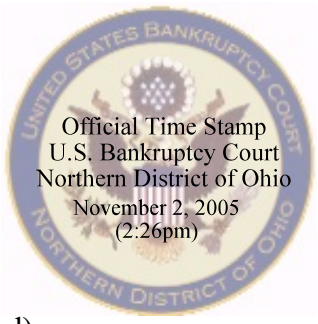
THIS OPINION NOT INTENDED FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 03-10361
	)	(Jointly Administered)
PHD, INC., et al.,	)	
	)	Chapter 11
Debtors.	)	
_____	)	Judge Pat E. Morgenstern-Clarren
	)	
THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PHD, INC., ON BEHALF OF THE ESTATE OF PHD, INC., et al.,	)	Adversary Proceeding No. 03-1332
	)	
Plaintiffs,	)	
	)	
v.	)	**MEMORANDUM OF OPINION REGARDING MOTIONS FOR SUMMARY JUDGMENT**
BANK ONE, N.A., et al.,	)	
	)	
Defendants.	)	

The official committee of unsecured creditors was authorized to file this adversary proceeding on behalf of the debtors in these jointly administered chapter 11 cases. The committee filed an amended complaint which asserts multiple claims against Bank One, NA (now known as JP Morgan Chase Bank, NA and referred to as "the bank" for purposes of this opinion).[1] The committee and the bank have filed cross-motions for summary judgment. The committee's motion for partial summary judgment asks for a determination that the bank's

[1] The amended complaint also asserts claims against Banc One Capital Partners, LLC, Daniel Phlegar, Grace Keys, Richard Henry, Stonehenge Financial Holdings, Inc., Stonehenge Partners, Inc., Stonehenge Services, Inc., and Bluestone Investors, L.P. (Docket 44). The committee and Banc One Capital Partners settled their issues. *See* Case No. 03-10361, docket 823, 831.

security interest does not extend to debtor PHD East, Inc. and its assets. The bank moves for summary judgment on all claims which the committee has made against it. Each party opposes the motion made by the other. For the reasons stated below, the committee's motion for partial summary judgment is denied and the bank's motion for summary judgment is also denied.[2]

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio

FACTS[3]

I.

On January 10, 2003, creditors filed an involuntary petition for chapter 7 relief against PHD, Inc. (PHD). PHD is owned by Richard Henry. PHD's wholly owned subsidiaries PHD East, Inc., PHD West, Inc., and PHD Southwest, Inc. filed chapter 11 petitions on January 29, 2003. On PHD's motion, the court converted its case to chapter 11 and administratively consolidated the four related cases. The debtors later sold substantially all of their assets outside the ordinary course of business.

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[2] The pleadings submitted on these motions are docket nos. 105, 106, 107, 108, 110, 111, 112, 114, 115, and 116. A number of these pleadings were filed under seal. *See* case no. 03-10361, docket 682 (stipulated protective order).

[3] The undisputed material facts are gleaned from the joint pretrial statement (Docket 19), the pleadings, and the evidence submitted on the motions for summary judgment. Stipulations of fact which the parties submitted after the submission of these motions are not referenced as they are not discussed in the motions.

II.

PHD and its subsidiaries PHD West, Inc. and PHD Southwest, Inc. were in the business of distributing small household appliances to retailers such as K-Mart and Wal-Mart. In 1996, as a means to finance their operations, PHD, Inc., PHD Southwest, Inc., and PHD West, Inc. entered into a credit facility agreement with the bank. The agreement provided for a multi-million dollar revolving loan secured by a continuing security interest in substantially all of the assets of PHD and the two corporate subsidiaries. The bank's security included all fixed collateral, revolving collateral including inventory, accounts receivable, and proceeds of collateral or receivables.

Before July 11, 2002, PHD operated a distribution center in Maryland as a division of PHD called PHD East. On July 11, 2002, PHD East, Inc. was incorporated as a Delaware corporation. PHD East, Inc. was and is a wholly owned subsidiary of PHD and at all relevant times PHD was an affiliate and insider of PHD East, Inc. as those terms are defined under the bankruptcy code. PHD East, Inc. did not execute a security agreement with the bank. On October 9, 2002, the bank filed a UCC-1 financing statement against PHD East, Inc. with the Delaware Secretary of State claiming as its collateral "all [of PHD East, Inc.'s] assets, wherever located, and proceeds and products thereof."

