UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

RONALD FRIEDMAN, as 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 No. 19-80071-dd

MOTION TO DISMISS OF DEFENDANT ANDREW KUPCHIK

Defendant Andrew Kupchik, pursuant to Fed. R. Civ. P. 12(b)(6) and Fed. R. Bankr. P. 7012(b)(6), respectfully moves the Court to dismiss this action as to him, with prejudice, on the ground that the Amended Complaint dated January 10, 2020 ("Complaint"), fails to state a claim upon which relief may be granted. Contemporaneously herewith, Mr. Kupchik submits a Memorandum of Law in support of this Motion to Dismiss, which more thoroughly addresses its grounds. Additionally, Mr. Kupchik incorporates herein by reference the exhibits and arguments contained in the Motion to Dismiss of Wellspring Capital Management, LLC, Wellspring Capital Partners IV, L.P., WCM Genpar IV, L.P., and WCM Genpar IV GP, LLC (collectively the "Wellspring Defendants").

The grounds for this Motion are as follows. The first two causes of action asserted against Mr. Kupchik allege that he and other shareholders of the Debtors[1] received distributions during 2012 and 2013 as part of second lien financing transactions entered into between Ellett Brothers, LLC and its subsidiaries and Prospect Capital Corporation ("Prospect"). Plaintiff, Ronald Friedman, as Trustee of the SportCo Creditors' Liquidation Trust, stands in the shoes Prospect. The second lien loan documents specifically acknowledge, authorize and direct that portions of the proceeds of the financing would be used to pay distributions to the Debtors' shareholders, including Mr. Kupchik. Prospect's direct participation in authorizing the distributions bars the fraudulent transfer claims that the Plaintiff is now asserting against Mr. Kupchik and the other shareholders.

In addition, the Complaint does not support a fraudulent transfer claim under New York law, which governs the transactions giving rise to the claims in the Complaint, because the Complaint does not allege that the borrowers were insolvent at the time of, or left with unreasonably small capital as a result of, the transactions, or that the borrowers entered into the transactions believing that they would incur debts that they were unable to pay.

Even if the Court applied South Carolina law, Plaintiff's fraudulent conveyance claims still fail. Under South Carolina law, a subsequent creditor must plead actual fraud to state a claim for fraudulent conveyance, and no actual fraud claim is pled in the Complaint. Prospect

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[1] On June 10, 2019, SportCo, United Sporting Companies, Inc. ("United Sporting"), Ellett, Bonitz Brothers, Inc. ("Bonitz"), Evans Sports, Inc. ("Evans"), Jerry's Sports, Inc. ("Jerry's"), Outdoor Sports Headquarters, Inc. ("Outdoor Sports"), Quality Boxes, Inc., and Simmons Guns Specialties, Inc. ("Simmons") (collectively, the "Debtors") filed for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the "Delaware Bankruptcy Court"), *see In re Sportco Holdings, Inc., et al.*, Case No. 19-11299 (LSS) (the "SportCo Bankruptcy"). The Debtors' Fourth Amended Combined Disclosure Statement and Joint Chapter 11 Plan of Liquidation ("Liquidation Plan") (Dkt. 525-1) was confirmed on November 6, 2019.

made an informed decision to participate as it was a party to the transactions and had notice of their purpose. . Prospect, and the Trustee standing in its shoes, therefore has no basis to assert a claim of actual fraud in connection with the distributions to Mr. Kupchik and the other shareholders.

Plaintiff's fraudulent transfer claims are also barred by South Carolina's three-year statute of limitations. Prospect had notice of the facts and circumstances to place a reasonable person on notice that a claim might exist at the time of the distributions it authorized in 2012 and 2013.

Finally, Plaintiff has failed to plead the existence of a triggering creditor holding an allowable, unsecured claim as of the Petition Date who has standing to bring the avoidance claim as required under § 544(b) of the Bankruptcy Code. Plaintiff cannot rely on Prospect as the triggering creditor, not only because Prospect ratified the transactions but also because the Debtors stipulated to a binding order entered in the Delaware Bankruptcy Court that Prospect held *secured* -- and not unsecured -- claims as of the Petition Date. Plaintiff should be judicially estopped from asserting that Prospect was an unsecured creditor as of the Petition Date, and consequently, Prospect cannot be the triggering creditor required for § 544(b) standing.

For the foregoing reasons and the reasons set forth in the Memorandum of Law submitted herewith, Defendant Andrew Kupchik respectfully moves the Court to dismiss the Complaint against him in its entirety, with prejudice, for failure to state a claim upon which relief may be granted.

[Signature Block on Following Page]

Respectfully submitted,

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Dated: February 19, 2020

Columbia, South Carolina

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

RONALD FRIEDMAN, as 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 No. 19-80071-dd

MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS OF DEFENDANT ANDREW KUPCHIK

Defendant Andrew Kupchik, pursuant to Fed. R. Civ. P. 12(b)(6) and Fed. R. Bankr. P. 7012(b)(6), respectfully submits this Memorandum of Law in support of his Motion to Dismiss the First Amended Complaint, with prejudice, for failure to state a claim upon which relief may be granted. In support of the Motion, Kupchik represents as follows:

SUMMARY OF NATURE OF CASE

The Plaintiff, Ronald Friedman, as Trustee of the SportCo Creditors' Liquidation Trust, standing in the shoes of Prospect Capital Corporation ("Prospect"), commenced this action seeking to set aside certain distributions paid to shareholders during 2012 and 2013 as part of second lien financing transactions entered into between Ellett Brothers, LLC ("Ellett") and its

subsidiaries and Prospect. Mr. Kupchik is alleged to be an equity holder of SportCo Holdings, Inc. ("SportCo") who received some of the distributions in question.

In 2012, Prospect entered into a second lien financing transaction with certain Debtors,[1] knowing and agreeing that the proceeds of its second lien loan would be used, in part, to pay a dividend to SportCo's shareholders. In 2013, Prospect agreed to an additional second lien loan with the same terms and purpose—to pay a dividend to SportCo's shareholders. Plaintiff alleges that these distributions constitute fraudulent transfers under 11 U.S.C. §§ 544(b) and 550 and S.C. Code Ann. §27-23-20, et. seq. (the "South Carolina Statute of Elizabeth"), despite the fact the second lien financing transactions specifically acknowledged, permitted and authorized that the financing proceeds would be used to pay such distributions to shareholders.

Plaintiff filed an Amended Complaint dated January 10, 2020 ("Complaint"). Mr. Kupchik now moves to dismiss the Complaint for failure to state a claim upon which relief may be granted against him. First, Prospect participated in, funded, and approved these bona fide second lien financing transactions, and negotiated and executed the contracts governing the transactions. The contracts specifically authorized and sanctioned the payment of dividends to shareholders, including Mr. Kupchik. Prospect's direct participation in authorizing the distributions bars the claims. No matter the legal concept—"ratification, consents, estoppel or material participa[tion] in the transaction"— "[c]reditors who authorized or sanctioned the

[1] On June 10, 2019, SportCo, United Sporting Companies, Inc. ("United Sporting"), Ellett, Bonitz Brothers, Inc. ("Bonitz"), Evans Sports, Inc. ("Evans"), Jerry's Sports, Inc. ("Jerry's"), Outdoor Sports Headquarters, Inc. ("Outdoor Sports"), Quality Boxes, Inc., and Simmons Guns Specialties, Inc. ("Simmons") (collectively, the "Debtors") filed for relief under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the "Delaware Bankruptcy Court"), *see In re Sportco Holdings, Inc., et al.*, Case No. 19-11299 (LSS) (the "SportCo Bankruptcy"). The Debtors' Fourth Amended Combined Disclosure Statement and Joint Chapter 11 Plan of Liquidation ("Liquidation Plan") (Dkt. 525-1) was confirmed on November 6, 2019.

transaction, or, indeed, participated in it themselves, can hardly claim to have been defrauded by it, or otherwise to be victims of it." *In re Lyondell Chem Co.*, 503 B.R. 348, 384-85 (Bankr. S.D.N.Y. 2014), *as corrected* (Jan. 16, 2014), *and abrogated on other grounds by In re Tribune*, 818 F.3d 98 (2d Cir. 2016).

