UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

Minutes of Proceedings

Date: April 19, 2006

In re:

AMES DEPARTMENT STORES, INC.

Case No. 01-42217 (REG)

LFD OPERATING, INC.

Plaintiff,

- against –

Adv. Pro. 01-8153 (AJG)

GENERAL ELECTRIC CAPITAL CORPORATION

Defendant.

Present: Hon. Arthur J. Gonzalez _____ _____
Bankruptcy Judge Courtroom Deputy Court Reporter

Proceedings:
¤ Motion for Relief from Automatic Stay Filed By _____
¤ Motion to Void Lien Held By _____
¤ Motion to Dismiss Filed By _____
¤ Motion for Summary Judgment Filed By _____
¤ Motion to Confirm/Modify Plan
¤ Motion to Convert to Chapter _____
¤ Appearances made, arguments presented
¤ Appearances made, no arguments presented
¤ No appearances
¤ Oral findings and conclusions made of record
¤ Witnesses sworn ¤ See attached list ¤ Exhibits entered ¤ See attached list
¤ Pretrial _____ ¤ Status Conference _____
⊠ Other **Mtn. by LFD Operating, Inc. to abstain, and any other relief sought.**
¤ Continued to _____ at for _____

Orders: As stated on the record of the hearing held on April 18, 2006
⊠ Relief sought in Plaintiff's motion:
¤ Granted ⊠ Denied, for the reasons set forth in Exhibit A attached hereto.
¤ Dismissed ¤ Awarded by Default

¤ Judgment to enter for:
¤ Plaintiff ¤ Defendant ¤ Applicant ¤ Respondent
¤ In the amount of $ _____ ¤ Cost in the amount of $ _____
¤ Matter taken under advisement
¤ Formal order or Judgment to enter
¤ Confirmation/modification of plan ¤ granted ¤ denied
¤ Other _____

FOR THE COURT:
Kathleen Farrell, Acting Clerk of Court

s/Arthur J. Gonzalez 4/19/06 By: Jacqueline De Pierola
United States Bankruptcy Judge Date Deputy

Exhibit A

The issue before the Court is whether to grant the motion for abstention (the "Abstention Motion") filed by LFD Operating, Inc. (the "Movant," alternatively "LFD") in its action against General Electric Capital Corporation ("GE Capital") or, in the alternative, to grant LFD's motion to remand (the "Remand Motion").

As of March 2, 2001, Ames Department Stores, Inc. ("Ames") and various affiliated entities entered into a credit agreement (the "Revolver") with a syndicate of banks and financial institutions, including GE Capital as a lender and agent (collectively, the "Pre-Petition Lenders"). GE Capital was collateralized by, among other things, Ames's inventory and cash proceeds from all sources. One of those sources was the sale proceeds from its operations. Sales proceeds from Ames's stores that were deposited in its accounts included monies from the sales of both LFD's merchandise and Ames's merchandise. Ames would transfer certain of these monies into lock box accounts (the "Lock Box Accounts") and then to certain blocked accounts (the "Blocked Accounts").

From at least February 2001, Ames's Pre-Petition Lenders would sweep all funds from the Blocked Accounts into a concentration account. The funds swept by GE Capital were applied by it according to the terms of the Revolver. Upon Ames's request, Pre-Petition Lenders would advance to Ames funds up to the limits of credit availability under the Revolver. Ames's Pre-Petition Lenders advanced funds to Ames by depositing such into a blocked Disbursement Account ("Disbursement Account") consisting of funds provided exclusively by GE Capital. The Disbursement Account was used to fund the continuing operations of Ames, including payroll, and operating expenses.

On August 20, 2001, Ames and certain affiliated entities filed voluntary Chapter 11 bankruptcy cases in the United States Bankruptcy Court for the Southern District of New York. The cases were assigned to the Honorable Robert E. Gerber. GE Capital, as agent, and other lenders (collectively, the "Post-Petition Lenders") provided a debtor-in-possession credit facility up to $700 million under that certain Debtor-In-Possession Credit Agreement dated as of August 20, 2001, and other agreements, instruments and documents related thereto (collectively, the "DIP Loan Documents"). As part of the court-approved DIP loan agreement, Ames agreed to abide by the terms and conditions of certain pre-petition loan agreements, among them an indemnification of GE Capital.

Ames continued to operate as a business until it became clear in August 2002 that it could not successfully reorganize as an ongoing business and would have to be liquidated.

On September 6, 2001, LFD filed an adversary proceeding (the "LFD-Ames Action") in bankruptcy court for declaratory and other relief against Ames. LFD was a licensee that sold footwear and other related merchandise in Ames's stores. LFD's complaint was premised on Ames's failure to pay monies allegedly held in trust by Ames and due LFD and which were instead paid over to Ames's lenders, including GE Capital. The payments at issue occurred when GE Capital swept funds according to the terms of the Revolver. LFD alleged in its complaint that such proceeds were its property. LFD asserted that Ames was obligated to turn over the proceeds, minus certain expenses, to LFD and Ames had failed to do so. LFD referred to the net amount of monies due them as the "Proceeds." [1]

Also, on September 6, 2001, LFD filed a proceeding, this one against GE Capital (the "LFD-GE Capital Action"), in the Supreme Court of the State of New York, County of New

[1] In the LFD-GE Capital Complaint, LFD makes reference to the same monies, with the only distinction being that they are referred to as the "net proceeds."

