IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF DELAWARE

In re	)	
	)	
HHL FINANCIAL SERVICES, INC.,	)	
PROFESSIONAL DATA SERVICES, INC.,	)	Case No. 97-398(SLR)
AND CREDAMERICA, INC.,	)	Chapter 11
	)	Jointly Administered
Debtors.	)	
	)	
	)	
ROBERT G. BERNBERG; GEORGE COLMAN,	)	
NATHAN N. GOLDMAN; ROBERT S.	)	
LeWINTER; ELLIOT L. MARVEL;	)	
BARRY J. NOVAK; JOEL NUSSBAUM;	)	
and JOHN SHERMAN,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	Adv. Pro. No. A98-315
	)	
HEALTH MANAGEMENT SYSTEMS, INC.;	)	
RUSSELL L. CARSON; ROBERT M.	)	
HOLSTER; PAUL J. KERZ; and	)	
RICHARD H. STOWE,	)	
	)	
Defendants.	)	

MEMORANDUM ORDER

At Wilmington this 5th day of June, 2001, having reviewed the pending motions for abstention and to dismiss,[1] and

[1]The court notes that the instant adversary proceeding was dismissed by order of Judge Walsh **without** notice to this judicial officer and with no objection by any party. (D.I. 21, 22) On or about May 23, 2001, upon verbal notice that there were still pending matters that required the court's attention, the court ordered the file from archives. The file arrived in chambers on May 30, 2001. The order dismissing the case is hereby voided, as

the papers filed in connection therewith;

IT IS ORDERED that plaintiffs' motion for abstention (D.I. 3) is denied as to plaintiffs' first cause of action and granted as to plaintiffs' second cause of action, for the reasons that follow:

a. Plaintiffs allege in their complaint that their cause of action "arises from defendants' control and domination of HHL Financial Services, Inc. ("HHL") and their abuse of that control to plunder HHL, with [Health Management Systems, Inc., ("HMS")] diverting over $30 million of revenues between 1990 and 1996. HHL collapsed under the weight of HMS' domination, defaulted on HHL promissory notes held by plaintiffs and ultimately collapsed into backruptcy." (D.I. 1, ¶1) More specifically, plaintiffs allege that "[b]etween 1990 and 1996, HMS imposed excessive management fees on HHL, orchestrated the divestiture of material HHL assets to HMS, and effectively diverted HHL corporate opportunities," leading to defaults under the HHL promissory notes issued to plaintiffs. (D.I. 1, ¶2) In their first cause of action, plaintiffs seek an order permitting disregard of HHL's corporate form and an award of money damages against defendants based on HHL's defaulted promissory notes. In their second cause of action, plaintiffs allege tortious interference with contractual relations.

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the bankruptcy court did not have jurisdiction to enter such an order absent referral of the matter pursuant to 28 U.S.C. § 157.

b. Plaintiffs have filed suit alleging substantially the same claims against defendants in the New York State Supreme Court, Nassau County (the "State Court action"), and aver that, although they filed the instant adversary proceeding "out of an excess of caution," the State Court action was appropriately filed and better suited to hear the claims asserted. (D.I. 3, ¶¶2,3)

c. Plaintiffs have the burden of proving the following requirements of mandatory abstention under 28 U.S.C. § 1334(c)(2):

> (1) A timely motion to abstain must be filed by a party to the proceeding;
>
> (2) The proceeding must be based upon state law;
>
> (3) The proceeding must be "related to" a case under title 11 of the bankruptcy code;
>
> (4) The action could not have been commenced in a federal court absent jurisdiction under 28 U.S.C. § 1334;
>
> (5) An action in state court has been commenced; and
>
> (6) The state court action can be timely adjudicated.

Indian River Homes, Inc. v. Wilmington Trust Co., C.A. No. 89-423-SLR, 1993 U.S. Dist. LEXIS 2521, at *5 (Feb. 17, 1993). Defendants concede that plaintiffs have carried their burden of proof with respect to factors one, four, and five. Defendants also concede that, on the merits of plaintiffs' claims, state law

issues predominate. (D.I. 8 at 6) Defendants argue, however, that plaintiffs have failed to meet their burden with respect to the third and sixth factor.

d. More specifically, defendants argue that plaintiffs' claims cannot be resolved without reference to the release provisions of the Confirmation Order. According to the defendants, "[t]hat undertaking is not merely 'related to' a case under title 11, but is a core proceeding arising in a case under title 11." (D.I. 8 at 7)

e. Defendants' underlying contention is that "[t]he plaintiffs' complaints are poorly disguised attempts to assert as individual claims, the claims that HHL, as debtor, may have had against the defendants, but released, after thorough analysis, through the Plan and Confirmation Order." (D.I. 8 at 6)[2]

f. As a general principle,

> [w]here a corporation has suffered an injury from actionable wrongs committed by its officers and directors, the remedy under a state's corporation laws is a suit on behalf of the corporation. Such a suit may be brought by the corporation, or, in some circumstances, can be brought by the shareholders or creditors on its behalf. Regardless of who initiates the suit, the recovery goes to the corporation. . . .

