UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

Ronald J. Friedman, as the trustee for the SportCo Creditors' Liquidation Trust,

Plaintiff,

v.

Wellspring Capital Management, LLC, Wellspring Capital Partners IV, L.P., WCM Genpar IV, L.P., WCM Genpar IV GP, LLC, Alexander E. Carles, Bradley Johnson, F. Hewitt Grant, Charles E. Walker, Jr., Todd Boehly, Bernard Ziomek, and Andrew Kupchik,

Defendants.

Adversary Proceeding No. 19-80071-DD

ORDER CERTIFYING QUESTIONS TO THE SOUTH CAROLINA SUPREME COURT

This matter is an adversary proceeding relating to chapter 11 bankruptcy cases filed in the United States Bankruptcy Court for the District of Delaware. Shortly prior to the bankruptcy cases being filed, a civil action was commenced by a creditor against the defendants in the South Carolina Court of Common Pleas, Lexington County, seeking to avoid alleged fraudulent conveyances pursuant to the South Carolina Statute of Elizabeth, S.C. Code § 27-23-10. The fraudulent conveyance claims relate to distributions made in 2012 and 2013, using loan proceeds received by the bankruptcy debtors from the creditor who commenced this action. After the bankruptcy cases were filed, the civil action was removed to the United States Bankruptcy Court for the District of South Carolina and the current plaintiff, the liquidating trustee appointed in the bankruptcy cases, was substituted for the creditor/plaintiff. He is pursuing this action under the authority of 11 U.S.C. § 544(b). The defendants filed motions to dismiss the adversary proceeding, which the Court granted. The plaintiff then sought reconsideration.

On October 14, 2020, the Court entered an order granting the motion to reconsider its order dismissing this adversary proceeding. The order vacated the Court's finding that the first and second causes of action asserted by the plaintiff for fraudulent conveyances under S.C. Code § 27-23-10 should be dismissed due to the plaintiff's failure to adequately plead insolvency. In order to determine whether the defendants should prevail on other grounds asserted in their motions to dismiss the first and second causes of action, the Court requests the South Carolina Supreme Court answer a question of South Carolina law.

Legal Standard

South Carolina Appellate Court Rule 244(a) states, in relevant part:

> The Supreme Court in its discretion may answer questions of law certified to it by any federal court of the United States or the highest appellate court or an intermediate appellate court of any other state, when requested by the certifying court if there are involved in any proceeding before that court questions of law of this state which may be determinative of the cause then pending in the certifying court when it appears to the certifying court there is no controlling precedent in the decisions of the Supreme Court.

Rule 244(b) requires the certification order to set forth "the questions of law to be answered, all findings of fact relevant to the questions certified, and a statement showing fully the nature of the controversy in which the questions arose."

Relevant Facts[1] and Nature of the Controversy

The civil action, initiated by a complaint containing multiple causes of action, was commenced in Lexington County by Prospect Capital Corporation, shortly prior to the filing of chapter 11 bankruptcy cases in the District of Delaware by SportCo Holdings, Inc. ("SportCo")

[1] The facts recited here are limited to those asserted in the complaint, as well as matters of public record and documents attached to the complaint and motions to dismiss, as the current posture of this case is a Rule 12(b)(6) motion to dismiss. *See Sec'y of State for Def. v. Trimble Navigation Ltd.*, 484 F.3d 700, 705 (4th Cir. 2007) (the court may take judicial notice of matters of public record and may consider documents attached to the complaint and the motion to dismiss, "so long as they are integral to the complaint and authentic.").

and its subsidiaries, including Ellett Brothers, LLC ("Ellett"), in June 2019.[2] The litigation was removed to the United States Bankruptcy Court for the District of South Carolina on September 6, 2019. Ronald J. Friedman was substituted as the plaintiff on January 10, 2020, and he filed an amended complaint the same day. The amended complaint asserts three causes of action: (1) avoidance and recovery of fraudulent transfers by Ellett against Wellspring Capital Partners IV, L.P. ("Wellspring IV"), WCM Genpar IV, L.P., WCM Genpar IV GP, LLC, F. Hewitt Grant, Charles E. Walker, Jr., Todd Boehly, Bernard Ziomek, and Andrew Kupchik (collectively, the "Transferee Defendants") and Wellspring Capital Management, LLC ("Wellspring Capital") pursuant to 11 U.S.C. §§ 544 and 550 and S.C. Code § 27-23-10; (2) avoidance and recovery of fraudulent transfers by SportCo against the Transferee Defendants and Wellspring Capital pursuant to 11 U.S.C. §§ 544 and 550 and S.C. Code § 27-23-10; and (3) negligent misrepresentations against Wellspring Capital, Alexander E. Carles, and Bradley Johnson.

