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2007 in Review: Defining Issues in Bankruptcy (Part II)

Featured Articles

Federal Bankruptcy Law

Featured Articles

District Court Decides that Equitable Subordination Runs with Claimant and Not with Claim

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Springfield Associates, L.L.C. v. Enron Corp. (In re Enron Corp., et al.), No. 06-CV-7828 (S.D.N.Y. Aug. 27, 2007)

In a case of interest to the financial community in light of the significant number of debt claims that are transferred either before or during a bankruptcy proceeding, and as evidenced by *amici curiae* having been filed by several organizations[1] that are active in the trading of debt securities, Judge Scheindlin from the United States District Court for the Southern District of New York, sitting in an appellate capacity, vacated orders previously entered by the bankruptcy court which called for the equitable subordination and disallowance of certain transferred claims. The decision deals with the equitable subordination of claims under §510(c) of the Bankruptcy Code (for inequitable conduct) and the disallowance of claims in a bankruptcy case under §502(d) of the Bankruptcy Code (because the claimant failed to return property that was recoverable by the bankruptcy estate-usually due to the claimant having received an avoidable preference or a fraudulent transfer). In each instance, the district court held that equitable subordination under §510(c) and disallowance under §502(d) are a function of "personal disabilities" that do not inhere in the claim. As a result, where the claim has been transferred <u>by assignment</u>, the personal disabilities of the transferor may travel with the claim and result in either equitable subordination or disallowance or both. In contrast, where the claim has been transferred <u>by sale</u> prior to the filing of the bankruptcy case and the personal disabilities are those of the transferor and not the transferee, there is no basis to subordinate or disallow the claim. The result is that equitable subordination or disallowance of a transferred claim will depend upon how and when the claim was transferred.

The facts in the *Enron* cases are not unique. Prior to the filing of the *Enron* chapter 11 cases, certain banks held claims against Enron or against its various affiliate and subsidiaries. Many of those claims were transferred prior to the Enron chapter 11 filing, apparently as a result of credit default swap contracts. According to Enron, those same banks had engaged in inequitable conduct and had property that should be returned to the Enron estate on the basis that the property had been transferred to them in either a preferential or fraudulent transfer that is avoidable in bankruptcy. During the chapter 11 cases, Enron filed complaints against the transferors seeking equitable subordination of their claims, the disallowance of their claims and both compensatory and punitive damages based on allegations that the transferors aided and abetted fraud and breach of fiduciary duty, and had engaged in an unlawful civil conspiracy with Enron insiders. Those cases are still ongoing. Enron also filed complaints against the transferees seeking to equitably subordinate the claims based upon the inequitable conduct of the transferors and also asking that the claims be disallowed because the transferors had not returned the property that had allegedly

This commentary is a follow-up to an article that appeared in the September 17, 2007 issue of Bloomberg Law Reports, Bankruptcy Law. *See* Mark N. Berman, *District Court Decides That Equitable Subordination Runs With Claimant Not With Claim*, Bloomberg Law Reports, Bankruptcy Law, Vol. 1, No. 14 (Sept. 17, 2007).

The same judge from the United States District Court for the Southern District of New York, who ruled on August 27, 2007 as to whether the purchaser of a claim can have that claim equitably subordinated or disallowed based upon conduct of the transferee, has provided more clarity as to the impact of her prior decision. *See Springfield Associates, L.L.C. v. Enron Corp.*, No. 06-CV-7828, 2007 BL 94971 (S.D.N.Y. Aug. 27, 2007). As a result, open market purchasers of claims should be feeling quite a bit better.

The prior decision held that equitable subordination under 11 U.S.C. §510(c) and disallowance under 11 U.S.C. §502(d) are functions of "personal disabilities" that do not inhere in the claim. *See Springfield Associates, L.L.C. v. Enron Corp.*, 2007 BL 94971. As a result, where the claim has been transferred *by assignment*, the personal disabilities of the transferor may travel with the claim and can result in either equitable subordination or disallowance or both. *Id.* In contrast, where the claim has been transferred *by sale* prior to the filing of the bankruptcy case and the personal disabilities are those of the transferor and not the transferee, there is no basis to subordinate or disallow the claim. *Id.* The result is that equitable subordination or disallowance of a transferred claim will depend upon how and when the claim was transferred. *Id.* However, that decision left some feeling a bit uneasy as they could not necessarily distinguish between when a claim would be transferred by a sale as opposed to an assignment and whether open market purchases of distressed debt claims were of one stripe or the other. Thus, on September 24, 2007, in a ruling on a motion for certification of interlocutory appeal, the Southern District of New York provided clarification by repeating the following two statements made in its prior decision:

> Equitable subordination and disallowance arising out of the conduct of the transferee (sic) will not be applied to good faith open market purchasers of claims.
>
> [S]ales of claims on the open markets are indisputably sales.

