IT IS SO ORDERED.

Dated: 03:21 PM July 21 2010

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

IN RE:	)	CASE NO. 05-52467
	)	
AIR ENTERPRISES, INC.,	)	CHAPTER 11
	)	
DEBTOR(S)	)	
	)	
THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF AIR ENTERPRISES, INC.,	)	**ADVERSARY NO. 10-5037**
	)	
	)	JUDGE MARILYN SHEA-STONUM
	)	
PLAINTIFF(S),	)	
	)	
vs.	)	
	)	
DOROTHY GAFFNEY, ET AL.	)	**MEMORANDUM OPINION AND ORDER RE: DEFENDANTS' MOTION TO DISMISS COMPLAINT**
	)	
DEFENDANT(S).	)	

This matter comes before the Court on defendants' motion to dismiss (the "Motion") the complaint (the "Complaint") filed by the Official Committee of Unsecured Creditors of Air Enterprises, Inc. (the "Committee"). After the initial pre-trial conference in this proceeding 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), and (O) over which this Court has jurisdiction pursuant to 28 U.S.C. §1334(b).

BACKGROUND FACTS

Air Enterprises, Inc. ("Air Enterprises") was an Ohio corporation that engaged in the business of planning, designing and installing custom air handling systems. In August 2002, Edward Gaffney, Sr., the sole shareholder and Chairman of Air Enterprises died unexpectedly. Thereafter Mr. Gaffey's widow, Dorothy Gaffney, and his son, Edward Gaffney, Jr., managed the business.

On April 27, 2005, Air Enterprises filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code and in May 2005 the Committee was appointed. In August 2005 this Court approved a sale of substantially all of Debtor's assets to Air Enterprises Acquisition, LLC pursuant to § 363 of the Bankruptcy Code. The sale proceeds totaled approximately $2.75 million and were insufficient to fully pay Debtor's secured lender. Unsecured claims total approximately $7 million and the bankruptcy estate is administratively insolvent.

In April 2006 the Committee filed two motions seeking entry of an order authorizing it to investigate and prosecute certain claims and causes of action on behalf of the bankruptcy estate. Pursuant to one of those motions the Committee sought the authority to address potential claims by the bankruptcy estate against the officers and directors of Air Enterprises. The motions were granted by an order entered on June 2, 2006. On April 1, 2010 the Committee filed this adversary proceeding on behalf of the bankruptcy estate against Dorothy Gaffney and Edward Gaffney, Jr. in their capacity as officers and directors of Air Enterprises.

STANDARD OF REVIEW

In the Motion, defendants contend that all counts in the Complaint against them as directors of Air Enterprises should be dismissed for failing to state a claim upon which relief can be granted pursuant to FED. R. BANKR. P. 7012(b) and FED. R. CIV. P. 12(b)(6). When considering a motion to dismiss the Court must accept all well-pleaded factual averments as true and then determine if those facts are sufficient to raise a right to relief above the speculative level. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007). The complaint must be construed in a light most favorable to the plaintiff and it need only contain sufficient factual matter to be plausible, even if recovery seems very remote and unlikely. *Riverview Health Inst., LLC v. Medical Mutual of Ohio*, 601 F.3d 505, 512 (6th Cir. 2010); *Courie v. Alcoa Wheel & Forged Products*, 577 F.3d 625, 630 (6th Cir. 2009) *citing Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 556 (2007).

DISCUSSION

The Complaint states three claims which it sets forth as follows: "First Claim for Relief: Negligence (all Defendants);" "Second Claim for Relief: Breach of Fiduciary Duty (all Defendants);" and "Third Claim for Relief: Corporate Waste (all Defendants)." In the Motion defendants do not separately challenge each claim but instead contend that, even if all the Complaint's factual allegations are accepted as true, plaintiff has alleged only simple negligence which is not actionable against corporate directors under Ohio law.

