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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

MORPHEUS LIGHTS, INC.,
Debtor.

Case No. 96-54222-JRG
Chapter 11

VARIABLE-PARAMETER FIXTURE
DEVELOPMENT CORPORATION,

Adversary No. 98-5089

Plaintiff,

vs.

**ORDER GRANTING COMERICA'S
MOTION TO DISMISS CLAIMS FOR
EQUITABLE SUBORDINATION AND
CONSPIRACY TO BREACH
FIDUCIARY DUTY AND DENYING
MOTION TO DISMISS CLAIM FOR
UNFAIR COMPETITION**

COMERICA BANK-CALIFORNIA, a
corporation, and PETER
DALTON,
an individual,

Defendant.

I. INTRODUCTION

Before the court is Defendant Comerica-Bank California's Motion to Dismiss the Complaint filed by Plaintiff Variable-Parameter Fixture Development Corporation.¹ On March 6, 1998, Variable, a general unsecured creditor of the debtor in

¹ The hearing was held concurrently with Peter Dalton's motion to dismiss. Both motions were taken under submission at that hearing and the court is issuing decisions on the motions concurrently as well.

1 possession, Morpheus Lights, Inc., filed a complaint for: (1)
2 equitable subordination; (2) breach of fiduciary duty; (3)
3 conspiracy to breach fiduciary duty; and (4) unfair competition.
4 The complaint names two defendants, Comerica, a lender of the
5 debtor, and Peter Dalton, the President and CEO of the debtor.
6 The essence of the complaint is that Comerica and Dalton have
7 engaged in a pattern of improper post-petition conduct whereby
8 Comerica and Dalton have taken control of the debtor and the
9 bankruptcy case for their own benefit. Such conduct allegedly
10 constitutes a breach of Dalton's fiduciary duties, renders
11 Comerica liable for enabling such a breach, constitutes unfair
12 competition, and justifies equitable subordination of Comerica's
13 claim.

14 The complaint alleges three claims for relief against
15 Comerica: Claim I is for equitable subordination under 11 U.S.C.
16 § 510(c); Claim III is for conspiracy to breach fiduciary duty;
17 and Claim IV is for unfair competition. Comerica has brought
18 this motion to dismiss all three claims.

19 **II. EQUITABLE SUBORDINATION**

20 Claim I is for equitable subordination under 11 U.S.C. §
21 510(c). Variable requests equitable subordination of Comerica's
22 claims to all general unsecured creditors due to Comerica's
23 alleged misconduct. Comerica contends that Claim I should be
24 dismissed under Rule 12(b)(1) for lack of jurisdiction over the
25 subject matter because Variable lacks standing to assert the
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1 claim.² The court agrees.

2 **A. A GENERAL UNSECURED CREDITOR DOES NOT HAVE STANDING TO**
3 **BRING AN EQUITABLE SUBORDINATION CLAIM**

4 Comerica contends that there is no clear authority in the
5 Ninth Circuit in support of the proposition that an individual
6 creditor has standing to assert a claim for equitable
7 subordination. Variable contends that there is no authority
8 which would support a finding that Variable lacks standing to
9 sue for equitable subordination. The court agrees that there
10 are very few cases in any circuit discussing the issue.³

11 ² Comerica also argues that the claim for equitable subordination should be dismissed
12 because it fails to allege inequitable conduct on the part of Comerica, and it fails to
13 allege any injury to unsecured creditors or unfair advantage to Comerica. Because Variable
14 has no standing at this time, the court does not need to address the additional arguments
15 made by Comerica.

16 ³ There are a few cases which discuss a creditor's standing to bring an equitable
17 subordination claim.

18 In 1981, a New York bankruptcy court held that the trustee is the proper party to bring an
19 equitable subordination claim. The court stated that the trustee is the representative of
20 the creditors and not the debtor. In re Lockwood, 14 B.R. 374 (Bankr. E.D.N.Y. 1981).

