UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

MOBILE ENERGY SERVICES HOLDINGS, INC., — Case No. 99-10168;
MOBILE ENERGY SERVICES COMPANY, L.L.C., — Case No. 99-10170

Debtors. — Jointly Administered under Case No. 99-10168

MOBILE ENERGY SERVICES HOLDINGS, INC.;
MOBILE ENERGY SERVICES COMPANY, L.L.C.

Plaintiffs, — Adversary Proceeding No. 99-1007

v.

KIMBERLY-CLARK TISSUE COMPANY

Defendant.

ORDER ON MOTION OF KIMBERLY-CLARK TISSUE COMPANY TO DISMISS PLAINTIFFS' ADVERSARY COMPLAINT

Donald Stewart and Jared White, Attorneys for Mobile Energy Services Holdings, Inc. and Mobile Energy Services Company, L.L.C.
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David M. Stahl, Howard L. Sharfstein, and Christopher I. Gruenwald, Attorneys for Kimberly-Clark Tissue Company
Travis Bedsole, Bankruptcy Administrator

This matter came on for hearing on the motion of Kimberly-Clark Tissue Company ("KC") to dismiss the adversary complaint filed by Mobile Energy Services Holdings, Inc. and Mobile Energy Services Company, L.L.C. (hereinafter collectively referred to as "Debtors") pursuant to Bankruptcy Rule 7012, which incorporates by reference Federal Rule of Civil Procedure 12(b). This Court has jurisdiction to hear this matter pursuant to 28 U.S.C.§157 and §1334 the Order of Reference of the District Court. This matter is a core proceeding pursuant to 28 U.S.C. §157(b)(2).

The Court has considered the pleadings, legal briefs and arguments of counsel. The motion to dismiss Count I and Count VI of the Debtors' amended complaint was argued before the Court and taken under submission.

The original complaint in this matter was filed on January 15, 1999 and incorporated five separate counts against KC. KC responded with its motion to dismiss and the Debtors filed an amended complaint on March 19, 1999 adding a sixth cause of action. KC filed a separate motion to dismiss Count VI.

Counts II, III, IV, and V were sent to arbitration pursuant to an order of this Court dated March 23, 1999 wherein the Court granted the motion of KC to compel arbitration on those matters. The Court entered a stipulated order supplementing its order of March 23, 1999 wherein all proceedings on Counts I and VI of Plaintiffs' amended complaint were stayed until the completion of arbitration of Counts II through V. The Court has been advised by the parties that the arbitration is now complete with regards to Counts II-V. The decision of the arbitrator fully resolves the issues presented in those counts and pursuant to the Master Operating Agreement, the parties are bound by the results. Therefore, Counts II through V are due to be dismissed.

Count I and Count VI of Plaintiffs' amended complaint are based on fraudulent transfer. KC's motion to dismiss Count I of the complaint was based on the following grounds: (1) failure to state a claim under Federal Rules of Civil Procedure 12(b)(6) as incorporated by Fed. Bankr. R. P. 7012(b); (2) lack of standing under Federal Rules of Civil Procedure 12(b)(1) as incorporated by Fed. Bankr. R. P. 7012(b); (3) failure to meet the applicable statute of limitations (4) justiciability. The motion of KC to dismiss Count VI of Plaintiffs' amended complaint is also based on Federal Rules of Civil Procedure 12(b)(6).

FACTUAL BACKGROUND

Mobile Energy Services Holdings, Inc. ("MESH") and Mobile Energy Services, Inc. ("MESC") filed voluntary petitions under Chapter 11 of the Bankruptcy Code on January 14, 1999. MESH is an Alabama corporation, with its principal offices located in Atlanta, Georgia. MESC is a limited liability corporation formed under the laws of Alabama whose offices are also located in Atlanta, Georgia. Ninety-nine percent (99%) of MESC's stock is owned by MESH, and the remaining one percent is owned by Southern Energy Resources, Inc. ("SER") (formerly Southern Electric International, Inc.). MESH is a wholly-owned subsidiary of the Southern Company ("Southern"). MESH and MESC were formed for the sole purpose of acquiring, owning, and managing the energy complex at the Mobile facility ("Energy Complex"). Both MESH and MESC remain in possession and control of their businesses as debtors-in-possession pursuant to §§1107 and 1008 of the Bankruptcy Code.

Defendant Kimberly-Clark Tissue Company ("KC") is a corporation formed under the laws of Pennsylvania with its principal offices in Irving, Texas. KC is a wholly owned subsidiary of Kimberly-Clark Corporation, which is engaged in the manufacture and sale of consumer products, paper and forest products and various other businesses. It has manufacturing operations in 38 countries and sells its products in 150 countries. By virtue of a merger in 1995 between Kimberly-Clark Corporation and Scott Paper Company, Kimberly-Clark presently owns the pulp mill and tissue mill at the Mobile facility, both of which are served by MESC's energy-producing assets.

Negotiations were entered into between Southern and KC's predecessor, Scott Paper Company ("Scott"), and, in December 1994, the acquisition of the Energy Complex by MESH was completed. Southern contributed $265 million toward the purchase of the Energy Complex, $190 million of which was in the form of a loan to MESH and $75 million of which was denominated as equity. The remainder of the $350 million purchase price was composed of $85 million in outstanding tax-exempt bond debt to the Industrial Development Board of the City of Mobile ("IDB"), which MESH assumed. Therefore, MESH incurred indebtedness of $275 million. About the same time, Scott and MESH entered into certain operating agreements, including energy services agreements for two of the three mills and the Master Operating Agreement ("MOA"), which governed many of the critical terms of the parties' prospective business relationships at the Mobile Facility. Article 13 of the MOA, styled "Termination of Agreement," contains the provisions dealing with the conditions and consequences of termination by the Mill Owners (KC) or MESH of the parties' agreement. Section 13.1 sets forth a mechanism for a Mill Owner to effect a termination of its energy services agreement in the event of a "Mill Closure."