The parties' versions of the facts regarding the incorporation of PHD East, Inc. differ in several respects. The bank argues that the incorporation of PHD East changed nothing and that both pre-and post-incorporation PHD East operated as a division of PHD; this is critical to the bank's legal position that it has a security interest in PHD East's property. In support, the bank points to evidence indicating that before incorporation PHD East was sometimes referred to as

PHD East, Inc. and that following incorporation PHD continued to do the buying, selling, and accounting for PHD East, and also leased the warehouse from which it operated. The committee, on the other hand, argues that PHD East is a separate legal entity that was incorporated and operated in such a way that the bank does not have a security interest in the PHD East property. The committee, too, presents evidence to support its legal position. This evidence includes facts relating to a centralized cash management system used by PHD and its three subsidiary corporations. Under this system, PHD administered accounting and banking functions for the four corporate entities and managed the collection, transfer, and disbursement of inventory to, and funds generated by, the four corporate operations. This system showed whether funds were received through PHD or through the subsidiaries. Each entity also maintained a separate corporate ledger. The committee also submitted evidence drawn from the books and records of PHD and PHD East. Those records show that on July 31, 2002–after PHD East's incorporation–the book value of PHD East Inc.'s accounts receivable was $4,094,268.00 and the book value of the inventory was $2,125,080.00. As of October 7, 2002, the records show PHD East, Inc. with accounts receivable of $4,028,978.00 and $2,686,020.00 of inventory. And as of January 5, 2003 those amounts were $4,834,251.00 and $1,145,285.00 respectively. After the chapter 11 filings, PHD East, Inc. continued to file reports showing its separate assets.

On September 27, 2002, PHD informed the bank that it had discovered errors in its financial statements, including an inventory overstatement of approximately $6,000,000.00. This put PHD in default of the credit facility agreement and the bank issued a notice of default on October 8, 2002. On October 12, 2002, PHD's loan balance with the bank was $19,454,380.15 and PHD's borrowing base certificate showed a collateral value to the bank of $18,600,000.00.

On January 10, 2003 (the PHD petition date), PHD's loan balance with the bank was $10,324,385.06 and PHD's borrowing base certificate showed a collateral value to the bank of $12,300,000.00.

III.

The other factual area raised in the motions is whether the bank's prepetition conduct was such that its claim should be equitably subordinated to that of other creditors. The bank argues that it is entitled to summary judgment that it was not an "insider" for purposes of this issue and that even judged by insider standards, its conduct does not warrant equitably subordinating its claim to that of unsecured creditors. Additional facts on this topic are set forth below.

DISCUSSION

The committee makes these claims against the bank in its amended complaint and the bank requests summary judgment in its favor on each of them:

Claim 1	Equitable Subordination under 11 U.S.C. § 510(c)
Claim 2	Improvement in position under 11 U.S.C. § 547
Claim 4	Improvement in position under 11 U.S.C. § 547
Claim 6	Avoidable preference under 11 U.S.C. § 544 and Ohio Rev. Code § 1313.56
Claim 7	Fraudulent transfer under 11 U.S.C. § 548(a)(1)(B)
Claim 8	Fraudulent conveyance under 11 U.S.C. § 544(b) and Ohio Rev. Code § 1336.05
Claim 9	Recovery of preferential transfers under 11 U.S.C. § 550
Claim 10	Fraudulent inducement- knowingly making false statements
Claim 11	Fraudulent inducement- failure to correct false statements
Claim 12	Negligent misrepresentation
Claim 13	Negligent misrepresentation- failure of duty to correct false statement

Claim 14	Declaratory judgment under 28 U.S.C. § 2201
Claim 15	Declaratory judgment - U.C.C. § 9-203
Claim 16	Declaratory judgment- U.C.C. §§ 9-502 and 9-506

First, the bank requests summary judgment on claims 4, 6, 7, 8, 9, 14, 15, and 16 to the extent they are based on alleged transfers to or from PHD East, Inc. and asserts that these claims are premised on the incorrect contention that merely incorporating PHD East, Inc. effected a transfer of assets from PHD to that entity and thereby eliminated the bank's security interest in those assets. Second, the bank requests summary judgment on preference claims 2 and 9 based on the fact that it was a fully secured party at all relevant times and, therefore, could not have improved its position to the detriment of unsecured creditors. Finally, it requests summary judgment on claims 1, 10, 11, 12, and 13 on the basis that its alleged misrepresentations did not amount to moral turpitude and unsecured creditors were not legally entitled to rely on them.

