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Avoiding Insider Status in Bankruptcy: Lessons from *Capmark Financial Group Inc. v. Goldman Sachs Credit Partners, L.P.*

By Benjamin S. Kaminetzky

Through various affiliated entities, large financial institutions may have multiple touch points to a company client or multiple roles in a complex financial transaction. For example, one affiliate could have an equity interest in a company, another affiliate could have a lending relationship with the company and yet a third affiliate could provide financial advisory services to the same company. Such scenarios pose a risk that the lending entity will be deemed an ''insider'' of the company under the Bankruptcy Code (the ''Code'') or similar state law. Insider status may in turn have significant ramifications on any potential recovery from the target company in bankruptcy, putting financial institutions at significantly greater risk of having long-completed transactions reversed and funds clawed back and/or having their claims in bankruptcy sent to the back of the line.

Financial institutions therefore scored a significant victory on April 9, 2013, when Judge Robert Sweet of the United States District Court for the Southern District of New York dismissed Capmark Financial Group Inc.'s (''Capmark'') insider preference action against four lender affiliates of The Goldman Sachs Group, Inc. (''Goldman Sachs''), which arose out of Capmark's 2009 bankruptcy.[1] Davis Polk represented the Goldman Sachs lender affiliates. The court held that mere participation by corporate sister subsidiaries in lending and equity relationships with the debtor is insufficient without more to make the lending subsidiary an insider of the debtor, even if a sister subsidiary has a director on the debtor's board. In doing so, the court reaffirmed that corporate veils separating a lender from an affiliated entity that may be an insider of the debtor will not lightly be disregarded, and that participation in an arm's-length transaction as an ordinary commercial lender will not give rise to insider status. As a result, the *Capmark* decision should pose a substantial obstacle to claims alleging that a lender is an ''insider'' by virtue of affiliated entities' contacts with a debtor, at least in the absence of evidence that the lender used the affiliates' contacts to influence the debtor's decisions.

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Case Background

A brief history of the Capmark bankruptcy is essential to understanding Capmark's claims and the import of Judge Sweet's decision. In 2006, a consortium of private equity firms acquired an approximately 75% equity stake in Capmark through GMACCH LLC (''GMACCH''). Private equity funds managed by affiliates of Goldman Sachs (the ''PIA Funds'') held a 19.8% stake in GMACCH and were permitted to appoint one designee to Capmark's board of directors. The PIA Funds selected a managing director of Goldman Sachs as their designee. In connection with this transaction, Capmark obtained two syndicated credit facilities, a $5.5 billion unsecured credit facility and a $5.25 billion unsecured bridge loan facility (the ''Bridge Loan''). Four lender affiliates of Goldman Sachs (the ''Goldman Lenders'') acquired positions in those credit facilities.

In late 2008, because of credit market turmoil and a related decline in the value of its mortgage-related holdings, Capmark found itself in a challenging financial situation. In particular, Capmark faced an $833 million payment due in March 2009 to its Bridge Loan lenders,

[1] *Capmark Fin. Grp. Inc., v. Goldman Sachs Credit Partners L.P.*, 491 B.R. 335 (S.D.N.Y. 2013).

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including, among others, the Goldman Lenders. After extensive negotiations, in May 2009 Capmark obtained a new $1.5 billion secured term loan facility (the ''Secured Credit Facility''), which it used mainly to pay down the 2006 unsecured credit facilities. Capmark also agreed to pay its Bridge Loan lenders about $75 million in cash. In this transaction, the Goldman Lenders allegedly received about $139 million in the Secured Credit Facility in exchange for a similar amount of the 2006 unsecured credit facilities, and about $5.5 million in cash.

On October 25, 2009, Capmark and a number of its affiliates commenced bankruptcy proceedings before Judge Sontchi of the United States Bankruptcy Court for the District of Delaware. As an intermediate step towards emergence, Capmark and the Secured Credit Facility lenders agreed to settle Capmark's potential claims arising out of the 2009 Secured Credit Facility—excluding potential preference claims against the Goldman Lenders—in exchange for a 91% payment by Capmark in satisfaction of the Secured Credit Facility (the ''Settlement''). The Settlement was opposed by Capmark's Official Committee of Unsecured Creditors.

A five-day hearing to evaluate the Settlement under Federal Rule of Bankruptcy Procedure 9019 was held before Judge Sontchi in October 2010. During this hearing, Capmark witnesses testified that the Secured Credit Facility negotiations were ''above board'' and ''arm's length,'' and that the Secured Credit Facility had been offered at ''market terms.'' Capmark incorporated this testimony into proposed findings of fact and conclusions of law submitted to Judge Sontchi.

