UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

MEGAN-RACINE ASSOCIATES, INC.	CASE NO. 92-00860
Debtor	Chapter 11

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

Currently before the Court is the February 4, 2000 motion ("Hudson Motion") by creditor

Hudson Engineering Corporation ("Hudson") for an Order Interpreting the First Amended Liquidating Plan ("Plan") of the Debtor Megan-Racine Associates, Inc. ("Debtor"). On March 28, 2000, the Debtor and Industrial Risk Insurance, Inc. ("IRI") submitted joint opposition to Hudson's motion ("IRI Opposition"). On the same day, Ideal Electric Company ("Ideal") submitted a memorandum in support of Hudson's motion ("Ideal Memo"). On March 29, 2000, Elliott Turbomachinery Company ("Elliott") also submitted a brief in support of Hudson's motion ("Elliott Brief"). Oral argument was heard on April 4, 2000, at a motion term held in Utica, New York after which the parties were afforded the opportunity to file supplemental submissions on the issue of whether Elliott and Ideal can be defined as "coventurers" of Hudson, as that term is used in the Plan and, if so, does the language used in the Plan effect a release of liability to IRI, as subrogee of the Debtor.

On June 28, 2000, Elliott submitted a supplemental brief in support of its position ("Elliott Supplemental Brief"). On June 29, 2000, IRI submitted its supplemental opposition ("IRI Supplemental Opposition"). Hudson submitted its supplemental memorandum of law ("Hudson Supplemental Memo") on July 27, 2000. On July 28, 2000, Ideal submitted its supplemental memorandum ("Ideal Supplemental Memo") and IRI submitted a reply memorandum to Elliott's supplemental brief ("IRI Reply Memo") the same day. On September 5, 2000, an affidavit from Attorney Marguerite K. Kingsmill ("Kingsmill") was submitted in support of Hudson's Motion. Kingsmill's only relevance to the instant proceeding is that, as counsel to Hudson at the time that the terms of the Plan were negotiated, she suggested inserting the term "coventurers" into the Debtor's Plan. Oral argument was heard once again on August 8, 2000, at a motion term held in Utica, New York at which time the matter was submitted for decision.

JURISDICTION

The Court has core jurisdiction over the parties and subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334(b) and 157(a), (b)(1) and (b)(2)(A) & (O).

FACTS

The Debtor was formed on March 31, 1987, for the purpose of developing, owning and operating a 48.3 megawatt cogeneration power plant facility ("Facility") in Canton, New York. To this end, the Debtor entered into an Engineering, Procurement and Construction Contract with Hudson on May 9, 1989, for the construction of the Facility. During construction, Hudson allegedly purchased from Elliott a steam turbine generator "string" that would constitute the core generation unit for the Facility. The steam turbine generator string consisted of a steam turbine, a generator and all the mechanisms that transfer power from the turbine to the generator. *See* Elliott Brief, at 2 n.1. The generator portion of the string was allegedly provided to Elliott by Ideal for inclusion in the steam turbine generator string. Upon completion in January 1992, Hudson delivered possession of the Facility to the Debtor who then commenced Facility operation.

On March 17, 1992, the Debtor filed a voluntary petition seeking relief under Chapter 11 of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"). Among the creditors jockeying to protect their interests in the Debtor's bankrupt estate were Hudson, Niagara Mohawk Power

Corporation ("Niagara Mohawk"), the Federal Deposit Insurance Corporation ("FDIC"), TransCanada Gas Services ("TransCanada") and Kraft, Inc. ("Kraft"). At no time during the administration of the Debtor's Chapter 11 case were Ideal, Elliott or IRI listed as creditors or parties-in-interest in the bankruptcy proceedings.

On May 2, 1996, as the Debtor continued operations as debtor-in-possession, an explosion and fire occurred at the Facility causing extensive damage at the Facility and in particular to the steam turbine generator string resulting in the cessation of the Facility's operations. Accordingly, the explosion compromised the Debtor's chances at successful reorganization and exacerbated the frustration of ongoing reorganization negotiations between the Debtor and the various interested creditors.