York. The LFD-GE Capital Action was predicated on the same set of facts and underlying legal theories. Specifically, LFD alleged that GE Capital's receipt of the proceeds from Ames under the terms of the Revolver was in fact the receipt of LFD's proceeds. In this action, LFD used the term "net proceeds." LFD in its complaint (the "Complaint) asserted three claims for relief (i) a cause of action for money had and received, (ii) a cause of action for an accounting and (iii) a cause of action for conversion. All these causes of action were premised, either in law or equity, on the assertion that the net proceeds were property of LFD.

Further, the LFD-Ames Action was reassigned to the Court from Judge Gerber. The Court held hearings regarding a LFD's request for a temporary restraining order on September 7, 2001 and September 24, 2001. The relief sought was, among other things, to require Ames to set aside approximately $9.0 million to ensure Ames's ability to satisfy LFD's demand for turnover of its alleged property if it were to prevail regarding the dispute over the property of the estate issue. The Court denied LFD's request on September 25, 2001. Thereafter, a discovery and trial schedule was ultimately agreed to and a trial was held on December 4, 2001.

By Notice of Removal dated October 4, 2001, GE Capital removed the LFD-GE Capital Action to this Court from state court pursuant to 28 U.S.C. §1452(a) and 28 U.S.C. §1441(a). The Notice of Removal asserted that LFD sought recovery of monies paid to GE Capital by Ames prepetition because LFD alleged the funds paid to GE Capital were really property of LFD. GE Capital asserted that the action was a core matter under 28 U.S.C. §157(b)(2)(A), (D), (E), (G), (K), and (O).

On October 11, 2001, in its Answer, GE Capital asserted four affirmative defenses, among other things, that as a result of the claims being adjudicated in the LFD-Ames proceeding, the LFD-GE Capital claim would, upon information and belief, become barred on the grounds of

estoppel and/or res judicata. Further, GE Capital alleged that the LFD-GE Capital action was a core matter.

On October 15, 2001, LFD replied by denying GE Capital's allegations in its notice of removal, including that the action was a core proceeding. LFD, without waiving its right to seek remand on jurisdictional or any other grounds, asserted that upon removal the action was at most a non-core proceeding and that LFD did not consent to final orders or judgments by the Court.

By motion dated October 16, 2001, LFD moved the Court to abstain from hearing the LFD-GE Capital Action, pursuant to 28 U.S.C. §1452 and 28 U.S.C. §1334(c)(2). In support of the Abstention Motion, LFD's counsel asserted in an affidavit, also dated October 16, 2001, that this again was a non-core matter to which LFD did not consent to the bankruptcy court entering a judgment. Further, LFD asserted that it had not waived its right to a jury trial in this matter and argued that this matter could be adjudicated in a reasonable amount of time in state court. Finally, LFD noted if Ames became a liquidating bankruptcy, the adverse consequences of a LFD-GE dispute being heard in state court would not present a significant hindrance to the administration of the estate in that it would favor abstention under the timely adjudication analysis.

Each party submitted briefs and the Court heard oral arguments on November 1, 2001. The issues argued were the authority of a bankruptcy court to order mandatory abstention in a removed case and the traditional mandatory abstention analysis, specifically whether or not the state court could timely adjudicate this matter.

As stated above, on December 4, 2001, the Court conducted a trial on submission and heard arguments in the LFD-Ames matter.

On March 8, 2002, the Court issued its memorandum decision (the "Memorandum Decision") finding that the proceeds in question were not property of LFD, but were property of

the Ames estate, and accordingly the Court dismissed all of LFD's claims against Ames in the LFD-Ames Action. Further, the Court rejected LFD's allegations that Ames improperly managed funds that LFD contended should have been segregated by Ames for LFD's benefit. The Court further held that the course of dealing between LFD and Ames belied that interpretation of their contract. The Court issued an order dated March 19, 2002 (the "March 19 Order") in accordance with its March 8, 2002 Decision. LFD appealed that order.

On April 1, 2002, GE Capital filed a motion for summary judgment in the LFD-GE Capital Action seeking dismissal of all the causes of action brought against it. In its moving papers, GE Capital contends that this Court's ruling in the LFD-Ames Action is collateral estoppel as to LFD's claims in the LFD-GE Capital Action due to the March 19 Order of this Court. More specifically, GE Capital contends that LFD cannot recover damages from GE Capital for money it had and received or conversion of proceeds where a final determination has already been made in the LFD-Ames Action that LFD did not own such monies. GE Capital also contends that LFD cannot seek an accounting where it has already been finally determined that there was no fiduciary relationship between LFD and Ames.

On April 19, 2002, LFD filed a motion for a stay of GE Capital's motion for summary judgment. GE Capital responded in opposition on May 3, 2002, requesting the Court deny LFD's request for a stay; if, however the Court were to exercise its discretion to grant a stay, GE Capital requested that the stay encompass all matters in this proceeding. LFD filed a reply to GE Capital's response on May 6, 2002. The matter was fully submitted at that time. Thereafter, the Court issued its order, dated July 1, 2002, (the "July 1 Order"), staying the LFD-GE Capital Action and stating that it would not determine the Abstention Motion until the District Court rendered a decision in the LFD-Ames appeal, and that the stay was also contingent pending further order of the Court. Following the September 1, 2004 decision of the District Court

affirming the Memorandum Decision, LFD appealed to the Second Circuit and never sought an order of the Court modifying the July 1 Order, as it could have under the very terms of the order. Thereafter, the July 1 Order remained in effect.

The July 1 Order has never been appealed nor has there been any effort to modify or reconsider such order. The Court notes that neither party, at anytime, sought any relief from the July 1 Order, prior to the January 13, 2006 presentment order, discussed below, which the debtor brought before the Court.

