

Chapter 7 Trustees Beware: What Are You Saying in the Motion for Substantive Consolidation?

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Delaware is known for its efficiency and the ability of its attorneys to effectively handle big bankruptcy cases. As a result, a number of pleadings have become common or standard and are routinely filed in many bankruptcy cases. In *Guiliano v. Shorenstein Company LLC (In re Sunset Aviation Inc.)*, the U.S. Bankruptcy Court for the District of Delaware in a Sept. 7 opinion reinforced the notion that, regardless of how typical a pleading may be, the filer needs to consider all implications of the filing and really think about how a pleading could affect later proceedings in the case.

According to the opinion, Regal Jets LLC filed for protection under Chapter 11 of the Bankruptcy Code on Feb. 25, 2009, and the case was converted to a case under Chapter 7 in June 2009. Sunset Aviation Inc. filed for protection under Chapter 7 on March 6, 2009, and JetDirect Aviation Inc. filed for Chapter 7 protection on May 1, 2009. The Chapter 7 trustee filed a motion to substantively consolidate the three Chapter 7 cases in July 2010 and an order was entered granting the requested relief on Aug. 19, 2010.

On Feb. 24, 2011, the trustee filed an adversary proceeding against Shorenstein Co. LLC seeking, among other things, to recover preferential transfers under Section 547 of the Bankruptcy Code. Transfers made by a debtor to a creditor within the 90 days prior to the bankruptcy filing are potentially recoverable as preferential transfers. For purposes of calculating the 90-day preference period, the trustee used the date of Regal Jets LLC's petition date of Feb. 25, 2009, resulting in the date range of Nov. 27, 2008, to Feb. 25, 2009. The transfer at issue with Shorenstein was made on Dec. 2, 2008, by JetDirect.

Shorenstein argued that the appropriate date from which to calculate the preference period was JetDirect's petition date on May 1, 2009, and using that date as the starting point, the disputed transfer did not occur during the 90-day preference period. The trustee countered that the appropriate starting point was Regal Jets' petition date because the substantive consolidation order was *nunc pro tunc* to the earliest petition date.

The issue addressed by the Bankruptcy Court was "whether an order for substantive consolidation is retroactively effective when it does not expressly provide that it is *nunc pro tunc*." This issue has not been addressed by the 3rd U.S. Circuit Court of Appeals but it has been the subject of at least two decisions of the District Court of Delaware. The Delaware District Court has previously held that an order allowing substantive consolidation is not automatically retroactive. However, the trustee argued that the Bankruptcy Court should accept the reasoning of the 6th Circuit that holds to the contrary.

The Bankruptcy Court refused to take a position inconsistent with the Delaware District Court and reinforced the line of cases holding that unless the order so provides, a substantive

consolidation order is not retroactive. In *In re Sunset Aviation*, neither the trustee's motion nor the substantive consolidation order provided for nunc pro tunc application. In fact, to the contrary, the order provided that "from the date of this order forward, all filings in any of these cases shall be made on the docket of Case No. 09-10778." Accordingly, the Bankruptcy Court held that the preference period should be calculated from the petition date of the transferor, i.e., JetDirect. As a result, the transfer to Shorenstein did not fall within the 90 days prior to JetDirect's petition date and was therefore not avoidable as a preferential transfer.

This result was probably not considered by the trustee when the motion for substantive consolidation was filed.

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