The Facility explosion facilitated the introduction of the Debtor's comprehensive risk insurer, IRI, into the mix and triggered the Debtor's claim under its comprehensive risk policy. In May 1996, IRI began making interim payments to the Debtor for various property damage claims under its policy. On August 28, 1996, Westinghouse Canada, Inc., the company retained to investigate the Facility explosion, issued its final damage report. As a result, IRI continued making interim payments to the Debtor until November 1997 in a sum total of $3,657,724 representing various equipment damage claims under the Debtor's comprehensive risk policy. By late October 1997, the Debtor, Hudson, Niagara Mohawk, Kraft, the FDIC, TransCanada and the Committee of Unsecured Creditors agreed to a "Global Settlement Term Sheet" purporting to be a negotiated settlement of all of the terms that would be included in the Debtor's final liquidation plan. The proposed terms of the Global Settlement Term Sheet were apparently negotiated to serve as the framework of and were to be implemented through a proposed final

plan of liquidation. Neither IRI, Elliott or Ideal were signatories to the Global Settlement Term Sheet.

The terms of the Global Settlement Term Sheet included, among other things, that the Debtor would settle any remaining property damage and business interruption claims with IRI for $7,000,000 and that the final liquidation plan should include releases to the signatories of the Global Settlement Term Sheet from any further liability to one another. For example, the opening paragraph of the Global Settlement Term Sheet states, in part, that "[t]he proposed Global Settlement... resolves all Claims, whether known or unknown, by and between the parties to the Case relating to MRA [the Debtor]..." Elliott Brief, Exhibit D, at 1. With specific regard to Hudson, the Global Settlement Term Sheet provided that "MRA [Debtor], the FDIC, Hudson and its affiliates, shall waive and release any and all claims against each other...in any way arising in or relating to the...Case." *Id.* at 3. Several similar clauses provided that liability releases will be given within the reorganization plan to the other parties to the Global Settlement Term Sheet. In addition, the section entitled "Assumptions and Methodology for Effecting the Global Settlement" concluded that "[t]he Global Settlement will be effected through a Liquidating Plan of Reorganization that will include releases for all parties, a discharge of indebtedness and an injunction prohibiting the commencement or continuation of actions ***against parties to the Global Settlement*** arising out of or relating to the Case." *Id.* at 4 (emphasis added).

Finally, the Global Settlement Term Sheet contemplated that the Debtor's $7,000,000 settlement with IRI was to take place prior to the proposed Plan confirmation. The Global Settlement Term Sheet states that "[t]he Debtor will use its best efforts...to obtain Court approval for and accept payment of the settlement of insurance claims prior to November 28, 1997." *Id.*

at 4. Other terms in the Global Settlement Term Sheet anticipate plan confirmation and distribution of proceeds thereunder not to take place until January 1998. *See e.g., id.* at 3 ("Because the distribution to equity will result in a tax liability to equity, some or all of the transactions must close ***no earlier*** than January 2, 1998...") (emphasis added).

On December 4, 1997, this Court entered an Order approving the Debtor's proposed settlement of its remaining insurance claims with IRI for the sum of $7,000,000 ("Settlement Order"). The total insurance settlement, including the previous interim payments totaled $10,657,724. The Order provided that the $7 million "Settlement Payment" from IRI to the Debtor was to take place within 15 days of IRI's receipt of the Court's Order. On December 8, 1997, a Court-approved release was executed by the Debtor releasing IRI from any further claims arising from the May 1996 explosion. On December 12, 1997, IRI issued a draft in the sum of $7,000,000 payable to the Debtor.

On January 27, 1998, the Debtor's Plan was confirmed by Order of this Court ("Confirmation Order"). At issue in Hudson's Motion is the purported "release" clause in Plan Section X.C. which contains the following language:

> [T]he Debtor...and all persons or entities which have asserted or are asserting Claims or who may in the future assert Claims derivatively or otherwise through or on behalf of the Debtor; and each holder of a Claim which is entitled to vote on or is deemed to have accepted the Plan ("the Releasors") shall be deemed for good and valuable consideration to have released and discharged the Debtor; the Members of the Committee; Hudson; Delta Hudson; McDermott; Niagara Mohawk; Kraft; St. Lawrence Gas; TransCanada; the Equity Interest Holders; and their respective parents, affiliates, subsidiaries, coventurers and all agents, employees, officers, directors, advisors, representatives, successors, assigns and equity holders of the foregoing; the FDIC; RECOLL; and all of the officers, directors and employees of the

> FDIC and RECOLL ("the Releasees") from any and all claims or causes of action which the Releasors (whether directly or on behalf of creditors), as well as each person claiming derivatively or otherwise through or on behalf of any of the Releasors, ever had, now has, or hereafter can, shall or may have as of the Confirmation Date against them in any way relating to the Debtor, including the financing thereof.