In July 1995, Southern, through MESH and SER (formerly, Southern Electric International), formed MESC with Southern Electric owning one percent and MESH owning 99 % of MESC's stock. MESH transferred the Energy Complex and related contracts, assets, and permits to MESC in July, 1995. Subsequently, approximately seven months after the Energy Complex was acquired from Scott, MESC and Scott entered into the Amended and Restated MOA, which replaced and superceded the original Master Operating Agreement entered into between Scott and MESH in 1994. The amended MOA contained virtually the identical termination provision as the 1994 Master Operating Agreement entered into between Scott and MESH. At the time of the December 1994 acquisition by MESH of the Energy Complex and the execution of the various operating service agreements, MESC did not even exist.

All of the transaction indebtedness incurred in December 1994 was retired approximately eight months later through new financing, this time obtained by MESC. In August 1995, MESC issued first mortgage bonds and a public offering ("1995 Bond Offering"). The 1995 Bond Offering generated gross proceeds of $255,210,000.00 in first mortgage bonds. Part of those proceeds were used to retire the $190 million Southern loan to MESH and to pay certain other costs associated with the acquisition of the Energy Complex. MESH unconditionally guaranteed MESC's obligations under the bonds issued in the 1995 Bond Offering. Also in 1995, the Industrial Development Board of the City of Mobile (IDB) issued new tax-exempt bonds.

On May 5, 1998, KC, in its capacity as pulp mill owner, sent a written notice announcing that it intended to effect a "Mill Closure" of the pulp mill to be effective September 1, 1999, and that KC was, therefore, exercising its right to terminate its rights and obligations under the Pulp Mill Energy Services Agreement and certain provisions of the Master Operating Agreement. In its announcement, KC stated that the basis for the closure under Article XIII, Section 13.1(a), would be that the pulp mill would be closed for a period of at least one year.

COUNT I

Statute of Limitations

MESC and MESH (Debtors) seek to avoid the transfers and obligations incurred in connection with the acquisition of the Energy Complex from Scott (now KC) in December 1994. This transfer was accomplished pursuant to the Master Operating Agreement (MOA) and the Pulp Mill Energy Services Agreements. Certain amendments to these agreements were made in July 1995. Debtors claim they are entitled to recover from KC the value of the transfers and obligations identified in paragraphs 18-26 of their complaint pursuant to Bankruptcy Code §§ 544(b)(1) and 550.

§544(b)(1) states as follows:

> Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C. § 544(b)(1).

Therefore, MESC and MESH, as Debtors-in-possession, must rely on the applicable state law to avoid a transfer or obligation. Debtors contend that the consideration paid for the Energy Complex was not reasonably equivalent to its actual value and that the Debtors were rendered insolvent as a result of the transfer. To determine whether Debtors have properly stated a cause of action, the Court must first determine which state's laws will supply the substantive elements of the claim.

KC has urged the Court to apply Alabama's choice of law rules and the Alabama statute of limitations to the Debtor's fraudulent transfer claim under Count I. The majority of decisions, including several courts within the Eleventh Circuit, in which federal courts sitting pursuant to bankruptcy jurisdiction, follow the holding of *Klaxon v. Stentor Elec. Mfg. Co.* 313 U.S. 487 (1941) and employ the choice of law rules of the state in which they sit.[1]

Debtors have offered that this Court need not follow the *Klaxon* decision because it controls choice of law determination in diversity cases. Debtors state that when a plaintiff's claims are based on federal bankruptcy law, the Supreme Court has suggested that a federal court "should not be required to follow the choice of law rule of the forum state pursuant to *Klaxon*, . . . but may exercise

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[1] *Weaver v. Kellogg (In re Weaver)*, 216 B.R. 563, 585 (S.D. Tex. 1997) (finding that in adversary proceeding brought by the Chapter 11 trustee "the Court must apply the choice of law rule of Texas, the forum state."); *Chalk Line Mfg. Inc. v. Frontenac Venture Ltd. (In re Chalk Line Mfg., Inc.)*, 1994 WL 394978 (Bankr. N.D. Ala. 1994) ("Alabama's choice of law rules must govern the Court's decision in this case."); *Hillsborough Holdings Corp. v. Celotex Corp. (In re Hillsborough Holdings Corp.)*, 166 B.R. 461, 468 (Bankr. M..D. Fla. 1994)) ("In determining which state's law applies, the bankruptcy court must apply choice-of-law rules of the state in which it sits.") (citations omitted); *Master Mortgage Inv. Fund Inc. v. American Nat'l Fire Ins. Co. (In re Master Mortgage Inv. Fund, Inc.)*, 151 B.R. 513, 518 (Bankr. W.D. Mo. 1993) ("As a federal bankruptcy court sitting in the state of Missouri and deciding a question that will be controlled by state law, this Court must use the choice of law rules used in the state of Missouri."). *In re Merritt Dredging Co., Inc.*, 839 F.2d 203, 206 (4th Cir. 1988) ("in the absence of a compelling federal interest which dictates otherwise, the *Klaxon* rule should prevail where a federal court seeks to determine the extent of a debtor's property interest.").