The committee requests partial summary judgment and a determination that debtor PHD East, Inc. is not bound by the bank's security agreement.

A. Summary Judgment Standard

Summary judgment is appropriate only where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *See* FED. R. CIV. P. 56(c) (made applicable by FED. R. BANKR. P. 7056); *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986). The movant must initially demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett,* 477 U.S. at 323. Summary judgment "shall be rendered . . . if the pleadings, depositions, answers to interrogatories, and admissions on

file, together with the affidavits, if any, show there is no genuine issue as to any material fact[.]" FED. R. CIV. P. 56(c).

Once a movant has met its burden, the burden shifts to the nonmoving party to show the existence of a material fact which must be tried. *Id.* The nonmoving party must oppose a proper summary judgment motion "by any of the kinds of evidentiary material listed in Rule 56(c), except the mere pleadings themselves . . . ." *Celotex Corp. v. Catrett,* 477 U.S. at 324. All reasonable inferences drawn from the evidence must be viewed in the light most favorable to the party opposing the motion. *Hanover Ins. Co. v. Am. Eng'g Co.*, 33 F.3d 727, 730 (6th Cir. 1994). The issue at this stage is whether there is evidence on which a trier of fact could reasonably find for the nonmoving party. *Street v. J.C. Bradford & Co.*, 886 F.2d 1472, 1477 (6th Cir. 1989). "[T]he fact that both parties make motions for summary judgment . . . does not require the Court to rule that no fact issue exists." *Bayer Corp. v. MascoTech, Inc. (In re Autostyle Plastics, Inc.)*, 269 F.3d 726, 735 (6th Cir. 2001).

B. The Motions

1. The PHD East Claims

The bank requests summary judgment on claims 4, 6, 7, 8, 9, 14, 15, and 16 insofar as they are based on transfers having been made to or from PHD East, Inc. (the PHD East claims). This is the bank's argument: (1) the bank had a floating lien on all PHD assets including inventory and accounts receivable; and (2) although PHD East, Inc. was incorporated it never acquired any separate assets. The bank also makes these alternate arguments: (1) if PHD East, Inc. held assets, it did so as a bailee for PHD; (2) if PHD East, Inc. owned assets, the bank had a perfected security interest in them based on daily collateral reports submitted to the bank; and (3)

PHD East, Inc. is a mere continuation of PHD East the division and the bank's security agreement with PHD is sufficient to cover any assets held by PHD East, Inc. The committee opposes this portion of the bank's motion for the same reason that it requests partial summary judgment which is that PHD East, Inc. is a separate legal entity that is not a party to or bound by the bank's credit facility agreement. The bank, in turn, opposes the committee's motion for the same reasons that it requests summary judgment.

On consideration, the issues regarding the existence of corporate PHD East, Inc. and its assets which are addressed in the bank's motion cannot be decided on summary judgment. It is undisputed that PHD East, Inc. was incorporated and became a legal entity as of July 11, 2002 and there is evidence that PHD East, Inc. held assets consisting of accounts receivables and inventory in its name after that date. Therefore, although the bank argues that there was never any transfer of assets from PHD to PHD East, Inc., the evidence submitted by the committee on the bank's motion establishes the existence of a material fact regarding whether PHD East, Inc. holds assets which are not subject to the bank's security interest. Additionally, determinations as to whether PHD East, Inc. held assets as a bailee for PHD, whether the bank has a security interest in PHD East, Inc.'s separate assets by virtue of daily collateral reports issued to it, and whether PHD East, Inc. was a mere continuation of PHD East (the division) all raise factual issues that, when considered in a light most favorable to the committee, cannot be resolved on summary judgment. As just one specific example of a disputed issue of material fact on these issues, the bank argues that PHD East, Inc. intended to grant the bank a security interest in its inventory and accounts receivable as evidenced by the daily collateral report submitted to the

bank.[4] The committee denies that these collateral reports were submitted on behalf of PHD East, Inc. and that they were intended to have this effect. Another area of factual dispute is the issue of PHD East, Inc.'s status as a bailee. The committee denies that characterization and points to evidence which tends to refute it. The bank's request for summary judgment on the PHD East claims is, therefore, denied.