Regarding the Ames main case proceedings, on August 14, 2002, it announced that it would liquidate and close all of its then remaining stores. On August 16, 2002, Judge Gerber authorized going out of business sales (the "GOB Sales") at all then remaining stores and centers. On September 30, 2002, a stipulation was entered whereby Ames and the Credit Parties, as such term is defined therein, agreed to establish two reserves (i) one regarding a dispute over fees (the "Fee Disputes") to be established in the amount of $14 million, and (ii) one regarding the indemnification rights of Credit Parties regarding the LFD-GE Capital Action to be established in the amount of $11.5 million. The total amount of the Fee and LFD Reserve to be established under the stipulation was $25.5 million. The reserve was to be funded from the proceeds of the GOB Sales. (Docket #1217). The amount Ames placed in escrow, as of November 2, 2002, was $31.5 million, pursuant to the stipulation dated September 30, 2002. (Docket #1802). Therefore, as of November 2002, the escrow fund was fully funded. However, the amount in escrow, as of December 31, 2005, was $16.5 million. Docket #2945. Since no disbursement of the funds in escrow would have been made as a result of the LFD-GE Capital Action, the Court assumes that this reduction is attributable to a resolution or payment of the Fee

Disputes and that the LFD litigation portion of the escrow is fully funded at $11.5 million. (Docket #1802). [2]

On November 21, 2003, Judge Gerber signed an order authorizing the debtor to purchase allowed but unpaid administrative claims at 50% of their value from trade vendors and landlords, and 40% of their value for employee wage claims. On February 26, 2004, in a decision issued by Judge Gerber in the Ames case, he referenced in a footnote the precarious state of Ames to pay its obligations to its creditors and further noted that the Ames estate stands in "material risk" of administrative insolvency. *In re Ames Dept. Stores, Inc.* 306 B.R. 43, 47-48, 53 (Bankr. S.D.N.Y. 2004) "[T]hough it is possible that the estate's efforts to sell property and recover in avoidance actions could ultimately be sufficient to make some distribution to unsecured creditors. Since the time that this substantial risk of administrative insolvency has been recognized, the Court has considered only the *allowability* of administrative expense claims, and *payment* on allowed administrative expense claims has been deferred, to permit administrative expense claims to be paid *pari passu,* if necessary." *In re Ames Dept. Stores, Inc.* 306 B.R. 43, 53 (Bankr. S.D.N.Y. 2004). In the December 31, 2005 Monthly Operating Report, Ames reports that it has $16.5 million in an escrow account and references the September 30, 2002 stipulation. Also, in the operation report, Ames indicates that it has approximately $13.5 million of cash. Docket #2945.

Regarding the LFD-Ames Action, by opinion and order dated September 1, 2004, the District Court affirmed the Court's March 19 Order and judgment. The Second Circuit affirmed the September 1, 2004 judgment of the District Court decision affirming the Memorandum Decision by Summary Order dated August 10, 2005.

[2] The parties seem to be under a misconception that the amount of money held in escrow for the LFD-GE Capital Action is not public knowledge. However, the information is available by looking at the docket in the Ames case (01- 42217) at docket #'s 1217.

Any further appellate rights of LFD expired as of November 8, 2005. Following that date, neither LFD, nor GE Capital, notified the Court of the Second Circuit Summary Order, which upheld the findings of this Court's Memorandum Decision. LFD did not seek any further review of the Memorandum Decision.

On December 12, 2005, the Court received a letter from special counsel to the Creditor's Committee for Ames. All the interested parties in this matter received a copy, including LFD and GE Capital. The letter gave a brief history of the matter and noted that LFD's time to seek appellate relief had expired. Furthermore, the letter noted that the matter was ripe for the Court to proceed with a decision on GE Capital's summary judgment motion.

Additionally, the letter noted that special counsel to the Creditor's Committee along with co-counsel for the debtor, had contacted GE Capital numerous times to request that they notify the Court of the outcome of the LFD-Ames appeal and/or that they take action to dismiss this matter. The letter noted that GE Capital was unresponsive to these requests. Furthermore, the letter noted the desire of the Creditor's Committee to recover the funds held in escrow so as to make further distributions to the administrative creditors and, hopefully, to soon be in a position to confirm a plan.

Although it is unclear to the Court why GE Capital apparently was unresponsive to this letter, the Court finds it inexplicable, in light of LFD's contentions - regarding its frustration that this Court did not as yet decided the Abstention Motion - in the Petition for Mandamus, as to why this letter did not prompt LFD to seek relief under the July 1 Order.

On January 13, 2006, the Court received a request from Ames in the form of a Notice of Presentment of Order seeking that the Court grant GE Capital's summary judgment motion and dismiss with prejudice LFD's adversary proceeding against GE Capital on the grounds that the

decision in the LFD-Ames matter barred LFD's claims against GE Capital in this action on the grounds of estoppel or res judicata.

On January 23, 2006, LFD, by letter, objected to the entry of an order granting GE Capital's Summary Judgment motion and requested that the Court decide its abstention/remand motion before any further proceedings were conducted in this action. LFD argued that the recent Second Circuit case *Mt. McKinley Ins. Co. v. Corning Inc.,* 399 F.3d 436 (2d. Cir. 2005) had mooted much of GE Capital's objections to the Abstention Motion. Also on January 23, 2006, LFD submitted by Notice of Presentment an order granting LFD's motion for remand of the adversary proceeding. A review of the Court's records indicates that this is the first communication to the Court by LFD since the May 6, 2002 response to the stay motion that resulted in the July 1 Order.