21 In 1983, an Oklahoma bankruptcy court held that the debtor does not have standing to pursue
22 an equitable subordination claim. The court stated that the proper party is the creditor
23 or the trustee acting as representative of the creditor. In re Weeks, 28 B.R. 958, 960
24 (Bankr. W.D.Okla. 1983).

25 In 1990 the Fifth Circuit addressed whether an individual creditor has standing to seek
26 equitable subordination under § 510(c). In In re Vitreous Steel Products Co., 911 F.2d
27 1223 (5th Cir. 1990), the court refused to allow an unsecured creditor the right to pursue
28 certain counts in an adversary complaint relating to the affirmative recovery of assets for
the estate. Id. at 1230-31. The court did, however, allow the unsecured creditor standing
to seek equitable subordination under § 510(c). Id. at 1231. Unfortunately, the decision
lacks any discussion of the standards that should be applied in determining whether the
granting of standing is appropriate. The court makes a distinction between equitable
subordination and actions that would affirmatively recover assets. The court stated that:

However, [the unsecured creditor] does have standing to seek equitable
subordination of the Bank's claim in bankruptcy under § 510(c). Equitable
subordination is not a benefit to all unsecured creditors equally, at
least where the creditor whose claim is objected to is at least partially
unsecured; it is a detriment to the creditor whose debt is subordinated.
Thus, when a party seeks equitable subordination, it is not acting in the
interests of all the unsecured creditors. While the Trustee may find that
it is in the best interests of the estate to seek equitable subordination,

1 Whether an individual creditor can bring an equitable
2 subordination claim against another creditor turns on whether
3 the creditor-plaintiff is the holder of the claim. If the
4 creditor-plaintiff holds the claim, then the creditor-plaintiff
5 has standing to pursue its claim. If, for example, the estate
6 holds the claim, then a representative of the estate, such as
7 the trustee or debtor in possession, is the proper party to
8 bring the claim. Such an analysis is necessary to promote the
9 orderly and equitable administration of the bankruptcy estate by
10 preventing individual creditors from pursuing separate actions
11 to the detriment of other creditors and of the estate as a
12 whole. See Solow v. Stone, 994 F.Supp 173 (S.D.N.Y. 1998).

13 The analysis begins with whether the claim constitutes
14 property of the bankruptcy estate. A creditor-plaintiff only
15 has standing if the claim is not property of the estate because
16 property of the estate does not belong to any individual
17 creditor. See Kalb Voorhis & Co. v. American Financial Corp., 8
18 F.3d 130, 132 (2nd Cir. 1993).

19 Whether a claim is property of the estate or of an
20 individual creditor depends on whether the claim is general or

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22 individual creditors have an interest in subordination separate and apart
23 from the interests of the estate as a whole. The individual creditor
 should have an opportunity to pursue its separate interest.

24 The court has held that equitable subordination should be viewed differently than an
25 affirmative recovery because equitable subordination benefits all creditors except the
26 creditor subordinated and an affirmative recovery benefits all creditors except the
27 creditor being sued. It has been argued that the court has created a distinction without
28 a true difference. See Craig H. Averch, *The Ability to Assert Claims on Behalf of the
Debtor: Does A Creditor Have a Leg to Stand On?*, 96 Comm.L.J. 115, 126 (1991) (criticizing
the court's reasoning in In re Vitreous Steel Products Co..) Without guiding standards to
determine when it is appropriate to grant standing to an unsecured creditor, the court does
not find this case determinative.

1 particular. "If a claim is a general one, with no
2 particularized injury arising from it, and if that claim could
3 be brought by any creditor of the debtor, the trustee is the
4 proper person to assert the claim, and the creditors are bound
5 by the outcome of the trustee's action." Id. quoting St. Paul
6 Fire and Marine Ins. Co., v. PepsiCo, Inc., 884 F.2d 688, 700-01
7 (2d Cir.1989) (citations omitted). When no trustee has been
8 appointed, as in this case, a debtor in possession has all the
9 rights and powers, and shall perform all the functions and
10 duties of a trustee. See 11 U.S.C. § 1107(a). For purposes of
11 deciding the standing issue, an unsecured creditors committee
12 asserting claims on behalf of Chapter 11 debtor also stands in a
13 position analogous to that of a trustee and, thus, could be
14 treated as though it were a trustee. See Matter of Mediators,
15 Inc., 190 B.R. 515 (Bankr. S.D.N.Y. 1995). In this case an
16 Official Unsecured Creditor's Committee (creditor's committee)
17 has been formed. Hence, any generalized claims should be
18 brought by the debtor in possession or creditor's committee.