[2]In their motion to dismiss, defendants essentially posit the same argument, that plaintiffs do not have standing to sue because their claims are derivative, not direct, causes of action, which belong to HHL. (D.I. 7)

> [A] derivative action[, then,] may state a claim for relief for mismanagement that causes the corporation's stock to decline in value **or result in an insolvency that renders creditors' claims uncollectible. Nevertheless, shareholders and creditors cannot recover for these damages in their individual capacities because their loss is the indirect result of the injury to the corporation.**

In re Reliance Acceptance Group, Inc., 235 B.R. 548, 554-55 (D. Del. 1999) (citing Hayes v. Gross, 982 F.2d 104 (3d Cir. 1992)) (emphasis added). The courts in both of the above cases allowed the shareholder litigation to go forward, finding that the injuries alleged by the plaintiff shareholders were based on specific misrepresentations directed at them and, therefore, distinct from the injury to the corporation and the indirect injury to shareholders generally based on corporate mismanagement. See also In re Ionosphere Clubs, Inc., 17 F.3d 600, 606 (2d Cir. 1994).

g. The court has not found any case that specifically applies the above analysis to a creditor. Nevertheless, it would appear that the Third Circuit would find that plaintiffs at bar, although creditors, are required to allege some wrong distinct from that suffered by the corporation in order to pursue an individual action. Plaintiffs have failed to carry their burden of proof in this regard as to their first cause of action. None of plaintiffs' factual allegations concerning defendants' wrongdoing (D.I. 1, ¶¶ 28-61) involve

either wrongs or injuries specific to plaintiffs. Indeed, plaintiffs assert correctly that defendants' alleged wrongdoing, e.g., transferring the "data processing assets of PDS to HMS, for inadequate or no consideration, was unjustified and against the best interests of HHL and HHL's creditors, including the individual plaintiffs." (D.I. 1, ¶ 52)[3] Therefore, the court concludes that plaintiffs' first cause of action, derivative by nature, is a core proceeding and abstention is not appropriate.[4]

h. The court concludes that plaintiffs' second cause of action is a direct cause of action and, therefore, abstention is appropriate. Plaintiffs allege in their complaint that defendants "knew that the HHL Notes constituted contracts obligating HHL to make payments, as therein provided, to the

[3]As argued by debtor, allowing plaintiffs to pursue this cause of action would disrupt the order of priorities established by the Bankruptcy Code, potentially giving plaintiffs a distribution (and not claimants senior in priority) based on wrongdoing that resulted in harm to all creditors and shareholders.

[4]Plaintiffs rely on the reasoning in Davis v. Merv Griffin Co., 128 B.R. 78, 96 (D.N.J. 1991), to argue that their first cause of action is a direct, not a derivative, cause of action. The holding in Davis has been brought into question, however, by the Third Circuit in Phar-Mor, Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1240 n.20 (3d Cir. 1994) ("Because piercing the corporate veil or alter ego causes of action are based upon preventing inequity or unfairness, it is not incompatible with the purposes of the doctrines to allow a debtor corporation to pursue a claim based upon such a theory). See In re Buildings by Jamie, Inc., 230 B.R. 36, 42-43 (Bankr. D.N.J. 1998) (finding that "[t]he majority of the courts in other jurisdictions that have addressed the issue of authority to pursue an alter ego action on behalf of a corporate debtor have also held that the trustee has standing.").

individual plaintiffs" and that defendants "intentionally procured HHL's default under the HHL Notes." (D.I. 1, ¶¶ 75-76) Under the standards discussed above, the wrong alleged is directed at plaintiffs and, therefore, constitutes a direct cause of action that is only "related to" the bankruptcy.

IT IS FURTHER ORDERED that defendants' motion to dismiss (D.I. 7) is granted as to plaintiffs' first cause of action and denied as to plaintiffs' second cause of action. Taking the facts alleged as true, Cruz v. Beto, 405 U.S. 319, 322 (1972), and based on the reasons set forth above, plaintiffs do not have standing to assert their first cause of action, as it is derivative by nature.[5] Defendants' motion to dismiss plaintiffs' second cause of action is denied as moot, given the court's decision on abstention.

United States District Judge

[5]This conclusion does not nullify the exception carved out in the Confirmation Order for plaintiffs' individual claims. That exception merely gave plaintiffs the opportunity to raise their claims, it did not entitle them to pursue derivative, as opposed to, individual claims.