On January 25, 2006, GE Capital objected by letter to the assertions of LFD's January 23 letter. GE Capital noted that the issue of whether or not mandatory abstention can apply to removed cases, consistent with the language of section 1334(c)(2), was resolved in the affirmative by the Second Circuit in *Mt. McKinley*. However, GE Capital argued that even under the recent case law LFD would still fail certain key elements of the abstention analysis, namely that mandatory abstention is not warranted unless the proceeding can be timely adjudicated in the state court. GE Capital argued that this Court was uniquely situated to resolve this matter and release the funds currently held in escrow for distribution to Ames's creditors.

Also, on January 25, 2006, this Court held a status conference regarding the presentment orders. During that conference in reference to a question from the Court as to why this matter was still pending and the comment that it seemed to be a colossal waste of time to continue the process; LFD's counsel stated, among other things, that this Court and Second Circuit had

resolved the property issues but that it intended to seek leave to amend its complaint to assert a cause of action based on the tortious interference with a contract.

Also, at the January 25, 2006 status conference, debtor's counsel stated that the significant amount of money that had been posted in escrow to support any GE Capital indemnification claim would be immediately available for distribution to Ames' administrative creditors if judgment were entered against LFD. No one disputed that assertion.

Further, at the January 25, 2006 status conference, each side raised *Mt. McKinley* and its possible effects on this proceeding. The Court ordered the parties to submit briefs on the issue of abstention, but limited to how *Mt. McKinley* would affect the issue.

On February 2, 2006, this Court *sua sponte* conducted a conference call and directed that, in light of the representations made by LFD's counsel regarding LFD's intention to amend its Complaint, it was appropriate that, in making its determination on the motion for abstention, the Court consider the full and actual complaint that was sought to be returned to the state court. The Court set a deadline of thirty days from the date of the conference, March 3, 2006, for LFD to amend its Complaint. The Court stated that the failure of LFD to amend its Complaint would result in a bar of any further amendment, unless good cause was established for relief from such bar.

The Court's directions from the February 2, 2006 conference call were reflected in a February 16, 2006 order (the "February 16 Order"), which was entered, over LFD's objections set forth in its letter to the Court dated February 8, 2006. It set forth that any motion for leave to amend the Complaint was to be filed by March 3, 2006. Furthermore, in the event a motion for leave to amend the Complaint were not filed by March 3, 2006, LFD would be barred from amending the Complaint, absent a further order finding good cause shown for relief from such bar. Additionally, any opposition to a timely motion for leave to amend the Complaint would

have to be filed by March 17, 2006. Finally, the schedule for supplemental briefing in connection with LFD's Motion for Abstention, which was to relate only to the *McKinley* case, was to be amended. Any submission by LFD was required to be filed by March 24, 2006 and any submission by GE Capital was to be filed by April 3, 2006. On February 24, 2006, LFD filed with the bankruptcy clerk a notice of appeal and motion for leave to appeal from the February 16 Order. In addition, LFD has filed in the District Court a Petition for Mandamus seeking (i) a vacatur of the order which directs LFD to file and motion for leave to amend its Complaint by March 3, 2006 or be barred from amending its Complaint and (ii) an order directing this Court to decide LFD's abstention motion before it engages in any further proceedings in this matter.

Also on February 24, 2006, LFD moved the bankruptcy court for a stay pending its disposition of the abstention motion and this Court's decision on LFD's motion to appeal from, and the petition for mandamus in support of, the February 16 Order. The Court scheduled a hearing on LFD's request for March 15, 2006. At the hearing, the Court heard arguments of LFD, GE Capital, and those of the debtor, who joined GE Capital in opposition to the motion, and thereafter, this Court denied the motion, for among other things, LFD's failure to establish irreparable harm to it if the stay were denied.

LFD did not seek leave from the Court to amend its Complaint by the March 3, 2006 deadline set by the February 16, 2006 Order. On April 3, 2006 briefing was completed by the parties on the *McKinley* case. Thereafter, the Court scheduled the date that it intended to render a decision as April 10, 2006 and subsequently adjourned to April 11, 2006, and again to today, April 18, 2006.

The Court finds it appropriate at this juncture to address one of the statements expressed by LFD in the Petition for Mandamus filed on February 24, 2006; specifically, the statement

noting that, "LFD's abstention motion was fully briefed over four years ago and was argued on November 1, 2001. Judge Gonzalez has not seen fit to decide the motion since then." LFD's Petition for Mandamus ¶2.

The adjudication of LFD-GE Capital Action was always dependant upon the resolution of the property of the estate issue. Unless it was determined that the proceeds were property of LFD, a position that LFD has apparently conceded, none of the counts in the action would be able to survive as pled.

The LFD-Ames Action and the LFD-GE Capital Action were each filed on September 6, 2001, in the bankruptcy court and the state court, respectively. Regarding the LFD-Ames Action, the Court conducted a trial on December 4, 2001, and rendered the Memorandum Decision on March 8, 2002. Although the Abstention Motion was filed on October 16, 2001, and was heard on November 1, 2001, the Court ruled on the LFD-Ames Action first because, as stated above, the threshold issue in both matters was the determination as to whether the proceeds were property of the estate. If the Court had determined that the property was LFD's property, then Ames would have been required to pay the amount at issue to LFD and the action against GE Capital would only serve as an alternative source of payment. Furthermore, it was quite evident at the time, and it is equally true to this day, that Ames had sufficient funds to satisfy any obligation to LFD under its complaint.