19 If it could be shown that Variable has been particularly
20 harmed by inequitable conduct of Comerica, Variable would have
21 standing to assert a claim for equitable subordination.
22 However, Variable has not alleged any injury particular to it.
23 Variable does allege that "Comerica and Pacific Western Bank
24 have exercised control over the Morpheus' settlement of a
25 pending patent infringement lawsuit by Variable-Parameter..."
26 See Complaint ¶ 14, p. 5. However, the injury that Variable
27 alleges is a general one. Variable alleges that "during the
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1 pendency of this case, Comerica has worked with Dalton toward
2 acquisition of Morpheus, and use of its assets, for the sole or
3 principal benefit of Comerica and Dalton, to the detriment of
4 Morpheus' unsecured creditors." See Complaint ¶ 16, p. 5.
5 Variable alleges that all unsecured creditors have been injured
6 alike and that any indebtedness of the debtor to Comerica should
7 be equitably subordinated to that owed all general unsecured
8 creditors. Because Variable has not alleged a particularized
9 injury, Morpheus or the creditor's committee are the proper
10 parties to assert a claim for equitable subordination.

11 However, the question remains: if the proper party to bring
12 the claim has not instituted a claim, or refuses to institute a
13 claim, can a general creditor then bring an equitable
14 subordination claim?

15 **B. IF THE PROPER PARTY TO BRING AN EQUITABLE SUBORDINATION**
16 **CLAIM DOES NOT BRING THE CLAIM, AN UNSECURED CREDITOR**
17 **DOES NOT HAVE STANDING TO PURSUE THE CLAIM ABSENT COURT**
18 **APPROVAL**

19 As a practical matter, bankruptcy law views the management
20 of a debtor as a neutral party who is the maximizer of value for
21 all parties-in-interest. See Craig H. Averch, *The Ability to*
22 *Assert Claims on Behalf of the Debtor: Does A Creditor Have a*
23 *Leg to Stand On?*, 96 *Comm.L.J.* 115 (1991). However, in some
24 cases, management of the debtor is not a neutral party and has
25 its own agenda. This is especially true when the debtor is
26 called upon to recover assets of the estate in the form of
27 claims against current management. *Id.* Management of the
28 debtor may also be reluctant to bring a lawsuit against
management-friendly lenders or shareholders for equitable

1 subordination or other affirmative actions. Id.

2 In First Bank Billings v. Feterl Mfg. Co. (In re Parker
3 Montana Co.), 47 Bankr. 419 (D.Mont 1985), the district court
4 affirmed a bankruptcy court judgment dismissing an equitable
5 subordination claim asserted by a creditor. The court held that
6 if a general creditor applied to the trustee to object to
7 another creditor's claim, and the trustee refused to object, and
8 the court authorizes the creditor to proceed, a general creditor
9 may have standing to object. However, barring permission, the
10 creditor could not proceed. Thus, the creditor is required to
11 seek court permission to bring a claim on behalf of the estate.

12 The Ninth Circuit Bankruptcy Appellate Panel has considered
13 the issue of creditor standing in an avoidance action, which by
14 statute should be brought by the trustee or debtor in
15 possession. The BAP held that creditors generally have no
16 remedy to institute an avoidance action except through the
17 trustee or debtor in possession. See In re Curry and Sorenson,
18 Inc., 57 B.R. 824, 828 (9th Cir. BAP 1986). If a creditor is
19 dissatisfied with the inaction of the trustee or debtor in
20 possession, its remedies include moving for replacement of the
21 debtor in possession with a chapter 11 trustee, for conversion
22 of the case to one under chapter 7, for dismissal of the chapter
23 11 case, for an order compelling the debtor in possession to
24 take action or conferring standing upon the creditor to
25 institute the action. Id. at 828. Thus, the BAP found that a
26 creditor may seek the court's permission to institute an action.