See Springfield Associates, L.L.C. v. Enron Corp, 2007 BL 113681 at 12 n.20.

The claimant had sought the right to appeal the district court's prior ruling, but will not be allowed to until the bankruptcy court first decides whether the claims at issue in *Enron* were transferred by sale or by assignment. Based upon the statements set forth above, the district court concluded that there should not be uncertainty in the markets while the bankruptcy court is making its decision, an assertion made in support of the effort to pursue an appeal without having to first go back to the bankruptcy court.

Protecting Directors of Troubled Companies from Personal Liability

Article contributed by
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The interests of various stakeholders holding interests in, and claims against, an insolvent or nearly-insolvent company often conflict. Secured creditors may want the company to proceed with a prompt liquidation in order to generate liquid assets from which to pay their claims. On the other hand, shareholders, unsecured creditors and employees may oppose liquidation because their interests or jobs could be wiped out, or liquidation would produce only minor distributions for them after secured creditors are paid. These latter groups are likely to prefer that a troubled company pursue workout strategies designed to avoid liquidation that would include taking on additional debt, even though the workout may ultimately fail and result in secured creditors receiving less than they would have collected via immediate liquidation.

Directors and officers of troubled companies often find themselves stuck in the middle, facing competing claims and interests, knowing that some constituency may be extremely upset - and ready to sue - no matter what course of action they choose for the corporation. Over the past several years, the threat that creditors or trustees of bankrupt companies may sue them for breach of fiduciary duties has loomed large in the minds of directors and officers. The Delaware Court of Chancery heightened concerns over personal liability in 1991 when it suggested in a footnote of an opinion that once a corporation is operating in the "zone of insolvency," its board of directors owes fiduciary duties to "the corporate enterprise."[2] That footnote led many to believe that creditors of an insolvent Delaware corporation may have the right to assert claims directly against the corporation's directors for breach of fiduciary duties.[3] Subsequent rulings of the Third Circuit Court of Appeals[4] and other courts[5] suggested that directors of insolvent companies may also face liability for a new cause of action, labeled "deepening insolvency," for artificial prolongation of an insolvent company's corporate life, resulting in damage to the corporation caused by increased debt.

Fortunately for directors of financially-troubled companies, the pendulum has swung decidedly in favor of narrowing the potential for their exposure to personal liability. In a widely hailed decision, the Delaware Supreme Court held that creditors may not bring a direct action for breach of fiduciary duties against directors of corporations that are either insolvent or in the zone of insolvency.[6] Shortly thereafter, the Delaware Supreme Court also held that Delaware law does not recognize a claim for "deepening insolvency."[7]

Nevertheless, creditors of insolvent corporations may bring derivative actions against corporate directors of insolvent corporations, just as shareholders of solvent corporations may assert such claims.[8]

As the fiduciary duties of corporate directors continue to apply when the corporation approaches insolvency or becomes insolvent, it is important for corporate directors and officers, and any crisis managers stepping into the shoes of management, to understand those duties and to identify concrete steps to be taken to protect themselves from personal liability.

Directors' Basic Fiduciary Duties

The corporate board of directors has the ultimate responsibility for managing the affairs of a corporation, and each director must fulfill certain fiduciary duties in connection therewith. Directors' fiduciary duties are governed by state law.[9] The two primary fiduciary duties of directors are the duty of care and the duty of loyalty.

The Duty of Care: This duty requires directors to exercise that degree of care which ordinarily careful and prudent persons would use in similar circumstances.[10] To fulfill their duty of care, directors must make informed decisions and use reasonable diligence in gathering information and considering material information.[11] A good faith effort to be informed and exercise judgment is the core duty of care inquiry.[12] A plaintiff can state a claim for breach of the duty of care by pleading that directors consciously and intentionally disregarded their responsibilities and adopted a "we don't care about the risks" attitude regarding a material corporate decision.[13] Similarly, a plaintiff can state claims of gross negligence in breach of the duty of care by alleging, for example, that a board undertook an acquisition without conducting due diligence, without retaining experienced advisors, and after holding a single meeting at which management made only a cursory presentation.[14]