The Court notes that GE Capital asserted defenses other than the property of the estate defense, in its answer to LFD's complaint. However, when the Court determined that the property at issue was not that of LFD, the basis of any liability, as pled, as to GE Capital was eliminated. After the issuance of the Memorandum Decision, the Court did not receive any inquiries from LFD regarding the Abstention Motion but, on April 1, 2002, when GE Capital moved for summary judgment based upon that decision, LFD responded by requesting that the

Court proceed with its determination of the Abstention Motion and stay the adjudication of the summary judgment motion. GE Capital responded to LFD's request, among other things, by requesting that if the Court were to stay the summary judgment, that it stay the entire action. Following the submission of the pleading with respect to the requests, the Court issued its July 1 Order staying the entire action until the District Court issued its ruling on the appeal and further order of the Court.

Following the issuance of the July 1 Order, LFD did not take any steps to alter amend, modify or appeal the July 1 Order during the more than three year appellate process even when it could have sought an order of the Court under the provisions of the July 1 Order after the rendering of the District Court decision on September 1, 2004. Further, no action was taken-even after LFD decided not to seek *certiorari* following the August 10, 2005 Second Circuit issuance of its summary order affirming the District Court's order which affirmed the March 8, 2002 Memorandum Decision, LFD never contacted the Court to inform the Court as to the status of the appellate process and to assert that under the July 1 Order it was now appropriate to address the Abstention Motion.

It was only after the debtor sought entry of the order in favor of GE Capital and dismissal with prejudice of the LFD-GE Capital Action that LFD first mentioned before this Court the Abstention Motion since May 2002. Although LFD had every right to assert it rights for review regarding that determination in the July 1 Order and take whatever steps it deemed necessary to assert such rights, it cannot escape the fact as stated above, that it did not take any steps even when it could have under the very terms of the order.

The distinction between core and non-core proceedings controls mandatory abstention. *Muskin, Inc. v. Strippit, Inc.*, 158 B.R. 478, 482 (9th Cir. BAP 1993). Section 1334(a) grants the

district court jurisdiction over cases under Title 11, and section 1334(b) grants to the district court concurrent jurisdiction with state courts over state proceedings related to bankruptcy. However, 28 U.S.C. §1334(c)(2) requires the court to abstain from taking jurisdiction from state courts over a related matter if, but for the bankruptcy, it would have to be brought in a state court and not a federal district court, and if such an action is commenced and can be timely adjudicated in a state forum. A related matter for the purposes of a bankruptcy case is one that will affect the bankruptcy estate. "The test for whether a civil proceeding is 'related to' a bankruptcy case is not controversial. It is 'whether [the action's] outcome might have any 'conceivable effect' on the bankrupt estate. If that question is answered affirmatively, the litigation falls within the 'related to' jurisdiction....'" *Bondi v. Grant Thornton Intern.*, 322 B.R. 44, 47 (S.D.N.Y. 2005) (internal citations omitted), quoting *Publicker Indus. Inc. v. United States (In re Cuyahoga Equip. Corp.*), 980 F.2d 110, 114 (2d Cir.1992). The nexus between the effect on the bankruptcy estate and the proceeding does not need to be significant. "The test for determining whether litigation has a significant connection with a pending bankruptcy proceeding is whether its outcome might have *any 'conceivable effect'* on the bankrupt estate. If that question is answered affirmatively, the litigation falls within the 'related to' jurisdiction of the bankruptcy court. Thus, the Court will consider whether an action has 'any conceivable effect' on the bankruptcy estate determines whether a federal court has 'related to' jurisdiction over the matter." *In re WorldCom, Inc. Securities Litigation*, 293 B.R. 308, 318 (S.D.N.Y. 2003) (internal citations omitted). The mandatory abstention provision of section 1334(c)(2) only applies if a case is a non-core matter with respect to 28 U.S.C. §157. If the subject matter of the jurisdiction is found to be core, then the matter is only subject to the discretionary abstention provisions of section 1334(c)(1). *Continental Airlines Inc. v. Chrysler*, 133 B.R. 585 (Bankr. D.Del. 1991). As noted recently by the Second Circuit in *Mt. McKinley Ins. Co. v. Corning Inc.*, 399 F.3d 436, 447(2d Cir. 2005),

"[t]he first step in a Section 1334(c)(2) abstention analysis is resolution of whether the proceeding is 'core'…." *Mt. McKinley Ins. Co.*, 399 F.3d at 447. Therefore, in order for this Court to determine which abstention provision is applicable in this matter, it will first be necessary for the Court to determine whether this is a core or non-core matter.

Core proceedings under section l57(b) are those matters, which arise under Title 11 or arise in a case under Title 11 in which the bankruptcy judge may enter final orders or judgments. "[T]he legislative history of [section 157] indicates that Congress intended that 'core proceedings' would be interpreted broadly…." *In re Best Products Co., Inc.,* 68 F.3d 26, 31 (2d. Cir.1995), citing 130 Cong.Rec. E1108-E1110 (daily ed. March 20, 1984) (statement of Representative Kastenmeier); id. at H1848, H1850 (daily ed. March 21, 1984) (statement of Representative Kindness).

Case law, rather than statutory law, has provided most of the distinctions of core or non-core matters. "The origin of the core/non-core distinction is found in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982), in which the Supreme Court struck down provisions of the 1978 Bankruptcy Act that vested authority in Article I bankruptcy courts to hear cases that, absent the parties' consent, constitutionally could only be heard by Article III courts--so-called 'non-core' proceedings." *In re U.S. Lines, Inc.*, 197 F.3d 631, 636 (2d. Cir.1999), citing *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.,* 458 U.S. 50 (1982).