The committee's request for a partial summary judgment determining that PHD East, Inc. is not bound by the bank's security interest is denied for substantially the same reasons. Although it is clear that PHD East, Inc. was incorporated and became a separate legal entity on July 11, 2002, the legal consequences of the incorporation with respect to the bank's security interest cannot be made on the competing evidence presented on the committee's motion.

2. The Improvement of Position Claims

Under claims 2 and 9, the committee asserts that the bank improved its secured position by at least $2,829,995.09 in the 90-day period before the bankruptcy filing and seeks to avoid and recover that amount as a preference under bankruptcy code §§ 547 and 550. The committee argues that although the bank was partially secured on October 12, 2002 (90 days before the petition date) it was fully secured by the petition date, having improved its position through the purchase of new inventory which the debtors acquired on credit and for which no proceeds of the bank's collateral were expended. The bank argues that the committee's claims are defective as a matter of law and requests summary judgment. The bank contends that as a consequence of its floating lien none of PHD's assets was free of its security interest during the preference period and, therefore, it could not have improved its position to the detriment of unsecured creditors

[4] Docket 110 at 11.

based on the protection provided by § 547(c)(5). The bank also argues that the committee cannot show that unsecured creditors received less as a result of its improved position as required by § 547(b)(5).

Section 547(c)(5) provides protection to a creditor with a floating lien on inventory, receivables, and their proceeds that was perfected before the preference period and allows avoidance of the security interest only to the extent that the transfer of security places the creditor in a better position on the petition date than it was 90 days before the bankruptcy. *See* 11 U.S.C. § 547(c)(5). Section 547(c)(5) "does not provide affirmative grounds to avoid a security interest, but merely establishes the maximum that can be avoided if there are transfers of security that are avoidable under [the] basic preference definitions." 3 WILLIAM L. NORTON, NORTON BANKRUPTCY LAW AND PRACTICE 2d § 57:23 (July 2005). Subsection 547(b) defines a preference and § 547(b)(5) requires proof that a creditor received more than it would have if the case were a chapter 7, the transfer had not been made, and the creditor had been paid as provided by the bankruptcy code. *See* 11 U.S.C. § 547(b)(5). The petition date is the relevant date for purposes of making the § 547(b)(5) determination. *See Neuger v. United States (In re Tenna Corp.)*, 801 F.2d 819 (6th Cir. 1986).

The issues of the extent to which the bank improved its secured position during the 90 day preference period and whether it did so to the detriment of unsecured creditors cannot be resolved on summary judgment for several reasons. One, as discussed above, there is a factual dispute as to whether the assets of PHD East, Inc. (if any) are to be included in calculating the bank's secured position. Two, an issue exists as to the appropriate valuation of the bank's collateral. The committee alleges that the bank improved its position based on a collateral value

of $18,600,000.00 on October 12, 2002 and $12,300,000.00 on the petition date. The committee submitted the affidavit of CPA Michael Pappas as evidence that the bank was only partially secured as of October 12, 2002, but did not provide the factual basis for that assessment. Although the bank argues that the committee is using a liquidation valuation that is not appropriate under the circumstances, it has not established that fact and it has not provided an alternative valuation. Finally, the bank's argument that it is exempted from an improvement in position claim appears to overstate the effect of § 547(c)(5). That section only grants complete protection to a secured creditor that is fully secured 90 days before the bankruptcy and the evidence submitted on summary judgment does not establish that the bank was so secured. Consequently, the issues of whether the bank improved its secured position in the 90 days before the bankruptcy filing and whether it received more than it would have in a hypothetical liquidation cannot be decided based on the evidence provided on the motion. The bank's request for summary judgment on claims 2 and 9 is, therefore, denied.

3. The Equitable Subordination Claims

Claim 1 of the amended complaint alleges that the bank engaged in inequitable conduct and that its secured claim should be equitably subordinated under bankruptcy code § 510(c). That section provides:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and a hearing, the court may–
>
> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or

> (2) order that any lien securing such a subordinated claim be transferred to the estate.