Ohio, like every other state, acknowledges the long established principle that directors have an obligation to the corporation which is in the nature of that of a fiduciary. *Radol v. Thomas,* 772 F.2d 244, 256 (6th Cir. 1986) *citing Ohio Drill & Tool Co. v. Johnson,* 625 F.2d 738, 742 (6th Cir. 1980); *Nienaber v. Katz,* 43 N.E.2d 322 (Ohio Ct. App. 1942). A director's obligation to a

corporation encompasses two distinct duties: a duty of loyalty and a duty of care. *Radol v. Thomas*, 772 F.2d at 256. *See also, DeNune v Consolidated Capital of North America, Inc.*, 288 F.Supp.2d 844, 859 (N.D. Ohio 2003) ("Under long-standing Ohio law, the officers and directors or a corporation that is insolvent or is on the brink of insolvency owe a fiduciary duty to the corporation itself and its creditors not to waste corporate assets which otherwise could be used to pay corporate debts."). In evaluating a director's compliance with the duty of care, courts are to adhere to the "business judgment rule" and, thus, will not inquire into the wisdom of actions taken by directors in the absence of fraud, bad faith or abuse of discretion. *Radol v. Thomas*, 772 F.2d at 257. *See also Koos v. Cent. Ohio Cellular, Inc.*, 641 N.E.2d 265, 272 (Ohio Ct. App. 1994).

A director's duties to a corporation and the application of the "business judgment rule" have been codified in § 1701.59 of the Ohio Revised Code ("ORC"). *See* ORC § 1701.59(B), (C). In 1986, amendments were added to § 1701.59 of the ORC to increase the protection afforded to corporate directors:

> The purpose behind the adoption of these amendments was "to make it clear that a director has the benefit of a presumption that he [or she] is acting in good faith and in a manner he [or she] reasonably believes is in (or not opposed to) the best interests of the corporation in all cases, including those affecting or involving a change in control or a termination of his [or her] services. It is believed that the changes are necessary because of the adoption by some courts, notably those of Delaware, of the view that, in such cases, the director becomes an interested party and, as a result, loses the benefit of the business judgment rule."

Stepak v. Schey, 553 N.E.2d 1072, 1077 (Ohio 1990) (concurrence) (citation omitted). A director cannot, however, be shielded by the business judgment rule where fraud, *ultra vires* acts, illegality and breach of fiduciary duty are alleged and proven. *Id.*

Regardless of whether the business judgment rule applies, § 1701.59(D) provides that in order to hold a corporate director liable for damages under Ohio law, a plaintiff must prove by clear and convincing evidence that the director's action or failure to act was "undertaken with deliberate intent to cause injury to the corporation *or* undertaken with reckless disregard for the best interests of the corporation." ORC § 1701.59(D) (emphasis added).[1] The Complaint does not directly frame defendants' actions in terms of a "deliberate intent to cause injury to" or a "reckless disregard for the best interests of" the corporation. Instead, the Complaint alleges that defendants were grossly negligent. *See, e.g.,* Complaint at ¶64, ¶69 and ¶73. In Ohio "gross negligence" will be found when:

> The actor's conduct is in reckless disregard of the safety [or rights] of others if he does an act or intentionally fails to do an act which it is his duty to the other to do, knowing or having reason to know of facts which would lead a reasonable man to realize, not only that his conduct creates an unreasonable risk of physical [or economic] harm to another, but also that such risk is substantially greater than that which is necessary to make his conduct negligent.

Harsh v. Lorain Cty. Speedway, Inc., 675 N.E.2d 885, 888 (Ohio Ct. App. 1996), *citing Thompson v. McNeill*, 559 N.E.2d 705 (Ohio 1990). *See also Thompson Elec., Inc. v. Bank One, Akron, N.A.*, 525 N.E.2d 761 (discussing "gross negligence" of financial institution); *Vandeventer v. Vandeventer*, 726 N.E.2d 534, 539 (Ohio Ct. App. 1999) (noting that "[g]ross neglect of duty amounts to 'willfullness and evinces a reckless disregard of the rights of others'").

To support the contention that defendants were grossly negligent the Complaint alleges, *inter alia*, the following facts:

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[1] The provisions of § 1701.59 of the ORC are drafted with reference only to the directors - and not the officers - of a corporation. The Complaint alleges liability against Edward Gaffney, Jr. in his capacity as both a director and an officer of Air Enterprises yet in the Motion, defendants only address purported deficiencies in the Complaint as it relates to actions against defendants as directors. The Court can, therefore, only assume that Mr. Gaffney is not seeking dismissal of the Complaint against him as it relates to his capacity as an officer of Air Enterprises.