its ‘independent judgment’ and choose that state’s substantive law which is appropriate in the case before it, pursuant to the Supreme Court’s nondispositive discussion of the issue in *[Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 161-63 (1946)].” *Kaiser Steel Corp. v. Jacobs* 87 B.R. 154, 157 (D. Colo. 1988). See also *Lindsay v. Beneficial Reinsurance Co.* (*In re Lindsay)*, 59 F.3d 942, 948 (9th Cir. 1995), cert. denied, 516 U.S. 1074 (1996) (“The rule in diversity cases, that federal courts must apply the conflict of laws principles of the forum state, does not apply to federal question cases such as bankruptcy.”). When a claim in bankruptcy “is to be determined by reference to state law,” but there is more than one state with significant contacts to the parties or to the controversy, determining which law to apply “requires the exercise of an informed judgment in the balancing of all the interests of the states with the most significant contacts in order to best accommodate the equities of the parties to the policies of those states.” *Vanston*, 329 U.S. at 161-62. The Court recognizes that “there is a clear split of authority whether federal courts sitting pursuant to the special grant of bankruptcy jurisdiction are mechanically bound to apply the *Klaxon* choice of law rule”. *Kaiser Steel Corp. v. Jacobs*, 87 B.R. at 157 (D. Colo. 1988) (citations omitted).

The cases relied on by the Debtors are not convincing and may be distinguished. The *Lindsay* case involved the interpretation of an element of a cause of action created entirely by a federal statute, 11 U.S. C. §548. This is distinguishable from the instant case involving a state law claim brought pursuant to the provisions of § 544(b), which allows a trustee (or a debtor-in-possession) to assert a state law cause of action such as the fraudulent conveyance complained of by Debtors. *Still v. Fuller (In re Southwest Equipment Rental)*, 1992 WL 684872, 10 (E.D. Tenn. 1992). The *Kaiser* case relied on by Debtors did discuss the application of federal choice of law rules, but that discussion was not relevant to the court’s holding. The court actually applied the choice of law rules of the forum state to the §544(b) action. *Kaiser Steel Corp. v. Jacobs (In re*

Kaiser Steel Corp.) 87 BR 154, 159 (D. Colo. 1988).

This Court concludes that based on *Klaxon* and the cases cited in footnote one above, it is appropriate to apply the choice of law rules of Alabama, the forum state. For the reasons set forth herein, the Court will apply the Alabama substantive law of fraudulent transfer and will apply Alabama's statute of limitations. See, *Roper v. City Nat'l Bank of Birmingham (In re Bethune)*, 18 B.R. 418, 419 (Bankr. N.D. Ala. 1982) (finding Alabama's statute of limitations applicable under section 544(b) where Alabama's fraudulent conveyance law was applicable); *Crews v. Carwile (In re Davis),* 138 B.R. 106, 108 (Bankr. M.D. Fla. 1992) (finding that where a bankruptcy court is using the forum state's substantive law, it must apply the forum state's statute of limitations); *Mahoney, Trocki & Assocs. V. Kunzman (In re Mahoney, Trocki & Assocs.)* 111 B.R. 914, 917 (Bankr. S.D. Cal. 1990) ("[A]s the California law on fraudulent conveyances is being utilized, California statute limitations must be applied as well."); *Evans v. Robbins (In re Robbins),* 91 B.R. 879, 883 (Bankr. W.D. Mo. 1988) (applying Missouri's statute of limitations where bankruptcy court sat in Missouri and Missouri substantive law applied); *Old Orchard Bank & Trust Co. v. Josefik (In re Josefik),* 72 B.R. 393, 397 n.4 (Bankr. N.D. Ill. 1987) ("Since the bankruptcy court is applying the forum state's substantive law of fraudulent conveyance in actions brought under Section 544(b), the bankruptcy court is required to apply the forum state's statute of limitations governing fraudulent conveyances.") (citations omitted).

The Debtors have alleged in paragraph 74 of Count I the elements of a claim for constructive fraudulent transfers under the Alabama Fraudulent Transfer Act (AFTA). See , Ala. Code 1975 §§8-9A-1, et. seq. which applies to all transfers made after January 1, 1990. This Court will apply the Alabama Fraudulent Transfer Act in this case. Even though no reported Alabama opinions have decided which Alabama choice of law doctrine would apply to a determination of the substantive fraudulent transfer law, the *lex loci delecti* doctrine has been applied by Alabama courts to a variety of causes of action, including torts. This doctrine focuses on the place of the injury. See, *Fitts v. Minnesota Mining & Manufacturing Co.*, 581 So.2d 819 (Ala. 1991) (favoring the *lex loci delecti* doctrine in wrongful death tort action); *Batey & Sanders, Inc. v. Dodd*, 755 So.2d 581 (Ala. Civ. App. 1999) (applying *lex loci delecti* to retaliatory discharge claim); *Jones v. Triple Crown Services Co.*, 44 F. Supp. 2d 1339 (M.D. Ala. 1999) (applying *lex loci delecti* to fraudulent joinder claim); *Whatley v. Merit Distribution Services,* 191 F.R.D. 655, 659-660 (S.D. Ala. 2000). Numerous courts have construed fraudulent transfer actions to be tort actions for purposes of a choice-of-law analysis. See, *In re Blatstein*, 260 B.R. 698 (E.D. Pa. 2001); *S.E.C. v. Infinity Group* Co., 27 F.Supp.2d 559, 564 (E.D. Pa. 1998); *Advanced Portfolio Technologies, Inc. v. Advanced Portfolio Technologies, Ltd.*, 1999 WL 64283, *5 (S.D. N.Y. 1999).