Second, New York law governs claims arising out of the transactions giving rise to the claims in the Complaint. Prospect, a New York-based entity, agreed to a broad choice of law provision in favor of New York: "any claims sounding *in contract or tort law* arising out of the subject matter" of the Agreement "shall be governed by and construed in accordance with the laws of the State of New York[.]" (Ex. 4, Second Amendment to the Second Lien Loan and Security Agreement (the "Second Amendment") ¶ 1(b) (emphasis added).)[2] The Complaint does not support a fraudulent transfer claim under New York law, in that it makes no allegations that the borrowers were insolvent at the time of, or left with unreasonably small capital as a result of, the transactions, or that the borrowers entered into the transactions believing that they would incur debts that they were unable to pay.

Even if the Court applied South Carolina law, Plaintiff's fraudulent conveyance claims still fail. Under South Carolina law, a subsequent creditor must plead actual fraud to state a claim for fraudulent conveyance. No such claim is pled here. Prospect was the counterparty to the transactions, had notice of their purpose and, therefore, made an informed decision to participate. Prospect, and the Trustee standing in its shoes, has "no ground upon which [it] can

[2] Mr. Kupchik is only alleged to be an equity holder in SportCo and was not a direct party to the second lien financing transactions. Therefore, Mr. Kupchik incorporates herein by reference the exhibits and arguments contained in the Motion to Dismiss of Wellspring Capital Management, LLC, Wellspring Capital Partners IV, L.P., WCM Genpar IV, L.P., and WCM Genpar IV GP, LLC (collectively the "Wellspring Defendants"). For purposes of Mr. Kupchik's Motion and this Memorandum, citation to "Ex." shall refer to the respective exhibit contained in the Declaration of Daniel H. Levi, dated February 19, 2020, and filed in support of the Wellspring Defendants' Motion to Dismiss.

say the [dividend] was a fraud upon [it]." *In re Ducate*, 369 B.R. 251, 260 (Bankr. D.S.C. 2007) (Duncan, J.). Indeed, this Court has held that "*it would be unjust*" for a creditor to "avoid a transfer, even one that is voluntary, as fraudulent if the creditor knew or should have known of the transfer before the debt was incurred." *Id.* at 260–61 (emphasis added).

Plaintiff's claim is also barred by South Carolina's three-year statute of limitations, as subject to the discovery rule. Prospect had notice of the facts and circumstances to place a reasonable person on notice that a claim might exist at the time of the distributions it authorized in 2012 and 2013. Moreover, as discussed herein, Prospect disclosed in its public filings with the U.S. Securities and Exchange Commission ("SEC"), including a specific disclosure in a 2015 SEC filing that it marked down this specific investment below par and that its investments may not be repaid in full. Prospect certainly had notice no later than 2015, more than three years before the Complaint was filed.

Finally, Plaintiff has failed to plead the existence of a triggering creditor holding an allowable, unsecured claim as of the Petition Date who has standing to bring the avoidance claim as required under § 544(b) of the Bankruptcy Code. 11 U.S.C. § 544(b). Plaintiff cannot rely on Prospect as the triggering creditor not only because Prospect ratified the transactions but also because the Debtors stipulated to, and the Delaware Bankruptcy Court entered, a binding order that Prospect held *secured* -- and not unsecured -- claims as of the Petition Date. Plaintiff should be judicially estopped from asserting that Prospect was an unsecured creditor as of the Petition Date, and consequently Prospect cannot be the triggering creditor required for § 544(b) standing.

STATEMENT OF FACTS

The following statement of facts is based on allegations in the Complaint, on documents that are integral to the Complaint, and documents that are a matter of public record.[3] Any such documents referred to are appended to the Declaration of Daniel H. Levi, dated February 19, 2020, and filed in support of the Wellspring Defendants' Motion to Dismiss.

I. The Parties

Plaintiff Ronald Friedman is the Trustee of the SportCo Creditors' Liquidation Trust. (Doc. No. 58, Compl. ¶ 6.) He alleges he is the successor-in-interest to the Debtors' causes of action to avoid and recover alleged prepetition fraudulent transfers dating back to 2012 and 2013. (*Id.* ¶ 4.) The only creditor that the Trustee specifically identifies in the Complaint is Prospect. (*Id.*; *see also id.* ¶¶ 72, 82.)

SportCo was a Delaware corporation and the parent and 100% owner of United Sporting, also a Delaware corporation. (*Id.* ¶ 19.) United Sporting was the 100% owner of Ellett, a South Carolina limited liability company with its principal place of business in South Carolina. (*Id.*) Ellett was the parent company of various subsidiaries, some incorporated in Delaware, some in South Carolina. (*See generally* Ex. 1, Liquidation Plan.) Ellett was a distributor of products and accessories for hunting, shooting, and other outdoor activities. (Doc. No. 58, Compl. ¶ 27.)

[3] For purposes of a Motion to Dismiss, the well-pleaded allegations of the Complaint are accepted as true. *See Nemet Chevrolet, Ltd. v. Consumeraffairs.com, Inc.*, 591 F.3d 250, 253 (4th Cir. 2009). However, the Court need not accept conclusory allegations, "legal conclusions, elements of a cause of action, and bare assertions devoid of further factual enhancement" and "unwarranted inferences, unreasonable conclusions, or arguments." *Id*. at 255 (internal citations omitted).

Mr. Kupchik is a citizen of the State of Pennsylvania. (*Id*. ¶18). Kupchik, along with the Defendants Charles E. Walker, Jr., F. Hewitt Grant, Bernard Ziomek[4], and Todd Boehly, are alleged to have been equity holders of SportCo who received distributions from the Debtors that Plaintiff claims to be fraudulent. (*Id*. ¶¶ 4, 14–18.) There are no allegations in the Complaint that Kupchik had any officer position or management responsibility with SportCo or any of the Debtor entities. He was merely a shareholder who received distributions in 2012 and 2013.

Plaintiff alleges that Defendant Wellspring Capital Partners IV, L.P. ("Wellspring") is a New York limited partnership that acquired Ellett in 2008 and was SportCo's largest shareholder (*Id*. ¶¶ 9, 30), and that Defendant Wellspring Capital Management LLC is a Delaware limited liability company that served as the manager of SportCo. (*Id*.¶ 8.) Plaintiff alleges that Defendant WCM GenPar IV, L.P. is a New York limited partnership and is the general partner of Wellspring, (*Id.* ¶ 10.), and that Defendant WCM GenPar IV GP, LLC is a New York limited liability company, and the general partner of WCM GenPar IV, L.P. (*Id.* ¶ 11.) Mr. Carles, a Managing Partner of Wellspring Capital, is alleged to be an officer and director of SportCo and its subsidiaries. (*Id*. ¶ 12.) Bradley Johnson was the President and Chief Executive Officer of SportCo. (*Id*. ¶ 13.)

Prospect is a Maryland corporation whose principal place of business is in New York. (*Id*. ¶ 22.) Prospect initially filed suit against Wellspring, Wellspring Capital, WCM GenPar, as well as Mr. Kupchik and the other shareholders, on May 23, 2019 in the Court of Common Pleas for the County of Lexington, South Carolina (the "State Court Action"). (*See* Doc. No. 1-2, Summons and Complaint, *Prospect Capital Corp.* v. *Wellspring Cap. Mgmt., LLC*, No. 2019-CP-32-02045 (S.C. Ct. Com. Pl. May 23, 2019)). Pursuant to the Liquidation Plan, Prospect

[4] Plaintiff alleges that Mr. Ziomek died in 2017, before the commencement of this action. (*Compl*. ¶ 17). Consequently, he cannot be a proper party to this action.

transferred to the Liquidation Trust the claims it previously asserted. (*See* Doc. No. 58, Compl. ¶ 7.)

II. The Transactions and Subsequent Events

A. The Transactions

Prospect and Summit Partners Credit Funds, LP ("Summit") were lenders under the Second Lien Loan and Security Agreement (the "Second Lien Loan Agreement" or "Agreement"). (*See id*. ¶ 35.) Under the specific terms of the Second Lien Loan Agreement,[5] Prospect served as agent for itself and Summit. (See Ex. 2, Second Lien Loan Agreement, Introductory Paragraph.) Plaintiff has not pled any facts alleging that Prospect or Summit was a creditor of any Debtor before the transactions at issue.

