IT IS SO ORDERED.

Dated: 11:40 AM June 02 2006

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE:	)	CASE NO. 05-52467
	)	
AIR ENTERPRISES, INC.,	)	CHAPTER 11
	)	
DEBTOR(S)	)	JUDGE MARILYN SHEA-STONUM

ORDER GRANTING MOTIONS OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS SEEKING AUTHORITY TO INVESTIGATE AND PROSECUTE CERTAIN CLAIMS AND CAUSES OF ACTION [DOCKET #185 AND #186]

This matter comes before the Court on two motions of the Official Committee of Unsecured Creditors (the "Committee") seeking authority to investigate and prosecute certain claims and causes of action on behalf of the bankruptcy estate. Through its first motion [docket #185], the Committe addresses potential claims by the estate against officers and directors of the debtor (the "O/D Motion") and those claims were set forth on a draft complaint that was attached as Exhibit B (the "O/D Complaint"). Through its second motion [docket #186], the Committee addresses potential claims by the estate for the recovery of preferences and for the recovery of insurance proceeds based

upon former employees' theft from debtor (the "Preference/Theft Motion"). [The actions described in the O/D Motion and the Preference/Theft Motion will hereinafter be collectively referred to as the "Potential Causes of Action"]. David Coleman, debtor's former chief financial officer, filed an objection to the Preference/Theft Motion [docket #192].

A hearing on the motions was held on May 22, 2006. Also heard was the Application of the Committe for an order authorizing and approving the continued retention of Brouse McDowell as counsel for the Committee to prosecute the Potential Causes of Action [docket #187]. No objections to the Application were filed and, after presentation of Committee counsel's arguments in support of the Applicaton, it was approved. An Order approving the Application was entered on May 24, 2006 [docket #198].

Appearing at the hearing were John Guy, counsel for debtor and Marc Merklin and Kate Bradley, counsel for the Committee. At the beginning of the hearing Mr. Merklin represented to the Court that a resolution had been reached with David Coleman so that his objection was no longer at issue in this matter. Mr. Merklin and counsel for Mr. Coleman submitted an agreed entry to reflect such resolution [docket #199]. Mr. Merklin then presented evidence in support of the Committee's motions and at the conclusion of the hearing the matter was taken under advisement.

This proceeding arises in a case referred to this Court by the Standing Order of Reference entered in this District on July 16, 1984. It is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A) over which this Court has jurisdiction pursuant to 28 U.S.C. §1334(b). Based upon the motions, the argument of counsel in support of the motions, the evidence presented at the hearing as well as other pleadings of record in this case, the Court makes the following findings of fact and conclusions of law.

APPLICABLE LAW

In *Canadian Pacific Forest Products Ltd. v. J.D. Irving Ltd. (In re the Gibson Group, Inc.)*, 66 F.3d 1436 (6th Cir. 1995) the Sixth Circuit Court of Appeals addressed whether in a chapter 11 case where a creditors' committee had been appointed, a single creditor could have standing to file an action to avoid allegedly preferential and fraudulent transfers made by the debtor in possession. In reaching its decision, the Sixth Circuit looked to the express language of § 547 and § 548 of the Bankruptcy Code and determined that neither of those provisions acts to preclude creditor standing and that such standing actually furthers Congress's purpose in balancing the interests between the debtor in possession and its creditors in a chapter 11 case.

> Section 457(b) provides that 'the trustee may avoid any [preferential] transfer . . . .," and Section 548(a) provides that "[t]he trustee may avoid any [fraudulent] transfer." A debtor-in-possession has all the powers of a trustee. Thus, although the starting point for our inquiry is the language used by Congress, . . ., we are faced with a situation where we must determine whether Congress intended to confer exclusive authority on the trustee or debtor-in-possession to bring avoidance actions in a Chapter 11 case if the debtor abuses its discretion in not bringing such an avoidance action. A debtor-in-possession often acts under the influence of conflicts of interest and may be tempted to use its discretion under Sections 547 and 548 as a sword to favor certain creditors over others, rather than as a tool to further its reorganization for the benefit of all creditors as Congress intended. Given this reality, we do not believe Congress intended to exclude creditors from seeking to avoid preferential or fraudulent transfer where the debtor-in-possession abuses it discretion.

Gibson, 66 F.3d at 1440-41 (alteration in original) (citations omitted). Based upon that determination, the Sixth Circuit held that a bankruptcy court may permit a single creditor or a creditors' committee in a chapter 11 case to initiate an action to avoid a preferential or fraudulent transfer if:

> (1) the creditor or the committee has alleged a colorable claim that would benefit the estate, if successful, based upon a cost-benefit analysis performed by the bankruptcy court;

(2) the creditor or the committee has made a demand on the debtor-in-possession to file the avoidance action;

(3) the demand has been refused; and

(4) the refusal is unjustified in light of the statutory obligations and fiduciary duties of the debtor-in-possession in a Chapter 11 reorganization.