Section l57 (b) provides the courts with core jurisdiction. Section 157(b)(1) sets forth the more general substantive doctrine that provides for core jurisdiction and section 157(b)(2) provides a non-exclusive list of core matters. Section l57(b)(l) authorizes the bankruptcy judge

to hear and determine all cases under Title 11 and all core proceedings arising under Title 11, or arising in a case under Title 11, and enter appropriate orders and judgments, subject to appeal under section l58. The bankruptcy judge may hear a non-core proceeding that is otherwise related to a case under Title 11, in which event the judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after a de novo review to which any party has timely objected. However, the bankruptcy judge may hear, determine and enter orders and judgments with the consent of all parties, subject to appeal under section l58.

As previously stated, section 157(b)(1) sets forth the more general substantive doctrine it provides for core jurisdiction. "[A]n open-ended, limitless construction would be incorrect. A determination of whether a matter is 'core' depends on the nature of the proceeding." *In re Best Products Co., Inc.*, 68 F.3d at 31, citing *In re S.G. Phillips Constructors, Inc.*, 45 F.3d 702, 707 (2d Cir.1995).

Courts need to consider the substance of the matter to determine if it is a core or non-core matter. *Mt. McKinley*, 399 F.3d at 448. In dealing with contract claims courts have also placed special weight on the timing surrounding the matter in the proceeding. "[T]he critical question in determining whether a contractual dispute is core by virtue of timing is not whether the *cause of action* accrued post-petition, but whether the *contract* was formed post-petition. The bankruptcy court has core jurisdiction over claims arising from a contract formed post-petition." *In re U.S. Lines, Inc.*, 197 F.3d at 638.

The effect on the estate of the debtor in resolution of a matter is also a factor that is considered by courts for the determination of core jurisdiction. Merely having at issue in proceeding monies that if available to the estate would make administration and liquidation of the estate easier would not provide a basis for a court to find that a matter is core. *In re U.S.*

Lines, Inc., 197 F.3d at 638, quoting *Orion*, 4 F.3d at 1102. Where a matter represents only a tangential and speculative effect on the bankruptcy proceeding, this will not be considered core. *Mt. McKinley*, 399 F.3d at 450. However, where an asset involved in a proceeding is the only potential source of cash available to that group of creditors, the courts have found this to be a core matter. *In re U.S. Lines, Inc.*, 197 F.3d at 638.

Aside from the general substantive description of a core proceeding in section 157 (b)(1), section 157(b)(2) also sets forth a non-exclusive list of core proceedings. *Mt. McKinley*, 399 F.3d at 448; see also, *In re Best Products Co., Inc.*, 68 F.3d at 31. 28 U.S.C.A. § 157 (b)(2) states:

> Core proceedings include, but are not limited to-- (A) matters concerning the administration of the estate; (B) allowance or disallowance of claims against the estate or exemptions from property of the estate, and estimation of claims or interests for the purposes of confirming a plan under chapter 11, 12, or 13 of title 11 but not the liquidation or estimation of contingent or unliquidated personal injury tort or wrongful death claims against the estate for purposes of distribution in a case under title 11; (C) counterclaims by the estate against persons filing claims against the estate; (D) orders in respect to obtaining credit; (E) orders to turn over property of the estate; (F) proceedings to determine, avoid, or recover preferences; (G) motions to terminate, annul, or modify the automatic stay; (H) proceedings to determine, avoid, or recover fraudulent conveyances; (I) determinations as to the dischargeability of particular debts; (J) objections to discharges; (K) determinations of the validity, extent, or priority of liens; (L) confirmations of plans; (M) orders approving the use or lease of property, including the use of cash collateral; (N) orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate; (O) other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor or the equity security holder relationship, except personal injury tort or wrongful death claims; and (P) recognition of foreign proceedings and other matters under chapter 15 of title 11.

In the instant matter, the Court finds the following provisions relevant and applicable to this proceeding are subsections (b)(2)(A), (D), (G), (K) and (O) of section 157.

The underlying issue in the LFD-GE Capital Action and the LFD-Ames Action has always been the determination of the property of the estate. The property of the estate issue arose from the operation of the Revolver whereby the proceeds received by Ames were swept into Revolver accounts. This lending arrangement was continued postpetition by the various loan documents and orders of the bankruptcy court. The indemnification rights of GE Capital that were triggered by the commencement of the LFD-GE Capital Action were subject to the collateralization rights under the lending agreements. Any attempt to proceed with property of the estate adjudication in the LFD-GE Capital Action would have implicated the section 362 stay.

The Court finds that LFD-GE Capital matter involves the determination of property of the estate, intricately involved in the pre- and postpetition financing of the debtor, including the impact of the obligation to indemnify and collateralize with Ames' property any such indemnification claim, as incorporated in the various bankruptcy court financing orders and the DIP Loan Documents. Furthermore, the fact that any attempt to litigate the property of the estate issue outside of the bankruptcy court would have implicated the automatic stay pursuant to 11 U.S.C. §362. Therefore, the Court finds that the LFD-GE Capital Action is a core matter and mandatory abstention is unavailable.

In addition, the Court notes that although the indemnification issue at the time of the filing of the Abstention Motion did not have as significant an impact on the administration of the estate as it does today, the availability of the finds set aside for the LFD-GE Capital Action, if released today, would nearly double the amount of cash that would be immediately available to satisfy administrative claims.