In 2012, Ellett and certain of its subsidiaries recapitalized their capital structure. (*See* Ex. 2, Second Lien Loan Agreement § 1.1.3.) As part of this recapitalization, on September 28, 2012, Ellett and certain of its subsidiaries entered into (i) the Third Amended and Restated Loan and Security Agreement, and (ii) the Second Lien Loan Agreement (collectively, the "2012 Loan Agreements") with Prospect and Summit. (Doc. No. 58, Compl. ¶ 35.) The 2012 Loan Agreements[6] collectively provided $280 million (the "2012 Loan") for the express purpose of enabling the Borrowers to pay down existing debts and pay a dividend to shareholders. (*See id*. ¶¶ 35, 36.) Prospect and Summit agreed in the Second Lien Loan Agreement to provide $170 million of the total financing. (Ex. 2, Second Lien Loan Agreement § 1.1.1.)

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[5] Notably, the Second Lien Loan Agreement is referenced specifically multiple times in the Complaint. (*See* Doc. No. 58, Compl. ¶¶ 35–36, 38–39.)

[6] The lenders to the 2012 Loan Agreements included Bank of America, Wells Fargo, Regions Bank (collectively, the Prepetition ABL Lenders"), who signed the Third Amended and Restated Loan and Security Agreement, and Prospect and Summit, who signed the Second Lien Loan Agreement. (Compl. ¶ 35 n.3.) The Prepetition ABL Lenders were paid in full with the proceeds of certain sales of Debtors' assets. (*See* Ex. 1 at 21.)

In consideration of their financing, Prospect and Summit bargained for and received certain rights and benefits, including board observer rights; (*See id*. § 9.1.10 (Board Information Rights)); audit rights (*See id.* § 9.1.1 (Visits and Inspections)); access to financial information (*See id.* § 9.1.3 (Financial and Other Information)); limitations on existing debt and distributions (*See id.* § 9.2.6 (Restrictions on Payment of Certain Debt; § 9.2.7 (Distributions)); and interest on the loans at a rate per annum equal to the greater of the LIBOR rate plus 11% and 12.75%. (*See id.* § 2.1.1 (Interest Rate)).

Prospect and Summit agreed to the required uses of the financing proceeds: "(i) to make a one-time Distribution to [United Sporting] (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." (*Id.* § 1.1.3.) The "Wellspring Debt" is defined as the "Debt of SportCo . . . by and between SportCo and Wellspring Capital IV, L.P. . . . the aggregate principal amount outstanding of $35,000,000." (*Id.* at App'x A.). The "Closing Date Distribution" is defined as "the one-time cash Distribution by Borrowers to [United Sporting] (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." (*Id.*; *see* Doc. No. 58, Compl. ¶ 36.) As required by the 2012 Loan Agreements, the Borrowers used approximately $139.6 million of proceeds to repay existing debts, approximately $134 million to fund distributions to shareholders (the "2012 Dividend"), and the remaining proceeds to pay the lending and transaction fees associated with the overall financial reorganization. (Doc. No. 58, Compl. ¶ 36; Ex. 2, § 1.1.3 Second Lien Loan Agreement.)

Prospect and Summit also made several affirmative representations in the Agreement. They each represented that they conducted their own due diligence and that "based upon such documents, information and analyses as [they have] deemed appropriate, made [their] own credit analysis of each Obligor and [their] own decision to enter into this Agreement and to fund the Term Loans[.]" (Ex. 2, Second Lien Loan Agreement § 12.10.) As a condition precedent to their funding, Prospect and Summit "received evidence satisfactory to them . . . that, after giving effect to" the transaction contemplated by the Agreement "each Borrower is Solvent." (*Id.* § 10.1.10.)

On March 7, 2013, Prospect agreed to loan additional amounts (the "2013 Supplement"), with the express requirement that the funds be used for a dividend to the Borrowers' shareholders (the "2013 Dividend"). (*See* Doc. No. 58, Compl. ¶¶ 38–39.) This additional $60 million financing was memorialized in an amendment to the Second Lien Loan Agreement (the "First Amendment"). (Ex. 3, First Amendment.) In that First Amendment, Prospect "consent[ed]" to both the loan and its intended purpose and again agreed that the loan "*shall be used* to make the Incremental Term Loan Funding Date Distribution." (*Id.* at 1 (emphasis added); *see also id.* ¶ 2(F).) The "Incremental Term Loan Funding Date Distribution" is "the one-time cash Distribution by Borrowers to [United Sporting] (for immediate further distribution to SportCo and Wellspring and the other shareholders of SportCo) on the Incremental Term Loan Funding Date in an amount up to . . . $60,000,000[.]" (*Id.* ¶ 2(A).)

Funding the 2013 Supplement was conditioned on both Prospect and Summit "receiv[ing] evidence satisfactory to them . . . that, after giving effect to the [2013 Supplement] and [2013 Dividend], each Borrower [was] Solvent." (*Id.*¶ 2(M).) They also amended Section

9.2.7, which had restricted further distributions, in order to expressly allow the 2013 Dividend to be made. (*Id*. ¶ 2(L).)

Prospect and Summit represented and agreed that New York law would govern "any claims sounding in contract or tort arising out of the subject matter" of the Agreement. (Ex.4, Second Amendment ¶ 1(b) (amending § 14.20.1 of Second Lien Loan Agreement).) While both the Second Lien Loan Agreement and its First Amendment included a New York choice of law provision (*See* Ex. 2, Second Lien Loan Agreement § 14.20; *See* Ex. 3, First Amendment ¶ 8), in 2014 Prospect and Summit clarified that the choice of law provision governing the transactions was meant to broadly cover any and all claims arising out of the subject matter of the transactions:

> This Agreement shall be governed by, and construed in accordance with, the law of the State of New York and the validity, interpretation, construction, and performance hereof shall be governed by and construed and enforced in accordance with, and any claim by any party hereto against any other party hereto (*including any claims sounding in contract or tort* arising out of the subject matter hereof and any determinations with respect to post-judgment interest) shall be determined in accordance with, the internal laws of the State of New York . . . .

(Ex.4, Second Amendment ¶ 1(b)). The Trustee is bound by this choice of law provision to which Prospect negotiated, consented and agreed.

B. Prospect's Subsequent Admissions in SEC Filings

Prospect made written disclosures to its investors in certified, contemporaneous SEC filings. Those filings show that Prospect was on notice of both the transaction and the risks associated therewith as early as 2013, and certainly no later than 2015 – more than three years prior to commencing this action.

Prospect's SEC filings warned its investors that the investments that Prospect makes are "highly speculative" and involve "a high degree of risk of credit loss." (*See* Ex. 5, Prospect Capital Corp. Form 10-K for Year Ended June 30, 2013 at 32, filed Aug. 21, 2013.) In its 2013

10-K, covering the period of the transactions, Prospect advised its investors that "[a] portfolio company's failure to satisfy financial or operating covenants imposed by us or other lenders could lead to defaults and, potentially, termination of its loans and foreclosure on its secured assets, which could trigger cross-defaults under other agreements and jeopardize a portfolio company's ability to meet its obligations under the debt or equity securities that we hold." (*Id.* at 44.)