19. Prior to September, 2002, Dorothy Gaffney had no involvement in the operations of Air Enterprises other than occasionally performing secretarial or other ministerial tasks.

20. Prior to September, 2002, Edward Gaffney, Jr.'s involvement in Air Enterprises was limited to the sales department.

21. Prior to September, 2002, neither Dorothy Gaffney nor Edward Gaffney, Jr. had any experience or background in cost accounting and each had only a very basic understanding of how to read and interpret balance sheets and income statements.

22. Notwithstanding her complete lack of experience and knowledge, Dorothy Gaffney rejected the advice of legal counsel to form an advisory board to guide and mentor her during at least her early period with the Company. Dorothy Gaffney rejected the idea of an advisory board for the sole reason that she did not wish to share the Company's financial information with outsiders.

30. In November 2002, Edward Gaffney, Jr. expanded Air Enterprises into the European market and established Air Enterprises Europe, Ltd. ("Air Enterprises Europe"), which opened a facility in Dublin, Ireland.

31. Upon information and belief, Edward Gaffney, Jr. did not develop a business plan prior to opening the Irish operations. Rather, the decision to open the Irish operations was based solely [sic] upon the Gaffney family's appreciation of their Irish heritage.

33. Air Enterprises Europe was never profitable and, ultimately, failed and ceased operations prior to the Petition Date.

34. In January 2004, Edward Gaffney, Jr. expanded Air Enterprises into the Asian market and established Air Enterprises Asia, which opened a facility in Singapore.

35. Upon information and belief, Edward Gaffney, Jr. did not develop a business plan prior to opening the Singapore operations.

36. Air Enterprises Asia was never profitable and, ultimately, failed and ceased operations prior to the Petition Date.

41. Although the Company had sustained significant losses for the entire fiscal year to date, Dorothy Gaffney did not understand the seriousness of the Company's financial condition until June, 2004. Further, Dorothy Gaffney made no attempt to investigate the losses, or to take steps to minimize further losses.

42. By July, 2004, the Company had a negative net worth.

43. In the summer of 2004, however, Dorothy Gaffney began to question the competence of the Company's management, particularly, James Dowey and David Coleman. Dorothy Gaffeny feared that David Coleman's accounting practices were improper, potentially even illegal and that James Dowey was shirking his responsibilities as President.

44. Despite such concerns, Dorothy Gaffney made no attempt to investigate the competence and dedication of management, and took no action to remedy the situation that she herself perceived to be a problem.

45. During that time, it also was discovered that the Company's books and records understated the amount of the Company's accounts payable.

46. Notwithstanding these facts and the compounding losses of the Company, Dorothy Gaffney took no action to verify that the Company's finances were being run in accordance with Generally Accepted Accounting Principles.

47. Upon information and belief, Dorothy Gaffney did not meet regularly with David Coleman or other management to review financial statements or to go over the Company's financial condition. Further, Dorothy Gaffney never met with the Company's accountants to review year end financial statements.

48. Dorothy Gaffney was so uninformed about the Company's financial condition that she believed the Company was viable, that the Company could operate as a going concern, and that its losses were inconsequential until the Company had exhausted its $4 million line of credit with FirstMerit Bank.

57. Edward Gaffney, Jr. intentionally inflated the Company's sales numbers and goals in order to portray Air Enterprises as something it was not, a flourishing entity.

Assuming, as this Court must in this procedural context, that the foregoing factual averments (especially those set forth in ¶¶ 44-48, 57) are true, it is "plausible" that plaintiff could prove by clear and convincing evidence that defendants acted with a "deliberate intent to cause injury to" or a "reckless disregard for the best interests of" Air Enterprises. If such proofs are made, plaintiff is entitled to seek, and if proven, recover damages against defendants as directors of Air Enterprises.

CONCLUSION

Based upon the foregoing the Court finds that defendants have not shows that the Complaint should be dismissed for a failure to state a claim upon which relief can be granted pursuant to FED. R. BANKR. P. 7012(b) and FED. R. CIV. P. 12(b)(6). Accordingly, the Motion is not well taken and is hereby denied in its entirety. An order scheduling a further pre-trial conference will be entered separately in this matter.

# # #

cc (*via* electronic mail):

Kate Bradley, Counsel to the Committee
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