In this case, the principal place in which the Debtors suffered their injury was in Alabama. The Debtors have alleged under their fraudulent transfer theory that KC's actions in closing the Pulp Mill irreparably injured Debtors' business by depriving Debtors of ongoing payments "for electricity and other services supplied by the Energy Complex-payments upon which [Debtors] depend for their ability to recoup their investment in the Energy Complex and, indeed, for their very survival" See, Amended Complaint, ¶ 2). The complaint also alleges that "to the extent [KC's] plans for the Pulp Mill . . . constitute a 'Pulp Mill closure' within the meaning of the Master Operating Agreement, then . . . the Debtors received less than reasonably equivalent value". See, Amended Complaint, ¶ 74. The injury sustained by Debtors from KC's conduct is the injury to their business (the Energy Complex) caused by the Pulp Mill Closure. The complaint further states that the operation of the Energy Complex is the Debtors' only business and source of revenue and that the closure of the Pulp Mill will threaten Debtors' ability to survive. See, Amended Complaint, ¶ ¶ 60, 61.

Even if this Court followed the choice of law analysis as the Debtors have urged, that the

Court may exercise its independent judgment and apply the law of the state which it determines is most appropriate to the facts of the case, the result would be the same. The recent case of *In re Gaston & Snow,* 243 F.3d 599, 604 (2nd Cir. 2001) recognized that the federal choice of law rule "applied the law of the jurisdiction with the most significant relationship with the action." In reviewing the allegations of the complaint, it is apparent that the injury complained of occurred in Alabama. The relationship between KC and the Debtors relative to Count I is centered around the Mobile facility and its ability to be viable. The Debtors' operations and assets are located in Mobile, Alabama. The Debtors' employees are located in Mobile, Alabama and the economic impact of the Pulp Mill closure is mostly felt in Mobile, Alabama. The Debtors are incorporated in Alabama and the Debtors chose Alabama as the forum for this bankruptcy proceeding.

The Debtors argue that either the state of Georgia or the state of New York have the most the sufficient contacts because the Debtors wire transferred the funds from Georgia to New York and the contract negotiations took place in New York. The Court, however, finds that the vast majority of contacts are clearly in Alabama and that Alabama law is the appropriate choice under either the independent judgment test or the *lex loci delecti* doctrine.

For constructive fraudulent transfer claims, § 8-9A-9(3) of AFTA provides a four year limitation period commencing at the time of the transfers under §§8-9A-4(c) or 8-9A-5(a) "when the action is brought by a creditor whose claim arose before the transfer was made." *Id*. §8-9A-9(3). The Count I fraudulent transfer is barred by the statute because it occurred more than four years before the instant suit was filed on January 14, 1999. The complaint does allege obligations existing in December 1994 under the 1984 IDB Bonds which were assumed by MESH, and the loans to MESH by Southern. However, these were repaid less than a year after the closing which took place in December 1994. See, ¶¶ 18-26 of the Amended Complaint. Even if the Debtors' alleged the existence of a creditor whose claim arose subsequent to the alleged fraudulent transfer, it would be barred by the one year limitation pursuant to §8-9A-9(4).

The Alabama version of the Uniform Fraudulent Transfer Act only applies to transfers. See, Ala. Code §8-9A-4, comment 4. The comment states that "this chapter applies only to transfers . . . . Whether an obligation is void as a fraudulent conveyance is to be determined by the courts by applying by analogy all the law that existed before the enactment of this chapter." *Id.* Neither Alabama case law nor its statutes have addressed whether an obligation may be the subject of a fraudulent conveyance action. As discussed above, the only obligations in existence in 1994 (other than mutual executory contractual obligations) at the time of the acquisition of the Energy Complex were the 1984 IDB indebtedness which was assumed by MESH in 1994 and for which Scott (KC) remained liable. However, this debt or obligation was paid in 1995 when the new IDB bonds were issued. See, ¶¶ 18-26, Amended Complaint.

The Debtors have pointed to the fact that in August 1995, the Debtors and Scott (now KC) executed restated and amended contracts. They submit that the December 1994 transfer should, for purposes of the Bankruptcy Code, be treated as simply part of a single transaction that was not consummated until 1995. This theory however ignores their own allegations in the complaint which fail to characterize the December 1994 closing as somehow contingent. The allegations make it clear that the $350 million was paid to Scott, in cash and assumption of debt, in December 1994. See, Amended Complaint, ¶ 20. It is not disputed that the various operating and service agreements, including the Energy Services Agreements and the Master Operating Agreement, were amended in August 1995. However, the payment of $350 million in 1994 for the Energy Complex was not contingent upon execution of future amendments to the existing agreement. Nor were any allegations made that the subsequent amendments were part of the consideration paid eight months earlier for the Energy Complex. In other words, the transfer was complete in 1994, and the Debtors cannot stretch the transaction into 1995 through the restated and amended contracts.

The Debtors have proposed that since AFTA only applies to transfers and not obligations, that the statute of limitations under AFTA would not apply to their claims under Count I. While the Court does not agree with Debtors, it seems clear that even applying Alabama's general statute of limitations, the claims under Count I would be time barred. Debtors have pointed out that prior to AFTA, fraudulent conveyance claims in Alabama were governed by Ala. Code 1975 §8-9-6. *Hope Developers, Inc. v. Vandiver*, 665 So.2d 910, 913 (Ala. 1995). That section provided that "[a]ll conveyances . . . of any estate or interest in real or personal property . . . made with the intent to hinder, delay, or defraud creditors, purchasers, or other person of their lawful actions, damages, forfeitures, debts or demands . . . are void." Ala. Code 1975 §8-9-6. Since §8-9-6 did not have its own statute of limitations, the courts looked to either a ten year period prescribed by Ala. Code 1975 §6-2-33, if the transfer was an interest in real property; or a six year period set out in Ala. Code 1975 §6-2-34, if the action was directed at a transfer of personal property. *Rowe v. Bonneau-Jeter Hardware Co.*, 16 So.2d 689, 693-94 (Ala. 1943) (since there "is no statute of limitations expressly applicable to the remedy in equity merely to vacate a fraudulent conveyance," the limitations period is drawn from statutes that govern actions to recover real and personal property). The Debtors have advocated that the six year limitations period set forth in §6-2-34[2] be used in this case.