In its 2015 10-K, Prospect disclosed that it wrote down the value of its investment in the Borrowers below par. (*See* Ex. 6, Prospect Capital Corp. Form 10-K for Year Ended June 20, 2015, filed Aug, 26, 2015 at 152.) In that filing, Prospect explained that Prospect's management had made the decision to change its valuation methodology of certain Debtors, to adopt an enterprise value "due to a deterioration in operating results and resulting credit impairment." *Id.* Prospect also disclosed that "[a]s a result of this change, and in recognition of recent company performance and current market conditions, we decreased the fair value of our investment in [certain Debtors] to $145,618[,000] as of June 30, 2015, a discount of $12,620[,000] from its amortized cost, compared to being valued at cost at June 30, 2014." *Id.* Prospect's 2015 SEC filing makes it clear that Prospect did not believe that the Debtors' assets were sufficient to repay the indebtedness owed to Prospect. Despite subsequent periodic market upturns (*see, e.g.*, Doc. No. 58, Compl. ¶ 33), Prospect never valued its investment in the 2012 Loan and 2013 Supplement above cost again.[7]

[7] *See* Ex. 7, Prospect Capital Corp. 10-K for Year Ended June 30, 2016 at 116 (Prospect reported the fair value of its investment in the Borrowers as $136,668,000,000.); Ex. 8, Prospect Capital Corp. 10-K for Year Ended June 30, 2017 at 156 ("the fair value of our investment in [United Sporting] decreased to $83,225[,000] as of June 30, 2017, a discount of $57,622[,000] from its amortized cost, compared to the $4,179[,000] unrealized depreciation recorded at June 30, 2016"); Ex. 9, Prospect Capital Corp. 10-K for Year Ended June 30, 2018 at 80, 121 (noting that

C. The State Court Action

On May 23, 2019, Prospect filed the State Court Action. *See generally* Doc. No. 1-2, Summons and Complaint, *Prospect Capital Corp.*, No. 2019-CP-32-02045. On June 10, 2019 (the "Petition Date"), the Debtors filed for bankruptcy. (Doc. No. 58, Compl. ¶ 66.) During the pendency of the SportCo Bankruptcy, the State Court Action was removed to this Court. (*See id.* ¶ 24.) The Liquidation Plan transferred the causes of action alleged in the State Court Action to the Liquidation Trust. (*See id*. ¶¶ 6–7.)

The Trustee was substituted as Plaintiff and filed the Complaint. (*See id.*) The first two causes of action in the Complaint assert alternative claims of action for fraudulent conveyance based on different transferors. (*See id*. ¶¶ 71–90.) The first cause of action alleges that Ellett made the purported fraudulent transfers, while the second alleges that SportCo made the transfers. (*Id.* ¶¶ 75, 85.) The first two causes of action are asserted against Kupchik and the other individual shareholders of SportCo who allegedly received distributions. The third cause of action for negligent misrepresentation is not directed to Kupchik. (*Id*. ¶¶ 91–101.)[8]

LAW AND ARGUMENT

I. Legal Standard

Fed. R. Civ. P. 12(b)(6) is applicable to adversary proceedings pursuant to Fed. R. Bankr. P. 7012. *In re Steinmetz*, 2011 WL 4543894, at *4 (Bankr. D.S.C. Mar. 18, 2011). To survive

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its investment in the Borrowers "is valued at discount to amortized cost of $68,285[,000]" and that the fair value of its investment in United Sporting is $58,806,000.).

[8] Plaintiff has demanded a jury trial on all issues. (Doc. No. 58, Compl. ¶ 70.) As an equitable statute, there is no right to a jury trial under the Statute of Elizabeth. *See Integrity Worldwide, Inc.* v. *Int'l Safety Access Corp.*, 2015 WL 1297823, at *6 (D.S.C. Mar. 23, 2015) (finding no jury trial right on Statute of Elizabeth claim); *In re Vereen*, 1999 WL 33485641, at *2 (Bankr. D.S.C. May 24, 1999) (same); *see also Oskin* v. *Johnson*, 735 S.E.2d 459, 463 (S.C. 2012) ("An action to set aside a conveyance under the Statute of Elizabeth is an equitable action."). Furthermore, the Second Lien Loan Agreement and First Amendment, as modified by the Second Amendment, contain a jury waiver provision. (Ex. 4, Second Amendment ¶ 7.)

a motion to dismiss, "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544, 570 (2007)). "Plausibility does not require probability, but does require something 'more than a sheer possibility that a defendant has acted unlawfully.'" *In re Steinmetz*, 2011 WL 4543894, at *4 (quoting *Iqbal*, 553 U.S. at 679).

While ordinarily limited to the allegations in the Complaint when deciding a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6), the Court may consider documents integral to the complaint. *See Kensington Volunteer Fire Dep't, Inc. v. Montgomery Cty., Md.*, 684 F.3d 462, 467 (4th Cir. 2012). The Court may also consider amendments to that Agreement. *Pope v. Barnwell Cty. Sch. Dist. No. 19*, 2017 WL 1148741, at *1 n.1 (D.S.C. Mar. 28, 2017) (court may consider contract and any of its amendments under Rule 12(b)(6)). Further, a court may consider matters of which it may take judicial notice, such as matters of public record. *Philips v. Pitt Cty. Mem'l Hosp.*, 572 F.3d 176, 180 (4th Cir. 2009).

II. The Fraudulent Conveyance Claims Fail as a Matter of Law

A. The Trustee Cannot Challenge Transactions That Prospect Ratified

Where—as here—the triggering creditor is subject to a defense that bars its claim, the trustee is also barred. *Smith* v. *Am. Founders Fin. Corp.*, 365 B.R. 647, 659 (S.D. Tex. 2007); *see also In re Refco, Inc. Sec. Litig.*, 2009 WL 7242548, at *12 (S.D.N.Y. Nov. 13, 2009), *report and recommendation adopted sub nom. In re Refco Sec. Litig.*, 2010 WL 5129072 (S.D.N.Y. Jan. 12, 2010); *In re J.R. Deans Co.*, 249 B.R. 121, 129 (Bankr. D.S.C. 2000). Dismissal under Rule 12(b)(6) is appropriate where the complaint reveals a meritorious affirmative defense. *In re Goodstein*, 2011 WL 1575509, at *1 (Bankr. D.S.C. Apr. 26, 2011) ("[T]he court may grant a 12(b)(6) motion 'when the face of the complaint clearly reveals the existence of a meritorious

affirmative defense.'") (quoting *Brooks* v. *City of Winston–Salem, N.C.*, 85 F.3d 178, 181 (4th Cir. 1996)).

Prospect, and the Trustee who stands in its shoes, cannot bring this fraudulent conveyance claim because Prospect "was a material participant in the alleged fraudulent transaction." *In re Refco*, 2009 WL 7242548, at *11. In 2012, Prospect negotiated and agreed to a transaction that authorized the challenged dividend. In 2013, Prospect agreed to a supplement of the second lien financing, as an amendment to its original contractual agreement. The Second Lien Loan Agreement and First Amendment (together, the "Loan Agreements") expressly state that proceeds of Prospect's loans would be used to pay distributions to shareholders, including Mr. Kupchik. (Ex. 2, Second Lien Loan Agreement § 1.1.3; Ex. 3, First Amendment at 1.) Prospect is barred from seeking to void transactions that it made years ago with its eyes wide open. *See, e.g.*, *In re Dunn*, 2006 WL 6810930, at *8 (B.A.P. 9th Cir. Oct. 31, 2006) (affirming dismissal of fraudulent transfer claims because creditor could not seek to invalidate transfer where "he executed the [r]esolution giving rise to the transfer" and is therefore estopped from attacking it); *Victory Med. Ctr. Beaumont, L.P.* v. *Conn. Gen. Life Ins. Co.*, 2018 WL 3467915, at *10–11 (E.D. Tex. July 17, 2018) (dismissing fraudulent conveyance action under theories of ratification, estoppel, and quasi-estoppel where creditor signed the instrument effectuating transfer); *In re Lyondell Chem. Co.*, 503 B.R. at 384–85 (dismissing fraudulent conveyance claim where creditors funded challenged transactions with knowledge of their purpose and thereby ratified them); *In re Crescent Res. Litig. Trust ex rel. Bernstein* v. *Duke Energy Corp.*, 500 B.R. 464, 479 (W.D. Tex. 2013) (barring fraudulent conveyance claim where lenders participated in the transaction with full knowledge of transaction); *U.S. Bank Nat'l Ass'n* v.

Verizon Commc'ns Inc., 479 B.R. 405, 411 (N.D. Tex. 2012) (barring fraudulent conveyance claim where triggering creditors participated in the challenged transactions).[9]

A trustee cannot assert a fraudulent conveyance claim on behalf of a creditor whose claim is barred, and therefore the claim should be dismissed. *See, e.g.*, *In re Refco*, 2009 WL 7242548, at *11 (where creditor "was heavily involved in structuring the transaction," and the credit agreement "provide[d] that the funds from [the creditor] could be used only for the" transaction, that same creditor could not "be the triggering creditor, because it was a material participant in the alleged fraudulent transaction"); *In re Crescent Res.*, 500 B.R. at 479; *HSBC Bank USA, Nat'l Ass'n* v. *Adelphia Commc'ns Corp.*, 2009 WL 385474, at *6–7 (W.D.N.Y. Feb. 12, 2009), *aff'd*, 634 F.3d 678 (2d Cir. 2011).