27 In addition, in In re LMJ, Inc., the court held that the
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1 proper remedy of a creditor when confronted with a debtor in
2 possession who declines to perform fiduciary duties, such as to
3 move to set aside an alleged fraudulent transfer, is to petition
4 for appointment of trustee. In re LMJ, Inc., 159 B.R. 926, 928
5 (Bankr. D.Nev. 1993) citing In re Baugh, 60 B.R. 102 (Bankr.
6 E.D.Ark.1986). An alternative option might be to seek
7 permission from the trustee or bankruptcy court to commence such
8 an action. See In re Munoz, 111 B.R. 928 (Bankr. D.Col.1990).
9 Hence, a creditor does not have standing to intervene due to a
10 trustee or debtor in possession's inaction without court
11 approval.

12 The court finds that requiring a creditor-plaintiff to seek
13 the court's permission before bringing a claim on behalf of the
14 estate is supported by sound policy reasons. The requirement
15 promotes the orderly and equitable administration of the
16 bankruptcy estate. If individual creditors were permitted to
17 pursue separate actions to the detriment of other creditors and
18 of the estate, the administration of the bankruptcy estate would
19 be chaotic.

20 Thus, the court concludes that the debtor in possession or
21 the creditor's committee are the holders of the equitable
22 subordination claim. If Variable is dissatisfied with the
23 parties' inaction, it can request an order compelling the
24 parties to take action or request court permission to institute
25 the claim. The court concludes that absent court permission,
26 Variable does not have standing to pursue the claim for
27 equitable subordination. The motion to dismiss is granted as to
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1 Claim I.

2 **III. CONSPIRACY TO BREACH FIDUCIARY DUTY**

3 Claim III is for conspiracy to breach fiduciary duty
4 against Comerica and Dalton. In the complaint, Variable alleges
5 that Comerica and Dalton have conspired to cause a breach of
6 Dalton's fiduciary duty owed to Variable and other unsecured
7 creditors. Although Comerica has not requested dismissal of
8 this claim on the basis of lack of standing, the issue of
9 standing must be addressed at the outset.⁴

10 As the court found above, a plaintiff only has standing if
11 it is the holder of the claim. If the claim is property of the
12 estate, the estate is the holder of the claim. Whether a claim
13 is property of the estate or of an individual creditor depends
14 on whether the claim is general or particular. Where it could
15 be shown that Variable has been individually harmed by
16 Comerica's conspiracy to breach the fiduciary duty owed by
17 Dalton, Variable has standing to assert a claim. However,
18 Variable has not alleged any injury particular to it. Because
19 Variable has not alleged a particularized injury, Morpheus or
20 the unsecured creditor's committee are the proper parties to
21 assert a claim for conspiracy to breach fiduciary duty.
22 Although Peter Dalton is the responsible person for Morpheus,
23 Variable is not without a remedy. Variable may seek court
24 permission to bring the claim. Thus, because Variable lacks
25 standing, the motion to dismiss Claim III is granted.

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27 ⁴ Comerica argues that the conspiracy to breach fiduciary duty claim should be
28 dismissed because it fails to state a claim upon which relief may be granted and it is
barred by the litigation privilege. Because Variable lacks standing at this time, the
court does not need to address the arguments made by Comerica.

1 **IV. UNFAIR COMPETITION**

2 Claim IV is for unfair competition under California
3 Business and Professional Code § 17200. Variable contends that
4 it and the general public have been injured by Comerica's unfair
5 business practices. Variable has standing to bring an action on
6 its own behalf or on behalf of the general public. Committee on
7 Children's Television, Inc. v. General Foods Corp., 35 Cal.3d
8 197, 209 (1983). Comerica does not dispute the issue of
9 standing. Comerica contends that Claim IV should be dismissed
10 because: (1) the claim is barred by the litigation privilege;
11 and (2) the complaint fails to state a claim upon which relief
12 can be granted under Rule 12(b)(6).