11 U.S.C. § 510(c). The Sixth Circuit has "adopted a three-part standard for establishing equitable subordination: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act." *Bayer Corp. v. MascoTech, Inc. (In re Autostyles Plastics, Inc.)*, 269 F.3d 726, 744 (6th Cir. 2001) (citing *First Nat'l Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Servs., Inc.)*, 974 F.2d 712, 717-18 (6th Cir. 1992)).

When equitable subordination is being considered, a higher standard is imposed on the conduct of insiders. Insider transactions are scrutinized more closely "not because the insider relationship makes them inherently wrong, but because insiders 'usually have greater opportunities for . . . inequitable conduct'." *Id.* at 745 (quoting *In re Fabricators,* 926 F.2d 1458, 1465 (5th Cir. 1991)). "Therefore, 'if the claimant is an insider, less egregious conduct may support equitable subordination'." *Id*. (quoting *In re Herby's Foods, Inc.*, 2 F.3d 128, 131 (5th Cir. 1993)). While the term "insider" is defined in the bankruptcy code, that definition is not limiting. *See* 11 U.S.C. §§ 101 (31) (using the term "includes" to define "insider") and § 102((3) (stating that the term "includes" is not limiting). Consequently, whether a claimant is an insider for purposes of equitable subordination is an issue of fact. *See Waslow v. MNC Commercial Corp. (In re M. Paolella & Sons, Inc.)*, 161 B.R. 107, 118 (E.D. Pa. 1993), *aff'd* 37 F.3d 1487 (3d Cir. 1994).

A finding of inequitable conduct by a non-insider requires proof by a preponderance of the evidence of "gross misconduct tantamount to fraud, overreaching, or spoilation[.]" *In re Baker & Getty Fin. Servs.*, 974 F.2d at 718. "Types of misconduct sufficient to warrant equitable subordination against non-insiders have included instances of '[v]ery substantial misconduct involving moral turpitude or some breach or some misrepresentation where other creditors were deceived to their damage . . . or gross misconduct amounting to overreaching . . .'." *Capitol Bank & Trust Co. v. 604 Columbus Avenue Realty Trust (In re 604 Columbus Avenue Realty Trust)*, 968 F.2d 1332, 1361 (1st Cir. 1992) (quoting *In re Mayo*, 112 B.R. 607, 650 (Bankr. D. Vt. 1990)). Under appropriate facts, equitable subordination has been deemed proper where a creditor misrepresented the debtor's financial situation to another creditor so that the creditor would continue to give the debtor credit. *See, for example, Bank of New Richmond v. Prod. Credit Assoc. of River Falls, Wisconsin (In re Osborne)*, 42 B.R. 988 (W.D. Wisc. 1984).

The committee alleges that the bank was an insider that misrepresented the debtors' lending relationship and financial condition to the debtors' vendors thereby inducing them to continue shipping goods to the debtors on 60-75 day terms and that the debtors' receipt and sale of those goods enabled the bank to satisfy its deficiency as well as pay down several million dollars on its line of credit. The committee argues that the bank is an insider because it owned a majority interest in Banc One Capital Partners, LLC (BOCP) which served as its banking arm and merchant banking group at all relevant times and which was entitled to a director's position on PHD's board of directors. The committee offers evidence of a number of communications between the bank and vendors and points to the bank's superior knowledge regarding the debtors' financial condition to support this claim, as follows:

From time to time, credit managers of the various corporations from which Debtors purchased inventory (Vendors) contacted Bank One seeking credit references. Prior to September 27, 2002, Randy Radik, Debtors' relationship manager at Bank One, communicated information regarding the Debtors to the Vendors. On or about September 13-16, 2002, Mr. Radik informed Frank O'Neill, Credit Manager for Remington Products Co. LLC (Vendor), that there was positive financial information for Debtors' 2002 fiscal year end. On September 17 and 18, 2002, Mr. Radik notified Mary Trahan of The Gillette Company ("Gillette") (Vendor) and Danielle Gans of Applica Consumer Products, Inc. ("Applica") (Vendor), respectively, that the Credit Facility Agreement had been extended through July 31, 2004.