In re Lyondell Chemical Co. is instructive. 503 B.R. at 384–85. There, certain lenders (the "LBO Lenders") financed a leveraged buyout and portions of the loan proceeds were distributed to Lyondell's shareholders. *Id.* at 353–54. Lyondell filed for chapter 11, and the trustee commenced suit to recover the distributions. *Id.* The court dismissed the trustee's claims brought on behalf of the LBO Lenders on the grounds that "creditors who are participants in an alleged fraudulent transfer, or who have ratified it, cannot then seek to have that transfer

[9] Although it does not appear that South Carolina has addressed this issue directly in the context of a fraudulent transfer claim, South Carolina courts have recognized similar principles where a party assented to an act it then challenges. *See, e.g., Cunningham* v. *Jaffe*, 251 F. Supp. 143, 149, 153 (D.S.C. 1966) (holding corporation and its shareholders were estopped from recovering amounts paid in salaries where salaries were "formally adopted at a stockholders and directors meeting . . . [and] made to the defendants pursuant to formal action of the corporation"); *Seabrook Island Prop. Owners Ass'n* v. *Pelzer*, 356 S.E.2d 411, 414 (S.C. Ct. App. 1987) (holding that, where party had knowledge of monetary charges assessed against him and acquiesced to them, he was estopped from claim seeking relief from those charges); *L.F.S. Corp.* v. *Kennedy*, 337 S.E.2d 209, 210 (S.C. 1985) (applying ratification to bar legal malpractice claim); *Miller ex rel. Grand Strand Diversified, Inc.* v. *Gandee*, 328 S.E.2d 482, 483–84 (S.C. Ct. App. 1985) (holding shareholder asserting derivative claim on behalf of corporation estopped from challenging transaction to which he previously assented).

avoided." *Id.* at 383. As the court explained, though the "rubrics" by which various courts have reached this same conclusion have varied—"ratification, consents, estoppel or material participa[tion] in the transaction"—all have agreed that: "[c]reditors who authorized or sanctioned the transaction, or, indeed, participated in it themselves, can hardly claim to have been defrauded by it, or otherwise to be victims of it." *Id.* at 383–84 (internal quotation marks omitted). The court concluded that the LBO Lenders could not have been "ignorant of the fact that [they] w[ere] lending for the purpose of financing an LBO, and that LBO proceeds would then go to stockholders—especially since . . . the loan documents required loan proceeds to be used for that purpose." *Id.* at 384–85.

The Northern District of Texas reached a similar conclusion when considering claims brought on behalf of creditors who financed the acquisition of Verizon's yellow page business by Idearc, when Idearc was spun-off from Verizon. *U.S. Bank Nat'l Ass'n*, 479 B.R. at 410. There, the creditor lenders had made the loans to Idearc "for the express purpose" of financing that acquisition. *Id.* After Idearc later filed for bankruptcy, the Court held that the trustee was barred from bringing a fraudulent conveyance suit for those creditor lenders because they "not only *knew* that their loans would be used to pay Verizon, they not only *consented* that their loans be used to pay Verizon; they *required* that their loans be used to pay Verizon." *Id.* at 411. Because of the credit lenders' participation in the transfers, they would have been barred from bringing the claims. *Id.* And therefore, so was the trustee. *Id.*

The same logic applies here. Prospect participated in and expressly consented to the transactions the Trustee now seeks to void. As admitted in the Complaint, the Second Lien Loan Agreement "provided that on or after closing, the Transferee Defendants would receive a 'one-

time cash Distribution.'"[10] (Doc. No. 58, Compl. ¶ 36; *see* Ex. 2, Second Lien Loan Agreement § 1.1.3.) Plaintiff conceded that the additional financing in 2013 specifically provided that the Transferee Defendants would receive a "one-time cash Distribution." (Doc. No. 58, Compl. ¶ 39; *see* Ex. 3, First Amendment at 1.) In fact, because the Second Lien Loan Agreement limited how and when distributions could be made, Prospect expressly agreed in the First Amendment to amend the Second Lien Loan Agreement to specifically permit the 2013 Dividend which the Trustee now seeks to avoid. (*See* Ex. 3, First Amendment ¶ 2(L).) It is incontrovertible that Prospect made the loans in 2012 and 2013 with the understanding that the proceeds were required to be used to pay the distributions the Trustee now challenges. Prospect's participation in the transactions bars it, and therefore the Trustee, from bringing these claims.

B. New York Law Governs and Precludes the Fraudulent Conveyance Claims

Prospect negotiated and executed an agreement containing a broad and binding New York choice of law provision. The Trustee standing in Prospect's shoes is likewise bound by the New York choice of law provision. Even if the Court does not apply the clear and binding contractual choice of law provision, application of South Carolina's choice of law provisions also mandates that New York law apply to Plaintiff's fraudulent conveyance claims against Mr. Kupchik and the other shareholders. Since Plaintiff has pled no facts to support a claim under New York law for constructive fraudulent conveyance, the first and second causes of action should be dismissed as to Mr. Kupchik.

[10] The Complaint defines the Transferee Defendants to include Mr. Kupchik and others.

1. The Loan Agreement's Choice of Law Provision Governs the Fraudulent Conveyance Claims

South Carolina respects parties' contractual choice of law provisions. *See, e.g.*, *Accident Ins. Comp., Inc.* v. *U.S. Bank Nat'l Ass'n*, 2019 WL 2865222, *2 (D.S.C. 2019) ("South Carolina choice-of-law rules dictate that the court must apply the law specified in the contract."). The Loan Agreements that Prospect negotiated and executed contain a choice of law provision requiring the application of New York law. Prospect and Wellspring are located in New York, and applying New York law to the agreement is reasonable on its face. Prospect and the Trustee should be held to the choice of law of its agreement. *See e.g. MainStreet Bank* v. *Nat'l Excavating Corp.*, 791 F. Supp. 2d 520, 529 (E.D. Va. 2011) (enforcing Virginia choice of law provision in loan agreement to fraudulent conveyances).

The choice of law provision is also broadly worded and applies to "any claims" arising out of the subject matter of the Loan Agreements that sound in "either contract or tort." (Ex. 4, Second Amendment ¶ 1(b).) The agreed choice of law provision should be enforced here. *See, e.g.*, *Hitachi Credit Am. Corp*. v. *Signet Bank*, 166 F.3d 614, 628 (4th Cir. 1999) (applying choice of law provision in agreement given the close relationship between the tort and the agreement); *Accident Ins. Comp., Inc.*, 2019 WL 2865222, at *4, n.3 (applying choice of law provision to tort claims where conduct giving rise to claims related to subject matter of the agreement); *Palmetto Health Credit Union* v. *Open Sols. Inc.*, 2010 WL 2710551, at *2 (D.S.C. July 7, 2010) (applying choice of law provision to tort claims because claims were sufficiently related to agreement).

While Mr. Kupchik was not a direct party to the Loan Agreements, he and the other shareholders nevertheless are entitled to enforce that provision as third-party beneficiaries. Whether someone is a third-party beneficiary to a contract is a matter of contract

interpretation. *See, e.g.*, *THI of S.C. at Columbia, LLC* v. *Wiggins*, 2011 WL 4089435, at *6 (D.S.C. Sept. 13, 2011); *In re BHB Enters., LLC*, 1998 WL 2016846, at *18 (Bankr. D.S.C. Sept. 30, 1998). Thus, the Court should look to the law specified in the Loan Agreements—New York—to consider this question. *See Lightsey* v. *Toshiba Corp.*, 2019 WL 5872168, at *3 (D.S.C. Mar. 4, 2019) (applying New York law to determine whether plaintiffs were third-party beneficiaries because contract specified New York law); *Vititoe* v. *Bridgestone Am. Tire Operations, Inc.*, 2018 WL 5724084, at *4 (D.S.C. Jan. 17, 2018) (applying law of the state chosen by the parties in contract to determine matter of contract interpretation).