Gibson, 66 F.3d at 1446. A creditor or a committee is deemed to have met its burden as to standing if it has fulfilled the first three requirements and the trustee or debtor-in-possession declines to take action without stating a reason. *Id.* The burden then shifts to the debtor-in-possession to establish, by a preponderance of the evidence, that its reason for not acting is justified. *Id.*

The Sixth Circuit's holding in *Gibson* only addressed avoidance actions. The Committee, however, contends that, upon satisfaction of the *Gibson* factors, it should be granted standing to prosecute any action on behalf of the debtor-in-possession or trustee. *See* O/D Motion at pp. 8-9 and Preference/Theft Motion at pg. 5. In support of that contention the Committee cites to *Fogel v. Zell*, 221 F.3d 955, 966 (7th Cir. 2000); *Louisiana World Exposition and Fed. Ins. Co.*, 858 F.2d 233, 247 (5th Cir. 1998); and *In re Colfor, Inc.*, No. 96-60306, 1998 Bankr. LEXIS 158 (Bankr. N.D. Ohio Jan. 5, 1998). Based upon a review of the cases cited and the fact that no objection was raised as to the Committee's contention, the Court finds that, if the *Gibson* factors are met, the Committee can be granted standing to pursue claims other than avoidance actions.

DISCUSSION

Gibson Factors Two, Three and Four: On April 21, 2006, the Committee sent to Mr. Guy a letter requesting that debtor either commence a lawsuit to prosecute the Potential Causes of Action or to authorize the Committe to proceed on behalf of the estate (the "Demand Letter"). *See* O/D Motion, Exhibit A and Preference/Theft Motion, Exhibit A. During the hearing, Mr. Guy

represented to the Court that he forwared a copy of the Demand Letter to debtor's sole officer and director, Dorothy Gaffney, as well as to Ms. Gaffney's counsel, Harry Greenfield. [Both Ms. Gaffney and Mr. Greenfield were served with the Committee's motions and received notice of the hearing on those motions and neither appeared]. Mr. Guy also represented to the Court that debtor consents to the Committee's request for authority to prosecute the Potential Causes of Action. Given the Demand Letter, the second factor of the *Gibson* test has been met and given debtor's consent to the Committee's request for standing, the third and fourth factors of the *Gibson* test are not at issue in this case.

Gibson Factor One: To meet the first factor of the *Gibson* test, the Committee must demonstrate that the Potential Causes of Action present colorable claims. If the Committe so demonstrates, the Court must consider whether the potention benefit of the Committee's pursuit of the Potential Causes of Action would outweith the cost.

A. Colorable Claims

In *Gibson*, the Sixth Circuit did not elaborate upon when a claim is "colorable" for purposes of analyzing whether a creditor or a committee in a chapter 11 case has standing to bring a claim on the estate's behalf. Many courts that have considered the issue have taken a liberal approach in determining when a claim is colorable. *See, e.g., Davis v. D.L. Feathersone*, 97 F.3d 734, 737-38 (4th Cir. 1996) (holding that a claim is colorable if "it is arguable and nonfrivolous, whether or not it would succeed on the merits"); *Nemeroff v. Abelson*, 620 F.2d 339, 348 (2nd Cir. 1980) (holding that a claim is colorable when "it has some legal and factual support, considered in light of the reasonable beliefs of the individual making the claim"). *See also In re iPCS, Inc.*, 297 B.R. 283, 291 (Bankr. N.D. Ga. 2003) (and cases cited therein). Other courts have taken a stricter approach and hold that

a "colorable claim" is one which is "plausable" and "not without some merit." *See, e.g., In re Grand Eagle Companies, Inc.*, 310 B.R. 79, 95 (Bankr. N.D. Ohio 2004). Under this stricter analysis the Court should, when possible, look beyond the complaint itself to determine whether a colorable claim has been alleged. *Id.*

Through the O/D Complaint, the Committee names as defendants former officers and directors of debtor (Dorothy Gaffney, Edward Gaffney, Jr. and James Dowey)[1] (collectively, the "O/D Defendants") and alleges claims for negligence, breach of fiduciary duty, deepening insolvency, and corporate waste. Although no reference was made in the O/D Complaint to the Ohio Revised Code ("ORC"), Mr. Merklin represented during the hearing that that the causes of action against the former officers and directors are based upon Ohio law.