Vendors routinely, and as a matter of practice in the trade, communicate with one another and share information about the creditworthiness of common customers including Debtors. In addition to individual communications, several Vendors are members of various trade organizations which provide a forum for communications regarding customers' financial condition and creditworthiness.

On September 27, 2002, Richard Henry informed Bank One that Debtors had overstated inventory by approximately $7 million (the "Inventory Misstatement" or "Overstatement"). Upon learning of the Overstatement, Mr. Radik arranged for transfer of Debtors' account to Bank One's loan workout group, the Managed Assets Division. T. Steven Blake managed the Cleveland, Ohio Division and on September 27, 2002, decided to exit the credit, i.e., terminate Bank One's lending relationship with the Borrowers as soon as possible and no later than December 31, 2002. As of September 27, 2002, Bob Rutt, the Asset manager for Borrowers' account, did not believe that Borrowers would secure alternative financing by year's end.

The Inventory Misstatement, as well as other adjustments, created an over advance on Borrowers' loan in the approximate amount of $3.2 million. Sales projections for Borrowers' upcoming holiday busy season, however, forecast a build in the Bank's collateral value such that the over advance situation would resolve by year end, 2002. Accordingly, Mr. Rutt and Mr. Blake decided to continue to advance money to Borrowers to correct the over advance and recover on the line of credit.

On or about November 13, 2002, Mrs. Gans contacted Bank One to inquire about management changes at PHD. Mr. Radik notified her that Borrowers' account had been transferred to Robert Rutt due to reorganization within the Bank. Mr. Radik forwarded Mrs. Gans to Bob Rutt who represented that Bank One was "supporting PHD". Mrs. Gans took contemporaneous notes of her conversations.

On or about November 19, 2002, Miss Trahan contacted Mr. Radik to discuss Borrowers' financial status and to inquire about extension of the Credit Facility Agreement. Radik informed her that the account had been transferred however, he refused to comment as to why the transfer occurred. Furthermore, Mr. Radik indicated to Miss Trahan that, as of the time he transferred the account to Rutt, Bank One had issued a commitment letter, but not yet extended the facility. This was inconsistent with Mr. Radik's representation of September 17, 2002. Immediately thereafter, Miss Trahan telephoned Mr. Rutt who notified her that Borrowers' account was transferred due to a restructuring within the Bank. Miss Trahan specifically asked Mr. Rutt if he was with the loan work-out department. Mr. Rutt denied his position and that the credit had been transferred to Managed Assets. (Mr. Rutt understands "managed assets" and "loan workout" to be synonymous). Furthermore, Mr. Rutt told Miss Trahan that the Credit Facility Agreement was officially extended through July 31, 2004, that an August 2002 field audit revealed Bank One's collateral base to be "intact", and that Borrowers had $1.5 million availability on the line of credit (which corroborated information received from Mr. Drakert at Krups during an earlier conversation). The record unequivocally establishes Mr. Rutt's representations to be false. Miss Trahan's conversations with Bank One's personnel, as well as her conversations with PHD representatives and other Vendors, during which she relayed this information, are documented by contemporaneous notes.

Based on information in the trade, including critical information from Bank One, several of Borrowers' major Vendors continued to ship goods to Debtors on credit.

Upon transfer to the Managed Assets Division, Bank One systematically swept funds from Borrowers' lock box accounts to pay down the line of credit, while contemporaneously stepping

> down the funds available to Borrowers. All the while, Vendors continued to ship goods to Debtors on credit, the sale of which generated accounts receivable collected to pay the Bank. As forecast by Borrowers' and Bank One's projections, the increase in collateral value during Borrowers' busy holiday season did correct the over advance position. As of the petition date, Bank One was substantially paid while Debtors owed, and continue to owe, unsecured creditors, including Vendors, several million dollars for goods received and sold, but not paid for.

Committee's Brief in Opposition, docket 112 at 5-9 (citations to record, footnote, and emphasis deleted).

The bank accepts the committee's allegations on this issue as true for purposes of its summary judgment request,[5] and argues that they do not come close to meeting the standard for equitable subordination. The bank argues that: (1) the bank was never an insider of PHD; (2) but even if the bank was an insider equitable subordination is not merited because the committee did not present evidence of the type of substantial inequitable conduct that would warrant equitable subordination of its claim.