Under New York law, a nonparty to a contract can enforce the contract as a third-party beneficiary upon establishing "(1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for [the nonparty's] benefit, and (3) that the benefit to them is sufficiently immediate . . . to indicate the assumption by the contracting parties of a duty to compensate them if the benefit is lost."[11] *Saratoga Schenectady Gastroenterology Assocs., P.C.* v. *Bette & Cring, LLC*, 83 A.D.3d 1256, 1257 (N.Y. App. Div. 2011). A nonparty is an intended beneficiary if the contractual language and circumstances "indicate that the promisee intends to give the beneficiary the benefit of the promised performance." *Bayerische Landesbank, N.Y. Branch* v. *Aladdin Cap. Mgmt LLC*, 692 F.3d 42, 52 (2d Cir. 2012) (quoting *Levin* v. *Tiber Holding Corp.*, 277 F.3d 243, 248 (2d Cir. 2002)).

[11] South Carolina third-party beneficiary law is substantively similar. *See Hardaway Concrete Co.* v. *Hall Contracting Corp.*, 647 S.E.2d 488, 492–93 (S.C. Ct. App. 2007) ("[I]f a contract is made for the benefit of a third person, that person may enforce the contract if the contracting parties intended to create a direct, rather than an incidental or consequential, benefit to such third person." (quoting *Bob Hammond Constr. Co.* v. *Banks Constr. Co.*, 440 S.E.2d 890, 891 (S.C. Ct. App. 1994)). Under South Carolina law, Wellspring is a third-party beneficiary able to enforce the contractual choice of law provision. *See Beverly* v. *Grand Stand Reg'l Med. Ctr., LLC*, 2020 WL 215928, at *5 (S.C. Ct. App. Jan. 25, 2020) (third party could enforce contract where contract showed intent to benefit the third party); *Hardaway Concrete*, 647 S.E.2d at 493 (same).

The elements establishing third-party beneficiary status are met here easily. The Loan Agreements are valid and binding contracts, and they specifically state that the parties intended the shareholders of SportCo, including Mr. Kupchik, to be beneficiaries of a dividend paid with loan proceeds. (Ex. 2, Second Lien Loan Agreement § 1.1.3; *id.* App'x A at 5 (emphasis added); *see also* Ex. 3, First Amendment ¶¶ 2(F), 2(A).) The Loan Agreements evince the contracting parties' intention that the shareholders receive an immediate benefit from the lenders' performance, in the form of shareholder distributions. Furthermore, the Loan Agreements expressly provide that Mr. Kupchik and the other shareholders were to receive a portion of the funds loaned pursuant to the agreements. It is clear that the parties intended that they would receive a direct benefit from the transactions and that these beneficiaries could enforce the Loan Agreements to secure that right. *See, e.g.*, *Bayerische*, 692 F.3d at 56 (third-party beneficiary could enforce contract where language "plausibly evince[d] an intent by the [contracting parties] to provide a benefit to the [third party]"); *Goodman-Marks Assocs., Inc.* v. *Westbury Post Assocs.*, 70 A.D.2d 145, 147–49 (N.Y. App. Div. 1979) (plaintiff could enforce contract as third-party beneficiary where contract provided that contracting party was to "pay [the] balance of [the] fee to [the plaintiff]").

Mr. Kupchik and the other shareholders, as third party beneficiaries, are thus entitled to enforce the choice of law provision in the Loan Agreements, as modified by the Second Amendment. *See, e.g.*, *Roby* v. *Corp. of Lloyd's*, 996 F.2d 1353, 1359 (2d Cir. 1993) (applying forum selection clause stating "each party hereto irrevocably agrees that the courts of England shall have exclusive jurisdiction to settle any dispute and/or controversy of whatsoever nature arising out of or relating to the [] membership . . . " and choice of law provision equally as broad

to third-party beneficiaries); *In re Kingate Mgmt. Ltd. Litig.*, 2016 WL 5339538, at *16 (S.D.N.Y. Sept. 21, 2016), *aff'd*, 746 F. App'x 40 (2d Cir. 2018).

South Carolina courts will enforce the parties' choice of law absent a strong public policy reason to disregard. *Jerrold A. Watson & Sons, LLC* v. *C.H. Robinson Company*, 2017 WL 11317861, at *4 (D.S.C. Sept. 28, 2017). That requires a showing that the clause is "against good morals or natural justice, or, for some other such reason the enforcement of it would be prejudicial to the general interests of [the state's] own citizens." *Accident Ins. Co.*, 2019 WL 2865222, at *4 (citations omitted) (noting that "[t]he South Carolina Supreme Court has never utilized the [] public policy exception to avoid application of foreign laws which prevent South Carolina citizens from recovering for a wrong."). Examples of foreign laws against good morals and natural justice include "prohibited marriages, wagers, lotteries, racing, contracts for gaming or the sale of liquors, and others." *Dawkins* v. *State*, 412 S.E.2d 407, 408 (S.C. 1991). Plaintiff has pled no such strong public policy reason, and none exists here.

2. Under South Carolina's Choice of Law Analysis, New York Law Applies

Federal courts apply the choice of law principles of the state within which they sit, and as such this Court will apply South Carolina's choice of law principles. *See In re Infinity Bus. Grp., Inc.*, 497 B.R. 794, 804 (Bankr. D.S.C. 2013) (citing *In re Merritt Dredging Co.*, 839 F.2d 203, 205–06 (4th Cir. 1988)). New York and South Carolina constructive fraudulent conveyance laws differ, *compare* N.Y. Debt. & Cred. Law §§ 273–75 *with* S.C. Code § 27-23-10, so the Court must classify the claim as sounding in either tort or contract to determine which choice of law analysis applies. *See Lister* v. *NationsBank of Del., N.A.*, 494 S.E.2d 449, 454–56 (S.C. Ct. App. 1997) (noting that South Carolina applies traditional common law choice of law rules

classifying claims as sounding in either contract or tort and that South Carolina has not adopted other tests).

If the contractual provision does not apply, Defendant submits that the Court should apply a tort-based choice of law analysis. A recent South Carolina district court decision applied tort-based choice of law principles to a fraudulent conveyance claim. *See, e.g.*, *Integrity Worldwide, Inc.* v. *Int'l Safety Access Corp.*, 2015 WL 1297823, at *2 (D.S.C. Mar. 23, 2015) (applying South Carolina law to fraudulent conveyance claim because injury occurred in South Carolina); *but see Ashmore for Wilson* v. *Dodds*, 262 F. Supp. 3d 341, 359–61 (D.S.C. 2017).[12] It would also be consistent with several other jurisdictions that have analyzed fraudulent conveyance as sounding in tort. *See, e.g.*, *MainStreet Bank*, 791 F. Supp. 2d at 529 n.14 (Maryland); *Bank of Am., N.A.* v. *Corporex Cos., LLC*, 99 F. Supp. 3d 708, 713 (E.D. Ky. 2015) (Kentucky), *abrogated on other grounds by Helm* v. *Ratterman*, 778 Fed. App'x 359, 370–73 (6th Cir. 2019); *Rosa* v. *TCC Commc'ns*, Inc., 2017 WL 980338, at *7 (S.D.N.Y. Mar. 13, 2017) (New York); *Terry* v. *Walker*, 2006 WL 736861, at *7 (W.D. Va. Mar. 23, 2006) (Virginia); *In re Sverica Acquisition Corp.*, 179 B.R. 457, 469 n.16 (Bankr. E.D. Pa. 1995) (Pennsylvania); *see*

[12] In *Ashmore*, the district court looked to *Sheldon* v. *Blauvelt*, 7 S.E. 593, 594 (1888). But *Sheldon* did not make a determination, or render a holding, as to whether a fraudulent conveyance sounds in tort or in contract. *See Sheldon*, 7 S.E. at 594. Rather, it applied a choice of law based on the facts and circumstances of that case. *Ashmore* reads *Sheldon's* choice of law analysis to be limited to those facts and therefore not controlling. *Ashmore*, 262 F. Supp. 3d at 361. Other courts that have looked to *Sheldon* for choice of law guidance have reached different conclusions as to the analysis that court engaged in. *See Ashmore*, 262 F. Supp. 3d at 360 (describing three interpretations of *Sheldon* ascribed to case law and secondary sources). Moreover, the court's decision in *Ashmore* is not binding on this Court. *See* Order Dismissing Case at 9, *In re Davis*, No. 06-02808-dd (Bankr. D.S.C., Oct. 2, 2006) ("[T]he modern trend [is] that a bankruptcy court is not bound by *stare decisis* to follow the decision of a single district judge in a multi-judge district.") (citing cases). Here, should the Court not enforce the contractual choice of law provision, it should follow *Integrity Worldwide* and apply South Carolina's tort choice of law analysis.

also Peter Spero, Fraudulent Transfers, Prebankruptcy Planning & Exemptions § 3:19 (2018) (collecting cases).