However, for the sake of completeness, the Court will address the criteria for mandatory abstention under 28 U.S.C. §1334(c)(2). If the proceeding is a non-core, related proceeding, the

bankruptcy court must abstain if the elements of section 1334(c)(2) are satisfied. "A party seeking mandatory abstention must prove each of the following: (1) the motion to abstain was timely; (2) the action is based on a state law claim; (3) the action is 'related to' but not 'arising in' a bankruptcy case or "arising under" the Bankruptcy Code; (4) Section 1334 provides the sole basis for federal jurisdiction; (5) an action is commenced in state court; (6) that action can be 'timely adjudicated' in state court." *In re WorldCom, Inc. Securities Litigation,* 293 B.R. 308, 331 (S.D.N.Y. 2003), citing *In re Adelphia Commun. Corp.,* 285 B.R. 127, 141 (Bankr.S.D.N.Y.2002); see also, *Renaissance Cosmetics, Inc. v. Development Specialists Inc.,* 277 B.R. 5, 12 (S.D.N.Y.2002), *Mt. McKinley,* 399 F.3d at 450, *Bondi,* 322 B.R. at 50.

The Court notes that the recent Second Circuit opinion of *Mt. McKinley* adheres to the traditional six-part test of mandatory abstention, including "timely adjudication," and it does not expand upon or extensively discuss that test. *Mt. McKinley*, 399 F.3d at 450.

A district court's decision to not abstain under the mandatory abstention provision of section 1334(c)(2) is reviewable by the court of appeals or the Supreme Court. However, the determination of the bankruptcy court is reviewable by the district court.

It is for the Court to determine, in its discretion, whether all six factors considered under section 1334(c)(2) have been met. "Although abstention under subsection (2) is mandatory in the sense that, if all six factors are found to be present, the Court '*shall* abstain from hearing such proceeding' (emphasis supplied), Congress necessarily vested in the bankruptcy court the discretion to determine factors (1) and (6)." *In re AHT Corp.*, 265 B.R. 379, 384 (Bankr. S.D.N.Y. 2001).

The burden is on the moving party to prove that a matter should not be before the court. *In re WorldCom, Inc. Sec. Litig.,* 293 B.R. at 331. "A party is not entitled to mandatory abstention if it fails to prove any *one* of the statutory requirements." *In re WorldCom, Inc. Sec.*

Litig., 293 B.R. at 331, citing *In re Adelphia Commun. Corp.*, 285 B.R. at 143-44. More then a "naked assertion" is needed to prove that this proceeding can be timely adjudicated in a state court. *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. at 331; see also, *In re Allied Mechanical and Plumbing Corp.*, 62 B.R. 873, 878 (Bankr. S.D.N.Y. 1986).

The only issue that is disputed by the parties regarding mandatory abstention under section 1334(c)(2) is whether the requirement that the matter can be "timely adjudicated" has been satisfied. The phrase "timely adjudication" is not defined in the Bankruptcy Code. Courts interpreting this phrase have focused on whether allowing an action to proceed in state court would have any unfavorable effect on the administration of a bankruptcy case. *In re Midgard Corp.* 204 B.R. 764, 778 (10th Cir.BAP (Okla.1997)).

Bankruptcy Courts have evaluated their ability to resolve a proceeding faster than another court as a factor weighing against mandatory abstention when considering the "timely adjudication" factor. "The requirement of timely adjudication necessarily entails a comparison of the time required for litigation in the State Court Action as compared with the litigation schedule in this Court …. Defendants have made no showing that the litigation can or will be timely dispatched in the State Court Action. Common experience in State and Federal trial courts would suggest that litigation in another court in the normal course would take many months (or even years) longer than in this Court even if the case is tried to a jury before a district judge." *In re AHT Corp.*, 265 B.R. at 388.

One recent case that has dealt with the issue of mandatory abstention is *Bondi v. Grant Thornton Intern*., 322 B.R. 44 (S.D.N.Y. 2005). The court in that case, in applying the six-part analysis, found that timely adjudication could not be found where it was shown the usual length of the state court proceeding suggested the matter in question would move slowly through the courts. The court in *Bondi* also noted that where a matter was collected to be part of a much

larger bankruptcy case, it would be impractical to sever it from the bankruptcy proceedings to allow for timely adjudication. *Bondi,* 322 B.R. at 50. As the court in *Bondi* noted, in reflection upon recent case law, "'[Section] 1334(c)(2) is intended to require federal courts to defer to the state courts to handle lawsuits which, although 'related to' a bankruptcy, can be promptly resolved in state court without interfering with the proceedings pending in the federal courts. That intention simply has no application to litigation of this sort, in which a case properly removed to federal court, is intertwined both with complex bankruptcy proceedings and equally complex securities class actions pending in federal court. Far from promoting 'timely adjudicat[ion]' of plaintiffs' claims, to remand here would simply complicate and slow down the resolution of those claims, as well as of the matters already pending before this Court.'" *Bondi*, 322 B.R. at 50, quoting *In re Global Crossing, Ltd. Sec. Litig.,* 311 B.R. 345, 349 (S.D.N.Y. 2003).

Where the movants for abstention have failed to convince a court that allowing the matter to proceeded in the state court "would not 'complicate and slow down the resolution' of this case and the other pending before this Court," they failed to meet its burden under section 1334(c)(2). *Bondi*, 322 B.R. at 51.

Similarly, the court in *In re WorldCom, Inc. Securities Litigation,* noted the importance of the size of the bankruptcy case, the complexity of the litigation, as well as the likelihood that "remanding to state court could slow the pace of litigation dramatically." *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. at 331.