13 **A. LITIGATION PRIVILEGE**

14 The Litigation Privilege is codified in California Civil
15 Code § 47 which in pertinent part provides that "a privileged
16 publication or broadcast is one made... in any... judicial
17 proceeding..." The California Supreme Court has held that:

18 [T]he privilege applies to any communication (1) made
19 in judicial or quasi-judicial proceedings; (2) by
20 litigants or other participants authorized by law;
21 (3) to achieve the objects of the litigation; and (4)
22 that have some connection or logical relation to the
23 action [citations omitted.]

24 Silberg v. Anderson, 50 Cal.3d 205, 212 (1990). The purpose of
25 the privilege is to allow litigants "the utmost freedom of
26 access to secure and defend their rights." Id.

27 Comerica contends that the actions complained of in the
28 complaint are all barred from suit by the litigation privilege.
Comerica states that the following alleged acts of misconduct
are based on Comerica's conduct in the bankruptcy proceeding:

1 (1) Comerica settled its motion to appoint a chapter 11 trustee;
2 (2) Comerica exercised substantial control over the operations
3 of Morpheus; (3) Comerica exercised control over Morpheus'
4 settlement of a pending patent infringement lawsuit; (4)
5 Comerica agreed to move Morpheus' operations to Redding; (5)
6 Comerica controlled Morpheus.

7 Comerica has separated out those actions that Variable
8 complains of which do have a substantial connection to the
9 bankruptcy proceedings. However, the crux of the allegations
10 against Comerica is that it has exceeded its role as a mere
11 lender to the debtor and has exercised control through a pattern
12 of wrongful acts and unfair practices which has injured the
13 debtor, creditors and estate. This type of conduct is separate
14 and distinct from conduct typically found within even the most
15 litigious court proceedings. The litigation privilege does not
16 bar suits addressing such injurious conduct.

17 **B. FAILURE TO STATE A CLAIM**

18 A Rule 12(b)(6) motion tests the legal sufficiency of the
19 claims stated in the complaint. De La Cruz v. Torney, 582 F.2d
20 45, 48 (9th Cir 1978). Under Rule 12(b)(6) any defendant may
21 move to dismiss for failure to state a claim upon which relief
22 can be granted. The party moving for dismissal has the burden
23 of proving that no claim has been stated. To prevail, the
24 movant must show "beyond a doubt that the plaintiff can prove no
25 set of facts in support of his claim [that] would entitle him to
26 relief." Loral Terracom v. Valley National Bank, 49 F.3d 555,
27 558 (9th Cir. 1995) (quoting Conley v. Gibson, 355 U.S. 41, 45-46
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1 (1957)). This language emphasizes the limited applicability of
2 Rule 12(b)(6) as the predicate for final dismissal of the
3 action, a disposition courts generally disfavor because it
4 summarily terminates cases on their merits. During this
5 threshold review, "[t]he issue is not whether a plaintiff will
6 ultimately prevail but whether the claimant is entitled to offer
7 evidence to support the claims." Cervantes v. City of San
8 Diego, 5 F.3d 1273, 1274-1275 (9th Cir. 1993) quoting Scheuer v.
9 Rhodes, 416 U.S. 232, (1974).

10 For Rule 12(b)(6) purposes, the court must accept the
11 plaintiff's factual allegations as true, drawing all reasonable
12 inferences in plaintiff's favor. Anderson v. Clow, 82 F.3d 1480,
13 1485 (9th Cir. 1996); Walleri v. Federal Home Loan Bank of
14 Seattle, 83 F.3d 1575, 1580 (9th Cir. 1996) quoting Scheuer, 416
15 U.S. at 236.