The Duty of Loyalty: This duty mandates directors to act in the best interests of the corporation and its shareholders.[15] This means that directors (and officers) must put the best interest of the corporation ahead of any personal interest they may have, such that any decision that is affected by self-interest must be entirely fair to the corporation.[16] To state a claim for disloyalty, a claim might allege that a board authorized the acquisition of a company controlled by one of its directors because that director was having financial problems and the board, in bad faith, decided to prefer that director's interests over those of the company.[17] If a director is on both sides of a transaction, then the director bears the burden of proving the fairness of that transaction.[18] The fairness test requires the director to demonstrate utmost good faith and the inherent fairness of his or her action.[19] The director must show that his or her conduct was fair to the corporation.[20]

Under the corporate opportunity doctrine, a corporate officer or director may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the corporate fiduciary will thereby be placed in a position inimical to his duties to the corporation.[21] Put differently, a director or officer may take a corporate opportunity if: (1) the opportunity is presented to the director or officer in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity.[22]

The Business Judgment Rule

The directors owe their fiduciary obligations to the corporation and its shareholders.[23] When a corporation is insolvent, the creditors take the place of the shareholders as the residual beneficiaries of any increase in value of the company.[24] Accordingly, the creditors of an insolvent corporation have standing to maintain derivative claims on behalf of the corporation for breaches of fiduciary duties.[25] The business judgment rule represents an important protection for directors against any claim brought by shareholders or creditors for breach of a fiduciary duty.

The business judgment rule in Delaware law creates a presumption that in making a business decision the disinterested directors of a corporation act on an informed basis, in good faith and in the honest belief that the action taken is in the best interests of the company.[26] The rule protects directors against claims of simple negligence. Overcoming the presumptions of the business judgment rule on the merits[27] has been described by the Third Circuit as a near-Herculean task.[28] This may be accomplished by showing either irrationality or inattention. A plaintiff may overcome the presumption that directors and officers acted in good faith by establishing that a decision was so egregious as to constitute corporate waste.[29] The decision must go so far beyond the bounds of reasonable business judgment that its only explanation is bad faith.[30] Alternatively, a plaintiff may overcome the presumption that directors and officers acted on an informed basis by establishing that a decision was the product of an irrational process or that directors failed to establish an information and reporting system reasonably designed to provide the senior management and the board with information regarding the corporation's legal compliance and business performance.[31]

What Happens When a Corporation Approaches Insolvency or Becomes Insolvent?

Reaching insolvency does not change the primary object of the directors' duties, which is the firm itself.[32] The directors continue to have the task of attempting to maximize the economic value of the firm.[33] The business judgment rule continues to apply to protect the directors of barely solvent and insolvent corporations.[34]

Delaware law does not impose an absolute obligation on the board of an insolvent company to cease operations and liquidate.[35] Rather, directors of an insolvent company may pursue strategies to maximize the company's value, including continuing to operate and take on additional debt in the hope of turning things around.[36] If they do so acting with due diligence and in good faith, the directors do not become the guarantors of that strategy's success, even if the entity becomes more insolvent as a result of the strategy they select.[37] Directors of insolvent corporations retain the freedom to engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation.[38] In addition, so long as directors are respectful of the corporation's obligations to honor the legal rights of its creditors, they are free to pursue, in good faith, profit for the corporation's equity holders.[39] Indeed, the business judgment rule exists precisely to permit directors and managers acting in good faith to pursue risky strategies that seem to promise great profit.[40] At the same time, however, directors would be protected by the business judgment rule if they decide, in good faith, to pursue a less risky strategy because they fear that a more risky strategy might render the firm unable to meet its legal obligations to creditors and other constituencies.[41]

So What Can a Director Do to Avoid Personal Liability?