Under South Carolina law, if a claim sounds in tort, "the substantive law . . . is determined by the state in which the injury occurred." *Lister*, 494 S.E.2d at 454. Under the place of injury approach, the Court should look to the location of the creditor harmed by the purportedly fraudulent conveyance. *See, e.g.*, *MainStreet Bank*, 791 F. Supp. 2d at 531. Plaintiff's alleged injury here is the financial harm Prospect purportedly suffered as a result of its investments in 2012 and 2013. (Doc. No. 58, Compl. ¶¶ 42, 77, 87.) When an entity suffers financial harm, the injury occurs where the entity maintains its principal place of business. *See, e.g.*, *In re Joseph Walker & Co.*, 522 B.R. 165, 189 n. 35 (Bankr. D.S.C. 2014) ("When an entity suffers an economic injury, the situs of that injury is the state in which the entity experiences the impact of the alleged financial loss: the state in which its business operates."); *In re Infinity Bus. Grp., Inc.*, 497 B.R. at 804 (tort claim governed by law of state where injured corporation's offices were located); *see also Lister*, 494 S.E.2d at 545–55. Prospect's principal place of business is in New York (*see* Doc. No. 58, Compl. ¶ 22), and it suffered its purported injuring relating to the fraudulent conveyance claims in New York.

3. The Trustee Fails to, and Cannot, Plead a Legally Sufficient Fraudulent Conveyance Claim Under New York Law

Applying New York law, Plaintiff has not stated and cannot state a claim for fraudulent conveyance. Under New York's Debtor and Creditor Law ("DCL"), a transfer is deemed to be constructively fraudulent where the transfer is made without "fair consideration" *and* one of the following conditions is met: (1) the transferor is insolvent or will be rendered insolvent by the transfer in question; (2) the transferor is engaged in or is about to engage in a business transaction for which its remaining property constitutes "unreasonably small capital"; or (3) the

transferor believes that it will incur debts beyond its ability to pay. DCL §§ 273–75; *Innovative Custom Brands, Inc.* v. *Minor*, 2016 WL 308805, at *3 (S.D.N.Y. Jan. 25, 2016). Plaintiff makes no attempt to plead facts sufficient to state a claim that satisfies the requirements of a fraudulent conveyance claim under New York law.

Plaintiff nowhere alleges that the Borrowers were insolvent, had unreasonably small capital, or believed that they would incur debts beyond their ability to pay. To the contrary, the Complaint alleges that the Borrowers were solvent and operated for years after the transactions. (*See* Doc. No. 58, Compl. ¶¶ 31–32; *see also* Ex. 2, Second Lien Loan Agreement § 8.1.11; Ex. 3, First Amendment ¶ 2(M)). Plaintiff asserts that the Debtors' experienced success for years following the transfers. (*See* Doc. No. 58, Compl. ¶¶ 31–32.) Nothing pled in or reasonably inferred from the allegations in the Complaint suggests that the Debtors were struggling to stay solvent following the transactions. Without pleading these facts, Plaintiff's allegations are insufficient to state a fraudulent conveyance claim under New York law and should be dismissed. *See, e.g.*, *Ray* v. *Ray*, 2019 WL 1649981, at *6 (S.D.N.Y. Mar. 28, 2019), *aff'd*, 2020 WL 374556 (2d Cir. Jan. 23, 2020) (dismissing DCL § 273 claim for failure to plead that defendant's assets were less than probable liabilities and DCL § 275 claim for failure to plead that defendant held a "subjective belief that she would incur debts beyond her ability to pay at the time the transfers were made"); *Innovative Custom Brands, Inc.*, 2016 WL 308805, at *3 (dismissing DCL § 273 claim for failure to adequately plead insolvency, DCL § 274 and claim for failure to plead that defendants lacked sufficient assets to pay creditors at the time of the transfers and DCL § 275 claim for failure to plead facts concerning defendants' subjective intent); *In re Operations NY LLC*, 490 B.R. 84, 98–99 (Bankr. S.D.N.Y. 2013) (dismissing DCL § 274 and § 275 claims).

C. Even if South Carolina Law Were to Apply, the Fraudulent Conveyance Claims Cannot Proceed as a Matter of Law

Even under South Carolina law, the Complaint fails to state a claim for fraudulent conveyance because Plaintiff, who stands in Prospect's shoes, should be required to plead actual fraud, which he failed to—and cannot—do. Further, because the triggering creditor upon whom Plaintiff relies for its right to assert these claims had notice of its rights more than three years before this action was filed, the claims are barred by the applicable statute of limitation.

1. The Trustee Failed to Plead Actual Fraud

The facts alleged show that Prospect became a creditor only because of the transactions, and not before. Since Prospect became a creditor through its knowing participation in the transactions it now challenges as fraudulent, and the Trustee alleged no facts demonstrating that Prospect was a creditor before those transactions were completed, Prospect should be required to plead actual fraud under the Statute of Elizabeth, as is required of all subsequent creditors.

A subsequent creditor—who has notice of the allegedly objectionable transaction when making its decision to extend credit to the borrower— may only have a transfer set aside upon a showing of actual fraud, *i.e.*, when "(1) the conveyance was voluntary, that is, without consideration, and (2) it was made with a view to future indebtedness or with an actual fraudulent intent on the part of the grantor to defraud creditors." *See In re Ducate*, 369 B.R. at 259 (quoting *In re J.R. Deans Co.*, 249 B.R. at 130–31). A subsequent creditor "can have no ground upon which he can say that a gift [the alleged fraudulent transfer] is a fraud upon him." *Id.* at 260 (quoting *Walker, Evans & Cogswell* v. *Bollmann Bros.*, 22 S.C. 512, 528 (S.C. 1885)); *see also Eigleberger* v. *Kibler*, 1 S.C. Eq. 113, 120 (S.C. Ct App. 1833) (creditors "with a full knowledge of the conveyance" who "stood by for near ten years" before bringing claim were not entitled to relief). This Court recognized in *In re Ducate* that "it would be *unjust* to allow a

subsequent creditor to avoid a transfer, even one that is voluntary, as fraudulent if the creditor knew or should have known of the transfer before the debt was incurred." 369 B.R. at 260–61 (emphasis added); *see also Gentry* v. *Lanneau*, 32 S.E. 523, 523 (S.C. 1899) ("[I]t is unquestionably true that the mere fact that a deed is without consideration . . . will not render it fraudulent as to subsequent creditors, especially where they have notice . . . .") (quoting *Jackson* v. *Pyler*, 17 S.E. 255, 256 (S.C. 1893)).

As pled in the Complaint, Prospect extended the second lien financing to the Borrowers contemporaneously with the allegedly fraudulent transfers. (Doc. No. 58, Compl. ¶¶ 35–36, 38–39.) The Loan Agreements that Prospect negotiated and executed memorialized its approval and knowledge that the proceeds of its loans would be used to fund the allegedly fraudulent conveyances. The First Amendment, which effectuated the 2013 Supplement and is incorporated into the Second Lien Loan Agreement, specifically lifted the restrictions to make distributions that Prospect had put in place through the Second Lien Loan Agreement in 2012. (*See* Ex. 3 ¶ 2(L).) Prospect thus is a subsequent creditor as to the 2012 Loan and the 2013 Supplement, because it had every opportunity to evaluate the allegedly fraudulent transfer before deciding whether to extend credit. Like any subsequent creditor, Prospect "can have no ground upon which [it] can say that a gift [the alleged fraudulent transfer] is a fraud upon [it]." *In re Ducate*, 369 B.R. at 260. Moreover, it would be "unjust" for Prospect to avoid the dividend that it negotiated and ratified. *Id*. at 161.