16 The court should construe a plaintiff's allegations
17 liberally, because the rules require only general or "notice"
18 pleading, rather than detailed fact pleading. Leatherman v.
19 Tarrant County Narcotics Intelligence and Coordination Unit, 507
20 U.S. 163, 168 (1993). The test is whether the facts pled would
21 support any valid claim entitling plaintiffs to relief under any
22 theory, even if plaintiff erroneously relied on a different
23 legal theory. Bowers v. Hardwick, 478 U.S. 186, 201 (1986);
24 Haddock v. Board of Dental Examiners, 777 F.2d 462, 464 (9th
25 Cir. 1985). However, conclusory allegations or legal
26 conclusions masquerading as factual conclusions will not suffice
27 to prevent a motion to dismiss. See Epstein v. Washington
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1 Energy Co., 83 F.3d 1136, 1139 (9th Cir. 1996)

2 The Unfair Business Practices Act defines unfair
3 competition as "any unlawful, unfair or fraudulent business
4 practice and unfair, deceptive, untrue or misleading
5 advertising." The Legislature intended that this "sweeping
6 language" include "anything that can properly be called a
7 business practice and that at the same time is forbidden by
8 law." Manufacturers Life Insurance Co. v. Superior Court, 10
9 Cal.4th 257, 268 (1995) citing Barquis v. Merchants Collection
10 Assn., 101 Cal.Rptr. 745 (1972). The broad language enables
11 courts to deal with the innumerable "new schemes which the
12 fertility of man's invention would contrive." Barquis, 101
13 Cal.Rptr. at 112.

14 The common law rule for unfair competition is grounded in
15 injury to competitors. Nationwide Mutual v. Dynasty Solar, 753
16 F.Supp 853 (1990). However, under the Business and Professional
17 Code, an unfair competition claim is aimed to protect the
18 general public as well as competitors. To state a claim under
19 the Act, one need not plead and prove the elements of a tort.
20 Instead, one need only show that members of the public are
21 likely to be deceived. Manufacturers, 10 Cal.4th at 257.

22 An unfair business practice occurs when the practice
23 "offends an established public policy or when the practice is
24 immoral, unethical, oppressive, unscrupulous or substantially
25 injurious to consumers." Podolsky v. First Healthcare Corp., 50
26 Cal.App.4th 632, 647. To test whether a business practice is
27 unfair involves an examination of that practices's impact on its
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1 alleged victim, balanced against the reasons, justifications and
2 motives of the alleged wrongdoer. Id. In brief, the court must
3 weigh the utility of the defendant's conduct against the gravity
4 of the harm alleged to the victim. Id.

5 Thus, the issue before the court on this motion to dismiss
6 is whether Comerica has shown beyond a doubt that Variable can
7 prove no set of facts in support of a claim for unfair
8 competition which would entitle Variable to relief.

9 Variable alleges in the complaint that Comerica has engaged
10 in unfair business practices by: "(a) imposing confirmation of
11 a plan of reorganization as an event of default under the stock
12 pledge; (b) otherwise controlling Morpheus; (c) obtaining an
13 equity interest in Vari-Lite and (d) committing other wrongful
14 acts and conduct as aforesaid [in the complaint.]" See
15 Complaint ¶ 31, p.9-10. Other wrongful acts that Variable has
16 alleged in the complaint include discouraging other investors
17 from purchasing the debtor's assets by refusing to make
18 information available about the debtor to prospective investors
19 on reasonable terms.

20 The court finds that Comerica has not met its burden to
21 show beyond a doubt that Variable can prove no set of facts in
22 support of a claim for unfair competition which would entitle
23 Variable to relief. Variable has alleged facts sufficient to
24 survive a motion to dismiss and is entitled to offer evidence to
25 support its claim of unfair competition. The motion to dismiss
26 Claim IV is denied.

27 **V. CONCLUSION**

28

**UNITED STATES BANKRUPTCY COURT
For The Northern District Of California**

1 Thus, based on the foregoing, the court grants Comerica's
2 motion to dismiss Claim I for equitable subordination and Claim
3 III for conspiracy to breach fiduciary duty based on Variable's
4 lack of standing at this point. Variable may bring these claims
5 again if it obtains court approval. The court denies Comerica's
6 motion to dismiss Claim IV for unfair competition.

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