As an initial matter, there are two ways directors typically obtain protection before they begin to serve. First, by statute,[42] Delaware corporations are permitted to include in their charters exculpatory provisions that insulate directors from personal liability for claims of breach of the duty of care (e.g., for mismanagement or inadequate oversight), including derivative claims.[43] The intent of the statute is to encourage capable persons to serve as directors of corporations by providing them with the freedom to make risky, good faith business decisions without fear of personal liability.[44] One simple step a director or potential director can take is ascertaining that the corporation has adopted such a provision. But the director must bear in mind that such an exculpatory provision does not provide a shield from liability for a knowing violation of law, or acts of disloyalty such as self-dealing.[45]

Second, directors and officers are often protected by inclusion in the corporation's by-laws of a provision for indemnification by the corporation for actions they take in their official capacities. Directors and officers will want to be sure that the corporation has procured directors' and officers' insurance to back up the indemnification. The extent of coverage differs from policy to policy, so directors should ascertain the extent and limits of the coverage the corporation has in place for them and consider whether such coverage is adequate. (Note that if the corporation's policy also provides coverage for (1) the corporation's expenses in indemnifying directors and officers, or (2) the corporation's own exposure to certain litigation claims, the directors and officers will want to ensure that the policy contains a "priority of payments endorsement," which gives priority to the coverage for the directors and officers. Further, most "D&O" policies provide that defense costs must be paid on a current, as due basis, but it is important to ascertain that the insurer and the corporation did not contract otherwise. Directors also want the policy to include an "innocent director clause" so they do not lose coverage due to misconduct of the corporation.)

Next, directors and officers must be able to recognize the tell-tale signs that a corporation is headed toward financial trouble, and remain vigilant in analyzing the corporation's financial strength. Current or projected cash flow problems, excessive pressure from creditors, loss of key personnel, loss of strategic alliances with business partners and eroding market share are warning signs that a corporation may be headed toward insolvency. While there are different definitions of insolvency under bankruptcy and fraudulent conveyance law, there is no need to waste time determining whether the corporation is legally insolvent. Instead, the director should pay attention to the business factors. Indicators of insolvency, in addition to the factors just described, include the inability of the company to pay its debts as they come due, arrearages on obligations to taxing authorities, overuse of banking or other credit facilities, suppliers delaying deliveries to the company and/or tightening credit terms, and the threat or institution of legal proceedings against the company for non-payment.

If directors believe that the corporation is insolvent or approaching insolvency, they must recognize that, although their fiduciary duties remain in place, different sets of skills and perspectives are needed. To be sure, the directors must attend all board meetings, and ascertain that the corporation has adequate information, and accounting and reporting systems in place that will provide senior management and the board with reliable information regarding the company's business performance and legal compliance. Furthermore, the board should seek advice from experienced financial, accounting and legal advisors.

This is the time for the directors to ask questions. For example: What problems of the corporation must we address? How can we minimize operational losses? Does the corporation need new sources of capital? Is there a need to improve collections? Is there a problem with corporate communication, whether internally or with important creditors and suppliers? Is there reason to believe that the company's financial and accounting controls are not adequate? What can we do to address any cash flow problems that have been identified? Would it be prudent to bring in outside crisis managers or turnaround consultants who have experience in the corporation's industry? Has the board considered all viable alternatives to maximize the value of the company?

The problems of insolvent or nearly insolvent companies usually cannot be remedied in one board meeting. Typically, barring unforeseen circumstances, these companies will develop and attempt to implement a financial plan to return to profitability and will consider alternative strategies including sales of assets or the prospect of restructuring debts in a consensual workout, and the prospect of reorganizing or selling substantially all assets through a bankruptcy, if necessary. Directors will need to, among other things, monitor cash budgets and projections, review related party transactions, preserve assets, especially cash, and avoid improper corporate distributions. A hands-on approach is necessary.

Throughout this process, the prudent director must devote attention, become informed of the material information reasonably available before making business decisions, ascertain whether the company has an adequate reporting mechanism in place, have the courage to ask questions, avoid self-dealing, be able to document the business justification underlying his or her decisions, and focus on maximizing the economic value of the firm.

Conclusion

Directors of insolvent corporations cannot always please everyone. Circumstances may arise where the efficient and fair course to follow for the corporation may diverge from the choice that shareholders, creditors, employees or any single group interested in the corporation would make if given the opportunity to act.[46] But by following the guidelines suggested herein, directors should be able to minimize their exposure to personal liability for breach of fiduciary duty for actions taken while steering a financially troubled company through difficult and challenging times.

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[1] Special thanks to Adam Stein, a 2007 summer associate at Herrick, Feinstein LLP, who assisted in the preparation of this article.

[2] *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, No. 12150 (Del. Ch. Dec. 30, 1991).

[3] *See, e.g., Weaver v. Kellogg*, 216 B.R. 563, 582–84 (S.D. Tex. 1997); *In re Buckhead America Corp.*, 178 B.R. 956, 968 (D. Del. 1994).

[4] *See Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340 (3rd Cir. 2001).