Summary judgment for the bank on the committee's claim for equitable subordination is not appropriate under the circumstances. The issue at this stage is whether there is evidence upon which the court could reasonably grant judgment to the committee on this claim. The bank argues that "even accepting entirely the Committee's version of events," Bank One did not make any representations that the vendors were legally entitled to rely on. The committee, however, has presented facts which, if taken as true, could result in judgment in its favor on the equitable subordination claim. The committee presented evidence to support a finding that the bank is an insider. Additionally, the committee presented evidence which tends to show that the bank had

[5] *See* Docket 115 at 9.

detailed knowledge of PHD, Inc's financial situation which the vendors did not have; that the bank made specific misrepresentations of fact to certain vendors (knowing that in this business those vendors would share the information with their fellow vendors) which misrepresentations induced the vendors to continue to ship goods on 60-75 days credit; and that the sale of those goods increased the bank's collateral value and allowed the bank to satisfy a deficiency as well as to pay down several million dollars on the line of credit. These facts, viewed in a light most favorable to the committee, can be seen as "gross misconduct tantamount to fraud, overreaching, or spoilation" which would warrant equitable subordination of all, or part, of the bank's claim. *In re Baker & Getty Fin. Servs.,* 974 F.2d at 718. In response, the bank argues that PHD's vendors considered information other than that obtained from the bank in making their credit decisions; the bank had no duty to tell the vendors that the bank had changed its mind about dealing with PHD Inc; the bank's statements that PHD's financial condition was positive (even when it wasn't) are not specific representations; and the bank cannot be liable because it was protecting PHD's privacy when it did not disseminate PHD's confidential financial information to the vendors.[6] On summary judgment, the court is not allowed to weigh the evidence or the credibility of testimony; the committee's evidence is to be believed and all reasonable inferences from that evidence must be drawn in favor of the committee. Under this standard, the evidence offered by the committee regarding the bank's status as an insider and its conduct and whether it resulted in injury or conferred an unfair advantage shows that there are genuine issues of material fact that preclude entry of summary judgment.

[6] Docket 105 at 16.

4. Common law tort claims

Claims 10, 11, 12, and 13 of the amended complaint are tort claims for fraudulent inducement and negligent misrepresentation which focus on statements the bank allegedly made to the debtors' vendors regarding the debtors' financial condition and affairs. The bank challenges the committee's right to pursue these claims and asserts that it made no misrepresentations about the debtors upon which a creditor was legally entitled to rely. The committee has a legal right to pursue these claims because it was granted authority to do so. And, as with the equitable subordination claim discussed above, there are factual issues regarding the bank's conduct which preclude summary judgment on these claims. Summary judgment on these claims is not appropriate.

CONCLUSION

The committee's motion for partial summary judgment is denied. The bank's motion for summary judgment is also denied. A separate order reflecting this decision will be entered.

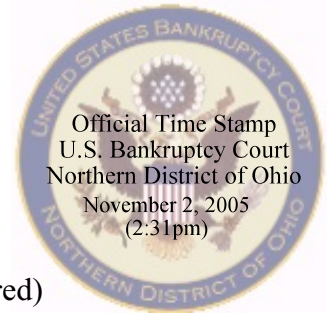
Date: 2 November 2005

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center

THIS OPINION NOT INTENDED FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 03-10361
	)	(Jointly Administered)
PHD, INC., et al.,	)	
	)	Chapter 11
Debtors.	)	
_____	)	Judge Pat E. Morgenstern-Clarren
	)	
THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PHD, INC., ON BEHALF OF THE ESTATE OF PHD, INC., et al.,	)	Adversary Proceeding No. 03-1332
Plaintiffs,	)	
v.	)	**ORDER**
BANK ONE, N.A., et al.,	)	
Defendants.	)	

For the reasons stated in the memorandum of opinion filed this same date,

IT IS, THEREFORE, ORDERED that the motion of the Official Committee of Unsecured Creditors for partial summary judgment is denied. (Docket 106).

IT IS FURTHER ORDERED that the motion of JPMorgan Chase Bank, N.A. for summary judgment is denied. (Docket 105).

Date: 2 November 2005

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

To be served by clerk's office email and the Bankruptcy Noticing Center