The entire text of Alabama Code 1975 § 6-2-34:

> The following must be commenced within six years:
>
> (1) Actions for any trespass to person or liberty, such as false imprisonment or assault and battery;
>
> (2) Actions for any trespass to real or personal property;
>
> (3) Actions for the detention or conversion of personal property;
>
> (4) Actions founded on promises in writing not under seal;
>
> (5) Actions for the recovery of money upon a loan, upon a stated or liquidated account or for arrears of rent due upon a parol demise;
>
> (6) Actions for the use and occupation of land;
>
> (7) Motions and other actions against the sureties of any sheriff, coroner, constable, or any public officer and actions against the sureties of executors, administrators, or guardians for any nonfeasance, misfeasance, or malfeasance, whatsoever, of their principal, the time to be computed from the act done or omitted by their principal which

The Debtors have not alleged in Count I an action for detention or conversion of personal property, which seems to be the only action referred to in §6-2-34 that could possibly apply. The Debtors are not seeking the return of specific property that has been either detained or converted. Instead, the Debtors are seeking damages in an amount equal to the value of the alleged voidable transfer. Therefore, the limitations period §6-2-34 does not apply to Count I.

The only general statute of limitation which would conceivably apply is the two year period contained in Ala. Code 1975 §6-2-38(1) which provides that "all actions for any injury to the person or rights of another not arising from contract and not specifically enumerated in this section must be brought within two years." This two year limitations period has been interpreted by Alabama courts to apply to actions for fraud. See, *Liberty National Life Insurance Co. v. McAlister*, 675 So.2d 1297, 1296 (Ala. 1995) (a fraud action is subject to a two-year statute of limitations.") "In the absence of a specific statute of limitation for fraudulent conveyances, most jurisdictions treat a fraudulent conveyance action as a fraud action for statute of limitations purposes," *In re Sverica Acquisition Corp., Inc.* 179 B.R. 457, 469 (Bankr. E.D. Pa. 1995) (citations omitted). Therefore, even if this Court is incorrect in relying on the four year limitation period in AFTA §8-9A-9 with regard to the fraudulent transfers alleged in Count I, then the two year limitation period in Ala. Code 1975 §6-2-38(1) would still bar Plaintiff's action and Count I is due to be dismissed.

Debtors have argued that because Scott (KC) was allegedly an intended beneficiary of the

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fixes the liability of the surety;
(8) Motions and other actions against attorneys-at-law for failure to pay over money of their clients or for neglect or omission of duty; and
(9) Actions upon any simple contract or specialty not specifically enumerated in this section.

Ala. Code 1975 § 6-2-34 (1999).

1995 IDB bond offering, KC, as Scott's successor, is liable under 11 U.S.C. §550(a)(1) as an "entity for whose benefit the transfer was made." However, the transfer must first be avoided under §544 for §550(a)(1) to be applicable. In this case, Count I is due to be dismissed with no avoidance under §544, thereby failing to establish any liability under §550. 11 U.S.C. §550(a).

Dismissal of Count I Under Fed. R. Bankr. P. 7012(b)(6)

The Court now turns to that portion of KC's motion to dismiss for failure to state a claim under Bankruptcy Rule 7012(b)(6). Generally, a court may not dismiss a complaint for failure to state a claim unless "it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations" in the complaint. *Hishon v. King & Spalding* 467 U.S. 69, 73 (1984); *Blackston v. Alabama*, 30 F.3d 117, 120 (11th Cir. 1994). On a motion to dismiss, the court must accept the Plaintiff's allegations as true and "must construe the facts as alleged in the light most favorable to the plaintiff." *Hishon*, 467 U.S. at 73; *Hunnings v. Texaco,* 29 F.3d 1480, 1484 (11th Cir. 1994). The Eleventh Circuit has stated that "[t]he threshold of sufficiency that a complaint must meet to survive a motion to dismiss for failure to state a claim is, as we have stated previously, 'exceedingly low.' " *Ancata v. Prison Health Services, Inc.*, 769 F.2d 700, 703 (11th Cir. 1985) (quoting *Quality Foods De Centro America S. A. v. Latin American Agribusiness Devel.*, 711 F.2d 989, 995 (11th Cir. 1983)). The Debtors have set out the statutory elements of a fraudulent transfer under Count I of their complaint. However, the mere recitation of the statutory elements of a cause of action will not necessarily suffice. See, e.g. *Municipal Utilities Bd. of Albertville v. Alabama Power Co.*, 934 F.2d 1493, 1501 (11th Cir. 1991) ("conclusory allegations will not survive a motion to dismiss if not supported by facts constituting a legitimate claim for relief"); *Campbell v. City of San Antonio*, 43 F.3d 973, 975 (5th Cir. 1995) (to survive a motion to dismiss under Rule 12(b)(6), "the complaint must contain either direct allegations on every material point necessary to sustain a recovery . . . or contain allegations from which an inference fairly may be drawn that evidence on these material points will be introduced at trial") (quoting 3 Wright & Miller, *Federal Practice and Procedure Civil 2d*, § 1216 at 156-159); *James W. Moore, 2 Moore's Federal Practice, §*12.34 [1][b] (3d Ed. 1999) ("liberal construction has its limits, for the pleading must at least set forth sufficient information for the court to determine whether some recognized legal theory exists on which relief could be accorded to the pleader. If it fails to do so, a motion under Rule 12(b)(6) will be granted").