In November 2010, Judge Sontchi approved the Settlement; his Findings of Fact and Conclusions of Law adopted verbatim Capmark's proposed findings that the Secured Credit Facility was negotiated at ''arm's length.''

Capmark emerged from bankruptcy on September 30, 2011. Less than one month later, reorganized Capmark commenced an action in the U.S. District Court for the Southern District of New York seeking to avoid as a preference the $145 million that the Goldman Lenders had obtained in the Secured Credit Facility transaction. Because the Secured Credit Facility transaction occurred more than 90 days before Capmark's bankruptcy filing, Capmark's preference claim depended on the Goldman Lenders being deemed ''insiders'' of Capmark.

Analysis of Insider Preference Claims

Under the Bankruptcy Code, a person automatically qualifies as an ''insider'' of a corporate debtor if that person is (1) a director, (2) an officer, (3) a ''person in control,'' (4) a general partner, (5) a relative of an insider, or (6) an affiliate of the debtor at the time of the transaction to be avoided.[2] A person falling under one of these categories is called a ''statutory insider,'' because such a person is expressly defined as an insider by the Code. The Code's definition of ''insider'' states that an insider ''*includes*'' the above-enumerated categories. Courts have thus concluded that ''insider'' status is not limited to the enumerated categories, and have developed a separate, unenumerated category of ''insider'' dubbed the ''non-statutory insider.'' The considerations used to determine non-statutory insider status are (1) a ''close relationship'' between the creditor and the debtor and (2) a non-arm's-length transaction.[3] The determination of non-statutory insider status is a fact-intensive inquiry.[4]

Whether a creditor qualifies as an insider of the debtor has multiple potential ramifications in a bankruptcy. Normally, a bankrupt debtor may claw back as ''preferential'' any transfer the debtor made to a creditor within 90 days before bankruptcy.[5] However, if a creditor qualifies as an insider of the debtor under the Code, the debtor's preferential claw-back period is expanded to cover all transactions occurring up to *one year* prior to bankruptcy.[6] Moreover, if a debtor seeks to subordinate a creditor's claim—i.e., to reduce the creditor's payment priority—relative to other claims because of alleged inequitable conduct by the creditor, courts apply ''special scrutiny'' and demand a lower burden of proof if the creditor was an insider of the debtor.[7] Additionally, if a debtor claims that a creditor defrauded it, courts consider the creditor's insider status as a factor in inferring fraudulent intent,[8] and in some jurisdictions courts may even consider transfers by debtors to insiders to be constructively fraudulent.[9] Under New York law in particular, which has a six-year statute of limitations for fraudulent transfer claims, *all* transfers to the insider-creditor during that six-year period may be at risk. In short, insider status has significant consequences, potentially unsettling long-completed transactions, permitting debtors to claw back prior transfers of funds, and/or creating a greater risk that claims will be subordinated to those of other creditors.

In its suit, Capmark alleged that the Goldman Lenders were both statutory and non-statutory insiders of Capmark, in order to extend Capmark's preferential transfer period from 90 days to one year. According to Capmark, the Goldman Lenders were statutory insiders because the PIA Funds—which held a 19.8% equity investment in GMACCH and the right to designate a board member—were statutory insiders, either as ''directors,'' ''general partners,'' or ''persons in control'' of Capmark. As for non-statutory insider status, Capmark alleged that the Goldman Lenders had a ''close relationship'' with Capmark because of the PIA Funds' equity holdings, service of a Goldman Sachs managing director as the PIA Funds' designee on the Capmark board and Goldman Sachs's role as financial advisor to Cap-

[2] *See* 11 U.S.C. § 101(31)(B), (E).

[3] *See Schubert v. Lucent Techs. Inc. (In re Winstar Commc'ns, Inc.)*, 554 F.3d 382, 396-97 (3d Cir. 2009); *Hirsch v. Tarricone (In re A. Tarricone, Inc.)*, 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002).

[4] *See In re Winstar*, 554 F.3d at 397-400.

[5] 11 U.S.C. § 547(b)(4)(A).

[6] *Id.* § 547(b)(4)(B).

[7] *Id.* § 510(c)(1); *see Official Comm. of Unsecured Creditors of Champion Enters. v. Credit Suisse (In re Champion Enters.)*, Bankr. No. 09-14014 (KG), Adv. No. 10-50514 (KG) (Bankr. D. Del. Sept. 1, 2010).

[8] *See MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 935 (S.D.N.Y. 1995) (''a close relationship among the parties to the transaction'' is a ''badge of fraud'' that may give rise to or strengthen an inference of fraudulent intent).

[9] *See Sharp Int'l Corp. v. State Street Bank & Trust Co. (In re Sharp Int'l Corp.)*, 403 F.3d 43, 53-54 (2d Cir. 2005) (discussing New York law).