The amended complaint alleges that Ellett was a sporting goods distributor acquired by Wellspring Capital in 2008. Wellspring Capital then formed SportCo to serve as the holding company for United Sporting Company, Inc., Ellett, and its subsidiaries. Ellett achieved high sales and revenues and had significant operations until sometime in 2016, when its profits began to decrease. In 2012, when Ellett "achieved record sales and earned revenues of approximately $1.2 billion," Ellett and its operating subsidiaries (the "Borrowers") entered into a Third Amended and Restated Loan and Security Agreement and a Second Lien Loan and Security Agreement ("Second Loan Agreement") (collectively, the "Loan Agreements") with lenders including Prospect, pursuant to which the lenders loaned $280 million to the Borrowers. More

[2] The debtors in the bankruptcy cases are SportCo Holdings, Inc.; Ellett Brothers, LLC; United Sporting Company, Inc.; Bonitz Brothers, Inc.; Evans Sports, Inc.; Jerry's Sports, Inc.; Outdoor Sports Headquarters, Inc.; Quality Boxes, Inc.; and Simmons Guns Specialties, Inc. The debtors' combined chapter 11 plan was confirmed by the Delaware bankruptcy court on November 6, 2019. The cases are still pending.

than $134 million of the loan proceeds were used to fund distributions to the Transferee Defendants. On March 7, 2013, the Borrowers entered into a First Amendment to the Loan Agreements (the "Amendment"), pursuant to which the Borrowers received an additional $60 million loan, $54,860,549.74 of which was used to fund additional distributions to the same transferees. These distributions are the transfers the plaintiff asserts are fraudulent.

The Second Loan Agreement and the Amendment both expressly stated that payment of the distributions was a permissive use for the loan proceeds. The Second Loan Agreement states:

> 1.1.3 Use of Proceeds. Proceeds of the Term Loans shall be used by Borrowers solely for one or more of the following purposes: (i) to make a one-time Distribution to Holdings (for further Distribution to SportCo) to repay a portion of the Wellspring Debt on the Closing Date; (ii) to pay the Closing Date Distribution on the Closing Date, and (iii) to pay the fees and transaction expenses associated with the closing of the Transactions described herein.

The "Closing Date Distribution" is defined as:

> [T]he one-time cash Distribution by Borrowers to Holdings (for further distribution to SportCo and Wellspring and the other shareholders of SportCo) on the Closing Date in an amount up to $134,500,000, which Distribution shall be excluded from all calculations of the Consolidated Fixed Charge Coverage Ratio.

The Amendment states:

> Section 1.1.3 of the Existing Loan Agreement is hereby amended by deleting the text set forth therein in its entirety and, in lieu thereof, inserting the following:
>
> "1.1.3 Use of Proceeds. Proceeds of the Closing Date Term Loan shall be used by Borrowers solely for one or more of the following purposes: (i) to make a one-time Distribution to Holdings (for further Distribution to SportCo) to repay a portion of the Wellspring Debt on the Closing Date; (ii) to pay the Closing Date Distribution on the Closing Date, and (iii) to pay the fees and transaction expenses associated with the closing of the Transactions described herein. Proceeds of the Incremental Term Loan shall be used solely (a) to pay the Incremental Term Loan Funding Date Distribution on the Incremental Term Loan Funding Date and (b) to pay the fees and transaction expenses in connection with the Incremental Term Loan. In no event may any Term Loan proceeds be used by Borrowers to make a contribution to the equity of any Subsidiary which is not a Borrower, to purchase or to carry, or

> to reduce, retire or refinance any Debt incurred to purchase or carry any Margin Stock or for any related purpose that violates the provisions of Regulations T, U or X of the Board of Governors."

The Second Loan Agreement and the Amendment, along with an additional amendment executed in September 2014 contain choice of law provisions stating that New York law applies to the Second Loan Agreement and Amendment and to claims by any party to the contract against another party arising out of the subject matter of the contract.

With respect to the fraudulent conveyance causes of action, the amended complaint asserts that at all relevant times, the transferors (SportCo and Ellett) had one or more unsecured creditors, that Prospect was a creditor of SportCo and Ellett prior to the distributions being made, that the distributions were made for no consideration, that the debts owed by SportCo and Ellett to Prospect and the other lenders have not been repaid in full, and that SportCo and Ellett failed to retain sufficient property to pay their creditors in full. As a result, the amended complaint asserts, the distributions are avoidable as fraudulent transfers pursuant to S.C. Code § 27-23-10. The plaintiff succeeds to the avoidance rights pursuant to 11 U.S.C. § 544. *See Moore v. Bay*, 284 U.S. 4, 5 (1931) (standing for the proposition that a bankruptcy trustee succeeds to the state law rights of a particular creditor but recovery benefits all creditors).