The complaint alleges that KC's exercise of the termination provisions of the Master Operating Agreement §13.1, coupled with its continuing operations on the site, retroactively render the 1994 Energy Complex Acquisition constructively fraudulent. Construing the Amended Complaint in its best light, KC could only be liable for a fraudulent transfer under Count I if KC is adjudged <u>not</u> to be in breach of the Master Operating Agreement (an issue which has already been arbitrated). Therefore, Count I is actually predicated upon the occurrence of future or contingent events.

The Amended Complaint seeks to recover for an alleged fraudulent transaction entered into in 1994 based on a series of events occurring subsequent to the transaction. Count I cannot state a cause of action that is based on a fraudulent transfer, which, itself, is dependent on a series of events occurring subsequent to the transaction. *Cooper v. Ashley Communications, Inc.*(*In re Morris Communications NC, Inc.)* 914 F.2d 458 (4th Cir. 1990) (events subsequent to the transfer of stock which resulted in appreciation of the stock could not render transfer fraudulent because the transaction must be judged for fraudulent transfer purposes at the time it was made); *Allard v. Flamingo Hilton* (*In re Chomakos)*, 69 F.3d 769 (6th Cir. 1995) (subsequent events that cause "investment" at casino to turn out badly cannot retroactively render transaction fraudulent). Further, the value received in a transfer alleged as fraudulent must be determined at the time of the transfer in issue, not years later based on hindsight. *Morris Communications*, 914 F.2d 466 (key temporal point for determining reasonably equivalent value is date of transfer); *Chomakos*, 69 F.3d 770; *Butler Aviation Int'l, Inc. v. White*, (*In re Fairchild Aircraft Corp.*), 6 F.3d 1119, 1126 (5th Cir. 1993) ("we cannot use hindsight to recalibrate the risk" of an earlier transfer).

Debtors are attempting to utilize fraudulent transfer laws as an alternative to a contractual remedy. This would have the effect of rendering "virtually every validly terminated executory contract revivable by a debtor by simply initiating bankruptcy proceedings. Such a holding is not only unwarranted, but contrary to the intent of the drafters of the code." *Coast Cities Truck Sales, Inc.v. Navistar Int'l Transportation Co. (In re Coast Cities Truck Sales, Inc.),* 147 B.R. 674, 677-78 (D.N.J. 1992); aff'd 5 F.3d 1488 (3d Cir. 1993). Both the Debtors and KC are sophisticated parties that were well represented by counsel when drafting the contracts relating to the acquisition of the Energy Complex. The Debtors are seeking to hold KC liable for the exercise of its negotiated contractual rights, when to do so works to the economic detriment of the Debtors.

The Debtors have cited the case of *Breeden v. Bennet (In re The Bennet Funding Group)*, 220 B.R. 743 (Bankr. N.D. N.Y. 1997) for the proposition that an investment or acquisition of a business may constitute a fraudulent conveyance. *Bennet Funding*, 220 B.R. at 771 (the prepetition sale of the debtor's stock interest in, and mortgage obligation on, hotel properties sold to a third party held to be a fraudulent conveyance under N.Y. Debtor and Creditor Law, §273 and Bankruptcy Code §548 because the debtor did not receive a reasonable consideration in return for property transferred). However, the *Bennett Funding* case is distinguished on its facts in that it involved an intentional fraudulent transfer of the debtor's property as part of a suspect sale transaction in which the debtor "effectively received nothing" and which was in fact part of the "largest Ponzie scheme in U.S. history." *Bennet Funding,* 220 B.R. at 771.

The Debtors have cited several cases in support of their proposition that subsequent events may be used to determine whether the Debtors received reasonably equivalent value at the time of the transfer. However, as KC points out, the cases cited by the Debtors do not support the proposition that subsequent contingent events may be relied upon to retroactively cast a transaction as fraudulent. The answer to a question raised in KC's brief points to the failure of Debtors to state a legal theory or claim upon which relief can be granted. That question is as follows: "Would the Debtors be challenging the 1994 Energy Complex acquisition as fraudulent <u>if</u> KC had not validly exercised its contractual rights in 1999 and closed the Pulp Mill? The answer, of course, is no." (Emphasis added). The cases cited by Debtors do not support their proposition. <u>See</u>, *In re Prince,* 85 F.3d 314 (7th Cir. 1996) (dealing with whether liquidation value or market value should be applied to the valuation of equity to be distributed under a reorganization plan); *Federal Communications Commission v. GWI PCSI, Inc.*, 230 F.3d 788 (5th Cir. 2000) (dealing with the issue of which of two possible dates was date of the "transfer" for fraudulent transfer purposes).

Other cases relied on by Debtors stand for the proposition that subsequently discovered information relevant to a valuation of assets or liabilities at the time of the transfer (but undisclosed at such time), may be taken into account to determine the actual or true valuation at the time of the transfer. *In re Coated Sales*, 144 B.R. 663, 667 (Bankr. S.D. N.Y. 1992); *In re Sunset Sales,* 220 B.R. 1005, 1015 (B.A.P. 10th Cir. 1998) <u>aff'd</u> 195 F.3d 568 (10th Cir. 1999). The closure of the Pulp Mill, which was a subsequent event, arose out of pre-existing, negotiated and publicly disclosed contract provisions between the Debtors and KC. Based on the authority contained herein, this Court determines that the Debtors have failed to state a cause of action under Count I of the Amended Complaint and that it is due to be dismissed pursuant to Bankruptcy Rule 7012(b)(6).