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mark in certain transactions. The complaint also alleged that transactions between the Goldman Lenders and Capmark were not at arm's length.

Judge Sweet's April 9 opinion dismissed both Capmark's statutory and non-statutory insider claims with prejudice.

With respect to the statutory insider claims, the court noted that Capmark had not alleged that the Goldman Lenders themselves fit any of the enumerated categories of insider. Instead, Capmark's statutory insider allegations related exclusively to the PIA Funds, whose alleged statutory-insider status Capmark argued was attributable to the Goldman Lenders.

Judge Sweet rejected even the initial step in Capmark's statutory claim, and held that Capmark failed to allege adequately that the PIA Funds were themselves statutory insiders. Quoting a decision of the Second Circuit, Judge Sweet held that an entity qualifies as a statutory insider under the ''person in control'' prong only if that entity exercises ''extensive control'' over the debtor, and that Capmark had failed to establish such control because the PIA Funds held only an approximately 15% indirect stake in Capmark. Even if Capmark had adequately alleged that the PIA Funds were statutory insiders, Judge Sweet held that Capmark's statutory insider claim would still fail because Capmark had not alleged facts sufficient to show the ''extraordinary circumstances'' necessary to pierce the veils separating the Goldman Lenders from the PIA Funds—which requires allegations sufficient to show both that Goldman Sachs exercised ''complete domination and control'' over both entities, and that the corporate form was used as a ''sham'' to perpetrate fraud or injustice. Judge Sweet moreover rejected Capmark's argument that Goldman Sachs's status under the securities laws rendered it an insider under the Code.

Capmark's non-statutory insider claim failed on two independent grounds:

First, Judge Sweet held that Capmark alleged only that the Goldman Lenders acted as ''ordinary commercial lenders that participated in a lending syndicate,'' which did not suffice to create the ''close relationship'' between the Goldman Lenders and the debtor necessary to establish non-statutory insider status. Because Capmark failed to plausibly allege facts supporting piercing the veils separating the Goldman Lenders and the PIA Funds, Judge Sweet determined that Capmark's non-statutory insider claim was subject to dismissal on this ground alone.

Second, Judge Sweet held that Capmark was judicially estopped from alleging that the Secured Credit Facility transaction was not at arm's length. The April 9 opinion quoted Capmark's prior representations to the bankruptcy court that the Secured Credit Facility was negotiated at ''arm's length,'' and noted that the bankruptcy court accepted these representations in his approval of the Settlement. Since Capmark had benefitted by taking the position in bankruptcy court that the transaction *was* negotiated at arm's length, Judge Sweet, relying on the Second Circuit's decision in *In re Adelphia Recovery Trust*,[10] concluded that Capmark was judicially estopped from alleging that the transaction *was not* at arm's length.

Possible Effects of the Decision

Judge Sweet's ruling clarifies the law of insider preference liability and provides comfort that a lender should not be subject to insider preference liability based on a corporate affiliate's equity interest in the debtor in the absence of evidence that the lender used its affiliate to influence the debtor's decisions.

Fundamentally, the opinion rejects the notion—often advanced by plaintiffs in preference or equitable subordination actions—that a lender should be deemed an insider based on an aggregation of contacts across various entities affiliated with the lender's ultimate parent corporation. Indeed, Judge Sweet's opinion recognized that ''these distinctions in form are relied upon by participants in structuring complex financial transactions''[11] and refused to disregard corporate separateness in the absence of allegations that would support veil piercing. The court synthesized case law showing that the level of corporate interrelatedness common to any parent-subsidiary relationship is not enough to pierce the veil. Judge Sweet reiterated that the standard for veil piercing is ''very demanding'' and requires a showing of ''complete domination and control'' and that the corporate form was used to perpetrate fraud or injustice. Moreover, the opinion clarifies that a plaintiff must make this showing to pierce the veil of each entity separating the affiliates in question.

In the specific context of preference liability, the opinion rejects a number of attempts to broaden the scope of statutory insider status, and confirms that a high level of control is required to find that an entity is a ''person in control'' under the Code. With regard to non-statutory insider status, the Third Circuit's decision in *In re Winstar*, 554 F.3d at 396-97, holds that a debtor seeking to establish non-statutory insider status must demonstrate *both* a close relationship between debtor and creditor *and* a non-arm's length transaction. By ruling that the absence of either a ''close relationship'' *or* a non-arm's length transaction is fatal to a claim, Judge Sweet's opinion suggests that the *Winstar* standard should be applied in the Second Circuit as well.

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[10] *Adelphia Recovery Trust v. HSBC Bank USA (In re Adelphia Recovery Trust)*, 634 F.3d 678, 697-99 (2d Cir. 2011).

[11] *Capmark Fin. Grp. Inc.*, 491 B.R. at 339.