The parties involved in this matter are from various locations. The plaintiff is a citizen of New York and is the trustee for the SportCo Creditors' Liquidation Trust, which was formed pursuant to the disclosure statement and chapter 11 plan filed in the Delaware bankruptcy court. Pursuant to the terms of the confirmed chapter 11 plan, Prospect assigned this action, which it originally filed, to the liquidation trust. Prospect is a Maryland corporation with its principal place of business in New York.

The defendant Wellspring Capital is a Delaware limited liability company with its principal place of business in New York. The defendant Wellspring IV is a New York limited partnership with its principal place of business in New York. The defendant WCM GenPar IV, LP is a New York limited partnership with its principal place of business in New York. The defendant WCM GenPar IV GP, LLC is a New York limited liability company with its principal place of business in New York. The defendant F. Hewitt Grant is a citizen and resident of South Carolina. The defendant Charles E. Walker, Jr. is a citizen and resident of Maryland. The defendant Todd Boehly is a citizen and resident of Connecticut. The defendant Bernard Ziomek was a citizen and resident of Pennsylvania.[3] The defendant Andrew Kupchik is a citizen and resident of Pennsylvania.

SportCo and Ellett made the transfers at issue in this action. SportCo was a Delaware corporation with a principal place of business in South Carolina, while Ellett was a South Carolina limited liability company with its principal place of business in South Carolina. Both entities have been deemed dissolved in connection with the bankruptcy cases.[4]

The relationships between the parties involved in this matter are complex. SportCo was the parent and 100% owner of United Sporting Company, Inc. ("United Sporting").[5] United Sporting, a Delaware corporation with a principal place of business in South Carolina, was the 100% owner of Ellett. Wellspring Capital, at all relevant times, served as the manager of SportCo and controlled Wellspring IV, SportCo and its subsidiaries' boards of directors, and the debtors and their subsidiaries. Wellspring IV was, at all relevant times, SportCo's largest

[3] The amended complaint indicates that Mr. Ziomek is deceased, and he has not appeared in the adversary proceeding.
[4] The confirmed bankruptcy plan states, "[E]ach such Debtor shall be deemed dissolved for all purposes unless the Liquidation Trustee determines that dissolution can have any adverse impact on the Causes of Action [which includes the causes of action asserted in the present case]."
[5] United Sporting Company, Inc. is also a debtor in the chapter 11 bankruptcy cases pending in the District of Delaware.

shareholder. WCM GenPar IV, LP is the general partner of Wellspring IV, and WCM GenPar IV GP, LLC is the general partner of WCM GenPar IV, LP. F. Hewitt Grant, Charles E. Walker, Jr., Todd Boehly, Bernard Ziomek, and Andrew Kupchik were equity holders of SportCo and recipients of the distributions that the plaintiff alleges were fraudulent transfers.

The defendants filed motions to dismiss this adversary proceeding on various grounds on February 19, 2020. After additional briefing, the Court held a hearing on the motions to dismiss on June 18, 2020. On August 27, 2020, the Court entered an order granting the motions to dismiss on the grounds that the amended complaint failed to adequately plead insolvency under S.C. Code § 27-23-10.[6] The plaintiff filed a motion to reconsider on September 8, 2020, and objections to the motion were filed by the defendants on September 24, 2020. The Court entered an order granting the motion to reconsider on October 14, 2020, recognizing the adequacy of the pleading under South Carolina law.[7] Thus, the motions to dismiss the first and second causes of action are again before the Court as to issues other than insolvency.

The defendants' motions to dismiss ask the Court to dismiss the first and second causes of action on various grounds. The parties disagree on what law should apply—federal or state, and further, if state law applies, New York or South Carolina. The defendants argue that New York law applies because there is a choice of law provision in the Second Loan Agreement and Amendment stating that New York law applies and because the defendants are third party beneficiaries of that contract. The defendants further argue that even in the event that the choice of law provision in the contract does not apply, South Carolina choice of law principles require a

[6] The Court also dismissed the third cause of action for negligent misrepresentation but the plaintiff did not ask for reconsideration of that portion of the Court's order, and further, it is not relevant to the question of law being certified. Thus, the negligent misrepresentation cause of action is not discussed in this order.