1. Breach of Fiduciary Duty and Negligence

Officers and directors of an Ohio corporation owe fiduciary duties of care including, but not limited to: (a) a duty to act in a manner which is in the best interests of the corporation and (b) a duty to act with the care that an ordinary prudent person would use under similar circumstances. *See* ORC § 1701.59. To support its contention that it has alleged colorable claims as to breach of fiduciary duty and negligence the Committe submitted the deposition transcripts of Ms. Dorothy Gaffney [docket #193] and Mr. Edward Gaffney [docket #194]. A review of those transcripts reveals evidence that could support the Committee's breach of fiduciary duty and negligence claims through defendants' (a) failure to properly monitor, manage and supervise the financial affairs of Air Enterprises, Inc.; (b) failure to supervise and take action against company mismanagement; and (c)

[1] The draft of the O/D Complaint also names David Coleman but, pursuant to the resolution of Mr. Coleman's objection, the Committee has agreed to forego naming Mr. Coleman as a defendant pending further investigation.

permitting Air Enterprises, Inc. to contract for and continue working on jobs that were causing significant financial losses to the company. *See, e.g.*, D. Gaffney Transcript at pp. 44, 48-49, 71-73, 134-144 and E. Gaffney Transcript at pp. 28, 39-41, 46, 51-53, 60, 76, 81-84. Based upon the facts alleged in the O/D Complaint and the depositions of the Gaffneys, the Court finds that the Committee has established "colorable claims" against the O/D Defendants as to breach of fiduciary duty and negligence.

2. Waste of Corporate Assets

An action for corporate waste will lie when a corporation effects a transaction on terms that no person of ordinary, sound business judgment could conclude would represent a fair exchange. *See, e.g., In re LTV Steel Co., Inc.*, 333 B.R. 397, 424 (Bankr. N.D. Ohio 2005). *See also Apicella v. PAF Corp.*, 479 N.E.2d 315 (Ohio Ct. App. 1984); *Murrell v. The Elder-Beerman Stores Corp.*, 239 N.E.2d 248 (Ohio Com. Pl. 1968). To support its contention that it has alleged colorable claims as to corporate waste the Committe submitted the deposition transcript of Dorothy Gaffney. A review of that transcript reveals evidence that could support the Committee's claim of wasted corporate assets through, for example, defendants' contracting for jobs which it undersold. *See, e.g.*, D. Gaffney Transcript at pp. 71-73, 134-144. Based upon the facts alleged in the O/D Complaint and the deposition of Dorothy Gaffney, the Court finds that the Committee has establised "colorable claims" against the O/D Defendants as to waste of corporate assets.

3. Deepening Insolvency

During the hearing, counsel for the Committee acknowledged that there is currently no Ohio or Sixth Circuit case law which recognizes a cause of action based upon a corporation's deepening insolvency. It is the Committee's contenion, however, that such a cause of action should be

recognized as it has been in several other jurisdictions. *See, e.g., In re Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340 (3rd Cir. 2001) (addressing Pennsylvania law). *See also, Kittay v. Atlantic Bank of N.Y. (In re Global Serv. Group LLC),* 316 B.R. 451, 457-59 (Bankr. S.D.N.Y. 2004) (collecting cases both accepting and rejecting the notion of deepening insolvency as an independent cause of action). A defendant may be liable for "deepening insolvency" where defendant's conduct, either fraudulently or even negligently, prolongs the life of a corporation and increases the corporation's debt and exposure to creditors. *In re LTV Steel Co., Inc.*, 333 B.R. 397, 421 (Bankr. N.D. Ohio 2005).

To support its contention that it has alleged a colorable claim as to "deepening insolvency" the Committe submitted the deposition transcript of Dorothy Gaffney. A review of that transcript does reveal some evidence that supports a finding that a claim of "deepening insolvency" (assuming such a claim would be recognized by Ohio law) is plausible. *See, e.g.*, D. Gaffney Transcript at pp. 71-73, 140, Exhibit 3 and Exhibit 4. Based upon the facts alleged in the O/D Complaint and the deposition of Dorothy Gaffney, the Court finds that the Committee has establised "colorable claims" against the O/D Defendants as to deepening insolvency.