<u>Lack of Standing</u>

KC has also moved to dismiss Count I pursuant to the Federal Rules of Bankruptcy Procedure 7012(b)(1) for lack of standing. Because a motion to dismiss for lack of standing is one attacking the court's subject matter jurisdiction, it is brought pursuant to Rule 12(b)(1). *Cone Corp.*

v.Florida Dept. of Transp. 921 F.2d 1190, 1203 n. 42 (11th Cir. 1991); *Morast v. Lance*, 807 F.2d 926, 932 n. 6 (11th Cir. 1987). KC has pointed out that the Debtors do not have standing to bring a fraudulent transfer claim with respect to the 1994 acquisition of the Energy Complex because they have not pled the existence of an actual unsecured creditor who would have standing to challenge the transaction. Fraudulent transfer laws are intended to protect innocent creditors whose rights are prejudiced as a result of a debtor's inequitable business dealings. See, *Continental Ins. Co. v. Dotson*, 70 So.2d 796, 801 (Ala. 1954). As the Alabama Supreme Court has recognized, only if a creditor of a debtor is prejudiced by the transaction is the transaction voidable by or on behalf of such creditor. Otherwise, the transaction is valid and binding between the parties. *Hill v. Farmers & Merchants Bank of Waterloo*, 641 So.2d 788, 790 (Ala. 1994). For a trustee or debtor-in-possession to have standing to assert a fraudulent transfer claim under §544 of the Code, it must first establish the existence of an actual creditor holding an allowed unsecured claim who could assert the avoidance action under applicable state law. 11 U.S.C. §544(b). A trustee's rights under §544(b) are derivative of the rights of the creditor into whose shoes the trustee steps, and the trustee's avoidance claims are subject to the same limitations, defenses and disabilities as that possessed by the creditor. See, generally 5 Collier on Bankruptcy ¶ 544.09[3] at 544-18-19. In a §544(b) action, a plaintiff must be able to point to an actual creditor with standing to commence a fraudulent transfer action under state law. *In re Wingspread Corp.*, 178 B.R. 938, 946 (Bankr. S.D.N.Y. 1995); *In re Marlar*, 252 B.R. 743, 754 (B.A.P. 8th Cir. 2000); *Smith v. Shoemaker (In re Smith)*, 120 B.R. 588, 590 (Bankr. M.D. Fla. 1990).

The only creditors identified in the complaint which are still in existence and could possibly satisfy the prerequisite of §544(b), are the IDB bondholders under the 1995 issuance and the holders of the First Mortgage Bonds. See, Complaint ¶¶ 23, 26. None of these creditors are sufficient to confer standing on the Debtors pursuant to Count I. As previously stated in this opinion, neither the IDB bonds or the First Mortgage Bonds were in existence in December 1994, which is the date of the Energy Complex acquisition. The holders of those bonds only became such in August 1995. Therefore, the Debtors' only standing to bring a fraudulent transfer claim under Count I must be based on the "subsequent creditor" section of the AFTA, because the Debtors have failed to identify a creditor whose present claim existed prior to the December 1994 transaction. Section 8-9A-9(4) establishes a limitations period of one year from the date of transfer for a cause of action challenging a transfer as constructively fraudulent under §8-9A-4(c) where the creditor's claim arose after the alleged fraudulent transfer was made. Ala. Code §§ 8-9A-9(4), 8-9A-4(c). Therefore, even if the Debtors have standing based on the subsequent creditor's section, the claim is barred.

COUNT VI

The Debtors' Amended Complaint avers in Count VI that KC's announced intent to terminate the contract with MESC effectuates a fraudulent transfer under 11 U.S.C. §548(a)(1)(B). The Debtors refer to the May 1998 notice to MESC that it intended to effect a "Mill Closure" of the Pulp Mill, to be effective September 1, 1999, and that KC was exercising its rights to terminate pursuant to provisions of the MOA. See, ¶ ¶ 48-55, Amended Complaint.

In order to prove a constructively fraudulent transfer under § 548(a)(1)(B) it is necessary for the Plaintiff to establish that a "transfer" occurred and that the Debtor did not receive "reasonably equivalent value" in exchange for the transfer.

The definition of a transfer under the Bankruptcy Code is as follows:

> "Transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.

11 U.S.C. §101(54).

The Debtors' argument may essentially be divided up into two parts. First, the Debtors have stated that even a proper termination of a contract can be a fraudulent transfer. They support this proposition with the case of *Darby v. Atkinson* 415 F.Supp 33 (W.D. Okl. 1976) where a creditor/lessor entered into a long term lease of property in order to construct a theater. After the debtor defaulted on rental payments, the creditor/lessor terminated the lease. The *Darby* case involved the termination of a real estate lease and is distinguishable on its facts from the instant case. The other cases cited by the Debtors in their briefs do not lend any substantive support that an executory contract such as found under facts in the instant case gives rise to fraudulent transfer liability when the termination of the executory contract is by a non-debtor party. Significantly, the *Darby* case is the only case cited by Debtors in their initial memorandum of law in opposition to Kimberly Clark Tissue Company's Motion to Dismiss. In a subsequent brief, the totality of the Debtors argument in support of such a proposition is relegated to a footnote which simply cites the *Darby* case again.