[5] *Official Committee of Unsecured Creditors v. Credit Suisse First Boston (In re Exide Technologies)*, 299 B.R. 732, 751–52 (Bankr. D. Del. 2003); *In re LTV Steel Co.*, 333 B.R. 397, 422 (Bankr. W.D. Ohio 2005) (collecting cases recognizing deepening insolvency as an independent cause of action).

[6] *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, No. 521, 2007 BL 3579 (Del. May 18, 2007).

[7] *Trenwick America Litigation Trust v. Billet*, No. 495, 2007 BL 80395 (Del. Aug. 14, 2007). Rather than issue its own opinion, the Delaware Supreme Court simply issued a two-page order affirming the judgment of the Chancery Court "on the basis of and for the reasons assigned by the Court of Chancery in its opinion dated August 10, 2006." This is noteworthy because the Court of Chancery's decision rejecting recognition of a claim for deepening insolvency under Delaware law was very sharply worded. For a description of the recent judicial trend rejecting deepening insolvency as a separate cause of action and limiting its use as a theory of damages, see Paul Rubin, *Deepening Insolvency is Sinking Fast*, The Bankruptcy Strategist, Vol. 24, No. 1 (December 2006/January 2007).

[8] A derivative claim alleges harm suffered by the corporation, while a direct claim alleges harm suffered by the individual plaintiff. The recovery on a derivative claim goes to the corporation, not the pocket of the individual plaintiff; thus derivative claims are less attractive to creditors than direct claims.

[9] The discussion contained herein focuses on Delaware law, since a large number of public companies are organized under Delaware law, and decisions of Delaware state courts on issues of corporate law and governance are highly influential.

[10] *Graham v. Allis-Chalmers Manufacturing Co.*, 188 A.2d 125, 130 (Del. 1963).

[11] *Brehm v. Eisner*, 746 A.2d 244, 259 (Del. 2000).

[12] *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 967–68 (Del. Ch. 1996).

[13] *See In re Walt Disney Co. Derivative Litigation*, 825 A.2d 275, 289 (Del. Ch. 2003).

[14] *Trenwick America Litigation Trust v. Ernst & Young*, 906 A.2d 168, 194 (Del. Ch. 2006).

[15] *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361–62 (Del. 1993).

[16] *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 891 A.2d 150, 191 (Del Ch. 2005), *aff'd*, 906 A.2d 114 (Del. 2006).

[17] *Trenwick*, 906 A.2d at 194.

[18] *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993).

[19] *Weinberger v. UOP*, 457 A.2d 701, 710 (Del. 1983).

[20] *Weinberger*, 457 A.2d at 710–711.

[21] *Broz v. Cellular Information Systems, Inc.*, 673 A.2d 148, 154–155 (Del. 1996).

[22] *Guth v. Loft, Inc.*, 5 A.2d 503, 509, 23 Del. Ch. 255, 268 (Del. 1939).

[23] *See North American Catholic*, 2007 BL 3579.

[24] *Id.*

[25] *Id.*

[26] *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246 (Del. 1999).

[27] To be clear, directors would prefer to avoid a trial determining whether they breached their fiduciary duties, and ought to act in a manner that will not assist potential plaintiffs (shareholders or creditors) in formulating any complaint that would survive a motion to dismiss. If a motion to dismiss is not granted, directors may be exposed to discovery that may be distracting, time consuming, expensive, and that may provide evidence that would enable the plaintiff to overcome a motion for summary judgment and force a trial or a settlement.

[28] *In re Tower Air Inc. (Stanziale v. Nachtomi)*, 416 F.3d 229, 238 (3rd Cir. 2005).

[29] *Id.* at 238 (*citing Gagliardi v. Trifoods International, Inc.* 683 A.2d 1049, 1053 (Del. Ch. 1996)).

[30] *Id.* at 238; *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246 (Del. 1999).

[31] *In re Caremark International*, 698 A.2d at 967–70.

[32] *Production Resources Group, L.L.C. v. NCT Group, Inc.*, 863 A.3d 772 (Del. Ch. 2004).

[33] *See id.* at 790–791; *see also Trenwick*, 906 A.2d at 205.