4. Theft Action

The debtor has indicated in its schedules that it holds a commercial tort claim (and associated insurance recovery claims arising out of that commercial tort claim) against former employees arising from an embezzlement scheme involving fictitious payees and invoices. The Committee conducted a preliminary investigation into the merits of this claim which reveals the following:

> 8. Thomas Hokes and Gene Hancock, former employees of Air Enterprises, issued purchase orders totaling $89,358.00 to National Mechanical, Ltd. ("NML") for labor and materials in connection with a November, 2004, contract between the Debtor and the Cleveland Clinic. NML then issued invoices totaling $89,358.00, which the Debtor paid in full.
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> 9. Subsequently, Debtor became suspicious of these payments and learned that NML did not appear to be a valid entity. The Debtor engaged American Express Tax and Business Services to conduct a forensic audit to determine whether the funds paid to NML were inappropriate and, if so, whether any of Debtor's employees were involved in the scheme. The audit concluded that NML was a fictitious entity created Mr. Hokes and Mr. Hancock in order to embezzle funds from the Debtor. The audit further concluded that Mr. Hokes and Mr. Hancock had issued similar fraudulent purchase orders to NML in connection with other jobs. It is unclear whether those invoices were paid.
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> 10. As a result of the audit, the Debtor filed a claim in the amount of $89,358.00 on its blanket crime insurance policy with St Paul Travelers. The insurance company has denied the claim. Debtor's corporate counsel reviewed the crime policy and determined that the claim is valid and should be covered by the policy. The Committee also has reviewed the policy and concurs with corporate counsel's analysis.

See Preference/Theft Motion at pg. 3. During the hearing the Committee presented the testimony of Donna Drumheller, former controller of Air Enterprises, Inc., which corrorborated the information uncovered by the Committee in its initial investigation. The Committee also introduced into evidence a copy of the audit performed by American Express Tax and Business Services Inc. Based upon the allegations in the Preference/Theft Motion and the corroboration of those allegations by Ms. Drumheller, the Court finds that the Committee has establised "colorable claims" as to an action to recover on the commerical tort claim of theft.

5. Preference Actions

The Committee performed a preliminary analysis of potential preference claims pursuant to § 547 of the Bankruptcy Code and presented the testimony evidence of Ms. Drumheller to support such claims. A list of potential preference defendants (entities received payments by debtor in the

90 days preceeding the bankruptcy filing) was attached to the Theft/Preference Motion as Exhibit B. Based upon the Committee's preliminary analysis and the testimony of Ms. Drumheller, the Court finds that the Committee has establised "colorable claims" as to preference actions pursuant to 11 U.S.C. § 547.

B. Cost / Benefit Analysis

Prior to the filing of this chapter 11 case, Air Enterprises, Inc. borrowed money from FirstMerit Bank, N.A. ("FirstMerit") and the indebtedness to FirstMerit as of the petition date was approximately $5.5 million. The loan by FirstMerit to Air Enterprises, Inc. was secured by a lien in substantially all of the company's assets. On May 31, 2005, a Final Order authorizing debtor's use of FirstMerit's cash collateral was entered [docket #68] (the "Cash Collateral Order"). The sale of substantially all of debtor's assets was approved by an Order entered on August 4, 2005 [docket #129]. The proceeds received from the sale of debtor's assets were not sufficient to satisfy the money owed to FirstMerit. Except for a "carve out" provided for in the Cash Collateral Order, this estate is currently administratively insolvent and estate professionals are owed approximately $100,000.00 in excess of the "carve out." Debtor's Schedule F lists general unsecured claims of $6,614.110.41 [docket #57].

If the Potential Causes of Action are not pursued, unsecured creditors will have no prospect of recovery from this bankruptcy estate. Prosecution of the Potential Causes of Action will be on a contingency fee basis and will, therefore, impose no direct cost to the estate other than counsel's reimbursable expenses in connection with the litigation and fees of any experts engaged by the Committee. *See* Order Approving Application of Brouse McDowell [docket #198]. Should the Committee be successful in its prosecution of the Potential Causes of Action it could reasonably

recover from $1 to 2.5 million. If only $1 million were recovered then, after payment of contingency fees and costs and the fees still owing to the estate professional, a $500,000 fund could be created for payment to holders of general unsecured claims. A reasonable "best case scenario" could ultimately provide unsecured creditors with a dividend of $0.15. Although the potential fund to pay unsecured creditors may only result in a minimal revovery, such recovery is greater than anything unsecured creditors could hope to recover if the Potential Causes of Action are not pursued. Accordingly, the Court finds that such potential benefit to the estate does outweigh the potential costs.

CONCLUSION

Based upon the foregoing, the Court finds that the Committee has satisfied the *Gibson* test as to the Potential Causes of Action. Accordingly, the Committee's motions [docket #185 and #186] are hereby granted.

# # #

cc (*via* electronic mail): MARC MERKLIN, Counsel for the Committee
JOHN GUY, Counsel for Debtor
HARRY GREENFIELD, Counsel for Dorothy Gaffney
SAUL EISEN, U.S. Trustee