Because Prospect is a subsequent creditor, the Complaint should be dismissed for failure to plead actual fraud. That the Plaintiff alleges that the transfers were purportedly made without consideration (*see* Doc. No. 58, Compl. ¶¶ 37, 40), is inadequate on its own to state a claim for fraudulent conveyance. *In re Ducate*, 369 B.R. at 259 (subsequent creditor must establish lack of

consideration *and* actual fraud to prevail). Actual fraud requires showing "a conscious intent to defeat, delay, or hinder [one's] creditors in the collection of their debts." *Judy* v. *Judy*, 742 S.E.2d 672, 675 (S.C. Ct. App. 2013) (quoting *First Carolinas Joint Stock Land Bank of Columbia* v. *Knotts*, 1 S.E.2d 797, 808 (S.C. 1939)). Such allegations of actual fraud are absent from the Complaint.

2. The Statute of Limitations Bars the Fraudulent Conveyance Claims

Plaintiff also cannot proceed on a fraudulent conveyance claim under South Carolina law because any such claim is barred by the Statute of Elizabeth's three-year statute of limitations. S.C. Code Ann. § 15-3-530(7); *In re J.R. Deans Co.*, 249 B.R. at 132. This three-year limitations period is subject to the "discovery rule" that the statute of limitations "does not begin to run until discovery of the fraud itself or of such facts as would have led to the knowledge thereof, if pursued with reasonable diligence." *Id.* (quotation marks and citations omitted). The discovery rule is triggered where "the facts and circumstances . . . place a reasonable person of common knowledge and experience on *notice* that a claim against another party might exist." *Dean* v. *Ruscon Corp.*, 468 S.E.2d 645, 647 (S.C. 1996). The discovery rule is triggered even when the injured party may not comprehend the full extent of its injury. *Id.*; *Davis* v. *Citimortgage, Inc.*, 2016 WL 4040084, at *2–3, 5 (D.S.C. July 28, 2016) (statute of limitations period began to run once plaintiff had constructive notice of unlawful conduct thus the possibility for legal recourse).

The statute of limitations began to run here when the purportedly fraudulent conveyances occurred (or, at the latest, when Prospect wrote down the value of its loans below par, reflecting its expectation that it would not recover the full amount of its loan). When Prospect executed the Second Lien Loan Agreement in 2012, it knew that there was a risk it would not be paid in full. Prospect recognized this in its public risk disclosures immediately following the transactions.

These risks were realized in August 2015, when Prospect disclosed that it marked down its investment in the Borrowers to an amount below a par recovery. Prospect never valued its investment in the Borrowers above cost again. *See supra* II.B. Prospect did not file suit on any cause of action prior to 2019.

Prospect participated in the challenged transfers, and secured the rights to inspect and audit the financials of the company that made the distributions it now challenges, therefore the three-year statute of limitations should begin to run when the challenged transfers occurred in 2012 and 2013. At the latest, the statute of limitations should have started to toll in 2015 when Prospect wrote down its second lien debt and disclosed in its SEC filings that it did not believe that it would not be able to recover in full the amount of its loans to the Borrowers. Certainly, at that point in time, Prospect was "on *notice* that a claim against another party might exist." *Dean*, 468 S.E.2d at 647. Therefore, at the absolute latest, Prospect must have filed suit by August 2018, and since it did not, its claim is barred.

D. The Trustee Has Failed to Allege a Triggering Creditor

Section 544(b) of the Bankruptcy Code merely gives the Trustee the status and rights of a triggering creditor under state law. *See* 11 U.S.C. § 544(b); *In re J.R. Deans Co.,* 249 B.R. at 129; *In re Lang*, 5 B.R. 371, 374 (Bankr. S.D.N.Y. 1980). In order to have standing to bring fraudulent conveyance claims, the Trustee must plausibly allege the existence of an unsecured creditor who both held an allowable unsecured claim on the Petition Date *and* could have asserted the claims set forth in the Complaint under applicable state law.

An examination of the Complaint reveals the Plaintiff has failed to plausibly allege the existence of an *unsecured* creditor who held an allowable claim on the Petition Date who could assert a claim for fraudulent conveyance. Plaintiff asserts that "[a]t all times relevant [to the Complaint], there have been one or more creditors, including, without limitation, Prospect, who

have held and still hold unsecured claims" against the relevant Debtors that "were and are allowable" under section 502 of the Bankruptcy Code and that such creditors have claims against the Defendants. (Doc. No. 58, Compl. ¶¶ 72, 82.) Prospect is the only alleged "unsecured" creditor specifically identified in the Complaint. However, Prospect cannot serve as the requisite "triggering creditor" under Section 544(b) because there is a binding court order establishing that Prospect was not an unsecured creditor, but a *secured* lender as of the Petition Date.

Prospect, the Debtors and the Trustee are bound by the Delaware Bankruptcy Court's Cash Collateral Order, in which it was stipulated that as of the Petition Date, Prospect's claims under the Second Lien Loan Agreement constituted allowed, secured—not *unsecured*—claims.[13] That Order provides that "[t]he Debtors acknowledge and agree that as of the Petition Date . . . the Prepetition Term Loan Obligations[14] constitute *allowed, secured claims* within the meaning of section 502 and 506 of the Bankruptcy Code." (Ex. 10, Cash Collateral Order at ¶ F(ix) (emphasis added).) The Order further provides that the Debtors' stipulations and agreements, including those with respect to Prospect's status as a secured creditor, are "binding, conclusive, and final . . . for all purposes" on any person or entity, including the Debtors, all creditors in the Debtors' chapter 11 cases, and their respective successors. (*Id.* at ¶ 40(c).) The Order was approved by the Delaware Bankruptcy Court in a now final and non-appealable order.

Plaintiff, as successor to the Debtors, is estopped from pleading that Prospect, or any of the other Second Lien Lenders, were unsecured creditors as of the Petition Date. "[W]here a

[13] *See* Final Order (I) Approving the Debtors' Postpetition Financing, (II) Authorizing the Debtors Continued Use of Cash Collateral, (III) Granting Liens, and Providing Superpriority Administrative Expense Status, (IV) Granting Adequate Protection to the Prepetition Lenders, (V) Modifying Automatic Stay, and (VI) Granting Related Relief (the "Cash Collateral Order" or the "Order"), Ex.10 at ¶ F(ix).

[14] The Cash Collateral Order defines the Prepetition Term Loan Obligations to include all amounts outstanding under the Second Lien Loan. (*See id.* ¶ F(v).)

party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position[.]" *In re Williams*, 553 B.R. 550, 554 (Bankr. D.S.C. 2016) (quoting *New Hampshire* v. *Maine*, 532 U.S. 742, 749 (2001)); *see also Lowery* v. *Stovall*, 92 F.3d 219, 223 (4th Cir. 1996).

Since the Complaint fails to allege facts that identify any creditors other than Prospect as a potential and valid triggering party under section 544(b)(1), it should be dismissed. *See, e.g.*, *In re Bolon*, 538 B.R. 391, 404–05 (Bankr. S.D. Ohio 2015) (dismissing claims under section 544(b) where complaint did not plausibly allege existence of an unsecured creditor); *In re Indus. Commercial Elec., Inc.*, 2004 WL 1354530, at *5 (Bankr. D. Mass. Apr. 27, 2004) (dismissing a section 544(b) action *sua sponte* based on failure to identify an unsecured creditor, where, *inter alia*, the Debtors' schedules listed the identified creditor as secured and the cash collateral motion characterized the creditor as secured); *see also J.R. Deans Co.*, 249 B.R. at 131 ("[t]he [c]ourt finds that the [t]rustee's speculations as to the fact that the . . . claimants were clearly creditors in existence at the time that the transfer occurred is insufficient to confer standing upon the [t]rustee.").

CONCLUSION

For the foregoing reasons, Andrew Kupchik respectfully moves the Court to request that the Court dismiss the Complaint against him in its entirety, with prejudice, for failure to state a claim upon which relief may be granted.

Respectfully submitted,

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