[7] The plaintiff's amended complaint pleads constructive fraud as to an existing creditor. In its order, the Court recognized that South Carolina law does not require insolvency at the time of the transfer. *See Gardner v. Kirven*, 184 S.C. 37, 191 S.E. 814 (1937); *Penning v. Reid*, 167 S.C. 263, 166 S.E. 139 (1932); *Buchanan v. McNinch*, 3 S.C. 498 (1872), *Cordery v. Zealy*, 18 S.C.L. 205 (1831); *Richardson v. Rhodus*, 48 S.C.L. 95 (Ct. App. 1866).

finding that New York law applies because a tort-based choice of law analysis should be applied to the fraudulent conveyance causes of action. The plaintiff responds that federal conflict of law principles apply but even if they do not, under South Carolina conflict of law rules, South Carolina law, not New York law, should apply. The parties do not dispute that most states classify fraudulent conveyance claims as torts for choice of law purposes but concede that there is no controlling authority on this point. The parties disagree on how to determine where the injury occurred—whether the determination is made based on the injury to the transferor/debtor (here, SportCo and Ellett), such that South Carolina law applies, or whether the determination is made based on the injury to the creditor (here, Prospect), such that New York law applies.[8] Federal courts in the Fourth Circuit have previously rejected the plaintiff's argument that federal conflict of law principles apply;[9] therefore, the question before the Court is whether South Carolina conflict of law principles result in the application of New York or South Carolina law.

Question of Law to be Answered

A question substantially similar to the question certified here was certified by the United States District Court for the District of South Carolina in 2017 in *Ashmore for Wilson v. Dodds*, C/A No. 8:15-cv-00561-JMC. The South Carolina Supreme Court accepted the certification. However, that question was never answered because the District Court case was settled prior to an answer being issued by the South Carolina Supreme Court. South Carolina choice of law principles provide that "the substantive law governing a tort action is determined by the state in which the injury occurred." *Lister v. NationsBank of Delaware, N.A.*, 329 S.C. 133, 143 (Ct. App. 1997) (citing *Bannister v. Hertz Corp.*, 316 S.C. 513 (Ct. App. 1994)). However, whether a

[8] The plaintiff also argues that South Carolina law should apply because South Carolina has the greatest interest in determining whether the transfers, made by South Carolina debtors, were void as fraudulent, and because applying South Carolina law will ensure uniformity and predictability.

[9] *See In re Merritt Dredging Co., Inc.*, 839 F.2d 205-06 (4th Cir. 1988).

fraudulent conveyance action is characterized as a tort action is unsettled. *See Sheehan v. Saoud*, 650 Fed. App'x 143 (4th Cir. 2016) (citing numerous cases, recognizing disagreement among courts regarding whether fraudulent conveyance action is a tort action); *MainStreet Bank v. Nat'l Excavating Corp.*, 791 F. Supp. 2d 520, 529 n.14 (E.D. Va. June 8, 2011) (acknowledging that Maryland law is not clear regarding whether a fraudulent conveyance action sounds in tort, but concluding that "given that the gravamen of the fraudulent conveyance claim is the wrongfulness of the conveyance and the injury to the creditor, rather than balancing equities or fairness, it is appropriate to conclude that fraudulent conveyance claims sound in tort."); *Terry v. Walker*, 2006 WL 736861, at *5 (W.D. Va. Mar. 23, 2006) (stating that some courts characterize fraudulent conveyance actions as tort actions, while others characterize them as matters in equity). It appears that there is no controlling authority in South Carolina regarding how a fraudulent conveyance claim should be characterized for conflict of law purposes. Further, if the fraudulent conveyance cause of action is treated as a tort-based cause of action rather than a contract-based or equity-based cause of action for choice of law purposes, it is unclear whether the injury to the creditor or the injury to the transferor/debtor is relevant for purposes of determining where the injury occurred.

Accordingly, the Court respectfully requests that the South Carolina Supreme Court answer the following certified question:

> Under South Carolina choice of law rules and the facts of this case, is a fraudulent conveyance cause of action characterized as tort-based, contract-based, or equity-based, and if tort-based, is the injury to the creditor or the injury to the transferor/debtor the relevant injury for purposes of determining where the injury occurred?

Conclusion

For the reasons set forth above, the Court certifies the foregoing question to the South Carolina Supreme Court. The clerk is directed to forward a copy of this order to the South Carolina Supreme Court under this Court's official seal, together with the amended complaint, all defendants' motions to dismiss, the plaintiff's response to the motions to dismiss, all replies to the plaintiff's response, and the Court's orders granting the motions to dismiss and the motion to reconsider, as well as copies of any other portions of the record that the South Carolina Supreme Court may request.

AND IT IS SO ORDERED.

FILED BY THE COURT
10/29/2020

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

Entered: 10/29/2020

David R. Duncan
US Bankruptcy Judge
District of South Carolina

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