not dispositive . . . . [and the] Court's analysis must be done as of the time of the transfers in question."

The district court noted that the debtor had substantial credit available to it at the time of the distributions at issue, the appellant did not allege that the debtor concealed its activities or engaged in fraud, and the appellant had not presented evidence that the debtor's lenders had declared a default under the debtor's lending facilities on account of the distributions at issue. Further, while the appellant alleged that it had raised a genuine issue of material fact as to whether the distributions were known to the lenders or otherwise inconsistent with the terms of the debtor's lending facilities, the district court agreed with the bankruptcy court that such evidence (if any) was not sufficient to withstand entry of summary judgment because the appellant was not able to reliably demonstrate that the lenders would have declared a default that precipitated a bankruptcy filing if the lenders had known of the distributions at issue. Instead, the district court agreed that the bankruptcy court's entry of summary judgment was appropriate because "what appellant proposes is a 'speculative exercise' not rooted in the case law."

—*Marcos Ramos, Richards, Layton & Finger, P.A., Wilmington, DE. The views expressed in this submission are those of the author and not necessarily those of Richards, Layton & Finger, P.A. or any of its clients.*