Recently, the court in *Renaissance Cosmetics, Inc. v. Development Specialists Inc.* 277 B.R. 5, 14 (S.D.N.Y. 2002) (reversed on other grounds), found that where a "case is 'at the starting line' in the New York State Court, and the Bankruptcy Proceeding is 'well advanced,' suggests that 'even the most efficient court system could not reach the finish line in a timely

fashion that would avoid interference with' the Bankruptcy Proceeding." *Renaissance Cosmetics, Inc.*, 277 B.R. at 14. The court in *Renaissance* noted that it took on average over 550 days in state court to resolve a similar matter. *Renaissance Cosmetics, Inc.*, 277 B.R. at 14 (reversed on other grounds).

In considering the matter before the Court as to whether the LFD-GE Capital Action can be timely adjudicated in state court, the Court examines the issues involved in that action. The Complaint against GE Capital is premised upon the allegation that LFD's property - in the form of the net proceeds - was paid to GE Capital under the Revolver. LFD's entire Complaint is based upon a determination of the property of the estate issue as raised in the LFD-Ames Action. Upon the filing of the LFD-GE Capital Action, any attempt to litigate that core issue (property of the estate) within that action would have implicated the section 362 stay and ultimately would have had to await the determination of that issue by the Court. That determination was made by the Memorandum Decision and, ultimately, any of LFD's rights to appellate review concluded on November 8, 2005. Further, regardless of which side prevailed in the LFD-Ames Action, the LFD-GE Capital Action would not be able to be timely adjudicated in state court. For, as a practical matter, once that determination was made, there would be nothing, as pled in the Compliant, to adjudicate in any court thereafter.

If LFD prevailed before the Court in the LFD-Ames Action, Ames would have to pay the judgment and the LFD-GE Capital matter would have been moot. Ames had the availability under the Revolver, and continues to have the sufficient cash set aside in escrow because of the indemnification terms of the relevant loan agreements, to satisfy any obligation to turn over LFD's alleged proceeds if it prevailed. The Court notes that availability was the basis, among other reasons, for this Court's denial of LFD's request for a temporary restraining order on September 25, 2001. That request sought, among other things, to require Ames to set aside funds

to secure any potential recovery of LFD. Furthermore, the possibility that any of GE Capital's other defenses would be litigated was always remote at best because the amount at issue would have been satisfied by Ames, as discussed above. Once the amount at issue was paid, there would be nothing to adjudicate in the LFD-GE Capital Action.

If Ames prevailed, as it did, the asserted basis of the causes of action, as pled, in the LFD-GE Capital Action would no longer exist. Therefore, there would be nothing to adjudicate in state court, and it would be a matter of scheduling a summary hearing to dispose of the action. "Timely adjudication" could not occur in the state court because any delay in transferring this proceeding to state court or, if the proceeding were in state court, bringing the matter before the state court once the property of the estate issue was finally concluded in all respects in the LFD-Ames Action, would be an unnecessary delay that would prevent a "timely adjudication" of the matter.

In conclusion, the Court finds that the LFD-GE Capital Action cannot be timely adjudicated in state court. Therefore, even if that action were determined to be non-core, LFD has failed to establish the grounds for mandatory abstention and its motion is denied.

It is also worth noting that as time has progressed the need from the debtor's prospective to conclude this action has increased. The debtor, as noted, is likely to be administratively insolvent, and the funds currently held in escrow now represent nearly double the funds currently available to satisfy administrative claims.

Finally, LFD seeks, in the alternative to mandatory abstention, for the Court to exercise its discretion and remand this proceeding to the state court based upon equitable grounds pursuant to 28 U.S.C. §1452(b). Section 1452(b) provides: "The court to which such claim or cause of action is removed may remand such claim or cause of action on any equitable ground ...." The bankruptcy court may remand such claim or cause of action back to the court from

which the claim or civil action had been removed, and does so at its discretion. *In re Adelphia Communications Corp*. 285 B.R. 127, 144 (Bankr. S.D.N.Y.2002), *In re River Center Holdings, LLC,* 288 B.R. 59, 68 (Bankr. S.D.N.Y. 2003), *Digital Satellite Lenders, LLC v. Ferchill*, Not Reported in F.Supp.2d, 2004 WL 1794502 (S.D.N.Y. 2004), and *In re NTL, Inc.*, 295 B.R. 706, 719 (Bankr. S.D.N.Y. 2003).

The effect on the efficient administration of the bankruptcy estate is a consideration courts have regarded as an important one in the remand analysis. *In re Adelphia Communications Corp.*, 285 B.R. at 144 and *In re River Center Holdings, LLC*, 288 B.R. at 69.

The Court finds that although LFD has raised the issue of equitable remand, it has failed to sufficiently demonstrate that this Court should exercise its discretion and remand this proceeding to the state court. The Court finds, among other considerations, the remand of the proceeding to state court would not serve as a positive effect on the efficient administration of the estate.

The Court also notes that LFD makes some mention of permissive abstention in its pleadings. However, it appears that it was raised in the context of equitable remand under section 1452(b). Regardless, the Court has considered such request and finds LFD has not established any basis under the applicable permissive abstention standards, under 28 U.S.C. §1334(c)(1), for the Court to grant such relief.

The Court schedules a hearing at 12:00 noon Wednesday, May 3, 2006, to address GE Capital's summary judgment. LFD is to file its response by 5:00 PM Tuesday, April 25, 2006, addressing why the Court should not issue an order granting GE Capital's summary judgment motion and dismissing the action, with prejudice. GE Capital shall file its response by 5:00 PM Monday, May 1, 2006. No written reply, without leave of the Court, thereafter is to be filed.