[34] *Trenwick*, 906 A.2d at 195 n.75; *Official Committee of Unsecured Creditors of Radnor Holdings Corp. v. Tennenbaum Capital Partners, LLC (In re Radnor Holdings Corp.)*, 353 B.R. 820, 843 (Bankr. D. Del. 2006).
[35] *Radnor Holdings*, 353 B.R. at 842–43; *Trenwick*, 906 A.2d at 204.
[36] *Radnor Holdings*, 353 B.R. at 842–43; *Trenwick*, 906 A.2d at 204.
[37] *Radnor Holdings*, 353 B.R. at 843; *Trenwick*, 906 A.2d at 205.
[38] *See North American Catholic*, 2007 BL 3579.
[39] *Trenwick*, 906 A.2d at 174–75.
[40] *Id.* at 193.
[41] *Production Resources*, 863 A.2d at 788.
[42] 8 Del. C. §102(b)(7).
[43] *Production Resources*, 863 A.2d at 777.
[44] *See id.*
[45] *See* 8 Del. C. §102(b)(7)(ii); *Production Resources*, 863 A.2d at 795.
Moreover, such exculpatory provisions do not protect directors from claims for fraud, fraudulent conveyance, or common law torts.
[46] *Credit Lyonnais*, No. 12150.

Federal Bankruptcy Law

Avoidance Powers

Iridium's Creditors' Committee's Fraudulent Conveyance Claims Denied by Bankruptcy Court

In re Iridium Operating LLC, No. 99-45005, 2007 BL 96565 (Bankr. S.D.N.Y. Aug. 31, 2007)

On August 31, 2007, the Bankruptcy Court for the Southern District of New York held that a creditors' committee seeking to recover transfers worth billions of dollars under fraudulent conveyance law failed to carry its burden of proving that the debtors were insolvent or had unreasonably small capital at the time of the transfers, thereby defeating the committee's fraudulent conveyance claims.

Development of Global Voice Communications System

Iridium Operating LLC and its related affiliates (collectively, "Iridium" or "Debtors") worked closely with Motorola, Inc. ("Motorola") in conceiving, developing, owning, and operating a global telecommunications system designed to provide voice communication and paging services anywhere in the world. The system was designed to work as long as the antenna of a subscriber's telephone handset or paging unit could be positioned to make radio contact with one of Iridium's sixty-six low earth orbiting satellites.

Iridium's system, like all other mobile satellite communications systems, operated best when there were no obstructions in the path or line of sight between the handset antenna and the orbiting satellite. Iridium and its investors, marketing analysts, bank lenders, and professionals knew from the earliest development phase that the system would have constraints, particularly in urban settings, automobiles, and buildings, where line of sight limitations were most challenging.

As expected, the system did not work consistently or predictably in many wireless environments because of building obstructions. Consequently, the number of subscribers to the Iridium satellite voice and paging services, actual minutes of use of those services, and revenues derived from subscriber usage were far less than Iridium's projections and business plans had forecasted.

For seven years after Iridium was spun off from Motorola, and prior to its bankruptcy and the sale of its assets, Motorola served as Iridium's patron and contract counter party, offering substantial technical and financial support. Significantly, Motorola received payments aggregating $3.7 billion ("Transfers") pursuant to its contracts with Iridium during the four years prior to the bankruptcy filing.

Iridium's Bankruptcy Filing

Iridium filed for bankruptcy protection in August 1999, nine months following the commercial activation of its service. In March 2000, Iridium's official creditor's committee ("Committee") was authorized to bring an action against Motorola on behalf of Debtors. In July 2001, the Committee commenced an adversary proceeding against Motorola and filed a complaint ("Complaint") seeking, among other things, the recovery of the Transfers based upon fraudulent conveyance law. After a year long discovery process, Motorola moved for judgment on the pleadings. The Committee objected to Motorola's motion, which was denied in February 2003.

In February 2006, following extensive document production and depositions, Motorola moved for summary judgment ("Summary Judgment Motion"), which the Committee opposed. Notably, while the Summary Judgment Motion was still pending, the instant opinion disposed of several causes of action included therein. In September 2006, the parties agreed to limit the first phase of the trial to Iridium's solvency and capital adequacy, as such findings were necessary to satisfy one of the essential statutory prerequisites for recovery of the Transfers under applicable fraudulent conveyance law. The trial commenced in October 2006 and closing arguments were heard nine months later.

Burden of Proof

As the party seeking to avoid the Transfers based on preference and fraudulent conveyance claims, the Committee had the burden of proving by a preponderance of the evidence that Iridium was either insolvent or inadequately capitalized at the time that each Transfer was made during the four year period from August 13, 1995 through August 13, 1999. *In re Roblin Industries, Inc.*, 78 F.3d 30, 34 (2d Cir. 1996).