Many of the cases cited by the Debtors concern termination of leases relating to real property, and are not applicable to the facts in the instant case dealing with the termination of an executory contract such as the Pulp Mill contract. The court, in *Durso Supermarkets, Inc. v. D'Urso (In re Durso Supermarkets, Inc.*, 193 B.R. 682 (Bankr. S.D. N.Y. 1996) distinguishes between a debtor's interest in a terminated real property lease (a property interest), and an interest in a terminated executory contract. The court found that because a debtor's interest in a terminated real property lease was an interest in property, its termination could properly be deemed a transfer. However, the court reasoned that had the lease been treated as an executory contract, "since the expiration of contractual rights due to the debtor's default is not a 'transfer' or 'conveyance' of those contractual rights, [the debtor's fraudulent transfer] case would fall." Id. at 697. The court also contrasted cases finding fraudulent transfer law inapplicable to the termination of executory contracts with cases involving the termination of commercial real property leases. See, e.g., *Coast*

Cities Truck Sales, Inc. v. Navistar Int'l Transportation Co., (In re Coast Cities Truck Sales, Inc.), 147 B.R. 674 (D.N.J. 1992), aff'd 5 F.3d 1488 (3d Cir. 1993); *Creditors' Committee for Jermoo's, Inc. (Matter of Jermoo's, Inc.)* 38 B.R. 197 (Bankr. W.D. Wis. 1984). The court concluded that the executory contract cases which repudiate the application of fraudulent transfer principles are inapplicable in the commercial lease context because the commercial leases, unlike executory contracts, involve transfers of interests in property. Id. at 699.

Other courts have held that when rights under an executory contract are terminated pursuant to the terms of the contract, such termination does not constitute a transfer of property interest, but rather constitutes an expiration or transformation of contract rights. See, e.g., *Allan v. Archer-Daniels-Midland Co. (In the Matter of Commodity Merchants, Inc.),* 538 F.2d 1260, 1263 (7th Cir. 1976) (termination of commodities contracts pursuant to contractual termination provision was not a transfer that could be avoided as a fraudulent transfer because "[t]he essence of a transfer is the relinquishment of a valuable property right" and no such property right was transferred by the termination of the contracts); *Coast Cities Truck Sales, Inc. v. Navistar Int'l Transportation Co.*, 147 B.R. at 677-78 (termination of an executory contract was not a transfer under §548 because upon termination of the contract, the debtor "possessed no rights as a matter of law which it could relinquish since the contract between [the parties] had expired by its own terms"); *In re Matter of Jermoos, Inc.*, 38 B.R. at 204 ("When property, real, tangible, or intangible, is transferred, the property itself is not transformed by the exchange. The termination of the right to perform under an executory contract, according to the terms of that contract, differs from a transfer of property in this sense: the rights terminated, unlike property, are transformed"; therefore, the termination of a franchise agreement according to its terms could not be the subject of a fraudulent transfer claim).

The Seventh Circuit upheld a bankruptcy court's finding that because the contract at issue specifically stated that it terminated upon the debtor's default, the other party did not receive any right at the default that it did not already have at the time the contract was executed. *Sullivan v. Willock (In re Wey)*, 854 F.2d 196, 199 (7th Cir. 1988). The court stated that "when a termination is pursuant to the terms of a contract, there is no transfer." Id. A more recent case has also held that "a pre-petition termination of a contract pursuant to its terms and the consequent cessation of a debtor's rights under a contract does not constitute a transfer within the meaning of either Code Section 547 (b) or 548 (a)". *In re LiTenda Mortgage Corp.*, 246 B.R. 185, 191 (Bankr. D.N.J. 2000). Therefore, the Court holds that there is no transfer and that the motion to dismiss the portion of Count VI relating to the rightful or "proper" termination of the executory contract is due to be granted.

The second portion of the Debtors' fraudulent transfer argument in Count VI is hinged upon the allegations that KC "breached" the executory contract and that such a termination was "improper". The Debtors state in their brief that "given the facts of this case, the Complaint sets forth a *prima facia* case that Kimberly-Clark has improperly sought to terminate the valuable Pulp Mill Contract which clearly amounts to a fraudulent transfer under §548 of the Bankruptcy Code". In other words, the Debtors urge that it is the improper nature of the termination that renders it an avoidable transfer. This Court has been made aware that the arbitration of Counts II, III, IV, and V has been concluded. The findings of the arbitrator have not been attached as an exhibit to the motion to dismiss or in the materials opposing the dismissal of Counts I and VI. KC has indicated in its supplemental memorandum that the propriety of KC's Pulp Mill Closure and its termination of the Pulp Mill ESA has been decided in KC's favor by the arbitrator. If this is in fact correct, then Count VI is due to be dismissed or, alternatively, the motion to dismiss should be treated as a motion for summary judgment. Fed. R. Bankr. P. 7012(b).

Therefore, the Court deems it appropriate to request that the parties supplement the materials provided to the Court with a copy of the arbitration ruling with the appropriate citations to those portions of the award which each party claims to be pertinent to the issues regarding the motion to dismiss Count VI of the Amended Complaint. This request is being made only with respect to those portions of Count VI of the complaint and of the motion to dismiss relating to the fraudulent conveyance based on an improper termination of the executory contract.

CONCLUSION

Based on the foregoing, the Court finds that KC's motion to dismiss Count I is due to be GRANTED and that the Debtors' claims under Count I of the Amended Complaint are due to be DISMISSED pursuant to being time barred by the statute of limitations, failure to state a claim upon which relief can be granted under Fed. R. Bankr. P.7012(b)(6), and lack of standing pursuant to Fed. R. Bankr. P. 7012(b)(1). With respect to only that portion of Count VI seeking a claim for the "proper" termination of the executory contract, said claim is due to be dismissed, and the motion of KC is GRANTED.

The Court will determine whether the motion to dismiss the balance of the allegations of Count VI relating to the Debtors' claims of fraudulent transfer under 11 U.S.C. §548 after the Court has been provided the supplemental materials referred to in this opinion. If either KC or the Debtors wish to file a supplemental memorandum of law, each party shall be limited to only one brief of not more than ten pages in length no later than May 3, 2002.

DATED: April 24, 2002