A similar clause in Plan Section X.D. generally purports to enjoin the commencement of any action against those parties released in Section X.C. Neither IRI, Elliott or Ideal either voted on the Debtor's Plan or received a distribution thereunder.

The parties do not dispute that on or about April 3, 1998, attorneys for IRI notified Hudson that IRI was in the process of further investigating the Facility explosion and intended to remove the steam turbine generator string to that end. By August 1998 IRI had removed the string and concluded that the explosion was the result of an actionable design and/or manufacturing defect. On April 16, 1999, IRI, as subrogee of the Debtor, commenced an action against Elliott and Ideal in New York State Supreme Court, St. Lawrence County, entitled *Gail Norstrom, Industrial Risk Insurers and Megan-Racine Associates, Inc., Plaintiffs, vs. Ideal Electric Company and Elliott Turbomachinery Co., Inc., Defendants*, referred to herein as the "state court action".[1] The state court action against Ideal and Elliott alleges negligence, product liability, breach of warranty and breach of contract relating to the May 1996 explosion of the steam turbine generator string. *See* Hudson Motion, Exhibit B. Although Hudson is not a named defendant in IRI's state court action, in a letter dated May 25, 1999, Elliott notified Hudson that it intended to seek indemnification from Hudson in the event it incurred any loss as a result of the

[1]Gail Norstrom is named in the state court action as the president of IRI.

state court action. On February 4, 2000, Hudson filed the instant motion. As of the date this matter was submitted for decision, Hudson remains a non-party to the state court litigation.[2]

ARGUMENTS

In its motion, Hudson sets forth three arguments. First, Hudson asserts that the Debtor's failure to disclose possible causes of action against Elliott and Ideal in bankruptcy precludes IRI's state court action. Hudson contends that the Debtor's then-potential state court action against Elliott and Ideal was property of the estate and as such was required to be disclosed as an estate asset. Moreover, Hudson contends that the Debtor's duty to schedule all assets "implies a correlating affirmative duty on the Debtor's part to fully investigate all potential causes of action against third parties on behalf of the bankruptcy estate." Hudson Supplemental Memo, at 3. Hudson maintains that the Debtor's failure to reveal property of the estate and/or affirmatively investigate the existence of possible causes of action against third parties constitutes a release and waiver of the Debtor's interest in that property. Hudson bases this argument on the doctrines of *res judicata*, equitable estoppel, judicial estoppel and standing.

Under *res judicata*, Hudson argues that the Court's Confirmation Order has a preclusive effect on claims that could have been brought up during bankruptcy prior to the Confirmation

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[2]According to the St. Lawrence County Clerk's Office, no impleader action had been commenced against Hudson in the state court action as of Tuesday, January 22, 2001.

Order but were not. Hudson contends that because the Debtor failed to raise claims against Elliott and Ideal in bankruptcy, the Confirmation Order precludes the raising of those claims in state court.

Under its equitable and judicial estoppel arguments, Hudson asserts that the Debtor's failure to disclose the existence of the causes of action against Ideal and Elliott, after using estate assets to investigate the explosion, acts as a bar to asserting those claims in a state court action.[3] Hudson asserts that by not raising the claims in bankruptcy or expressly reserving those causes of action in its Plan, the Debtor is now both equitably and judicially estopped from taking what Hudson argues is an inconsistent position by raising those claims in state court. Without defining exactly what the "test" referred to is, Hudson argues in its Supplemental Memorandum that "the controlling rule of law in the Second Circuit is and has always been to employ the doctrine of judicial estoppel when the test for its application has been met, and that test has been met in this case." Hudson Supplemental Memo, at 5.

Hudson's final preclusion argument is that the Debtor lacks standing to bring the state court action because the causes of action which provide the basis for the state court action belong to the bankrupt estate rather than to the Debtor and as such provide no basis by which the Debtor can maintain an action in its own right.

Second, Hudson maintains that because a state court action is precluded for the aforementioned reasons, so too is a state court action by IRI. Hudson asserts that because a subrogee only possesses those rights possessed by the subrogor and because any state court action

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[3]Hudson asserts that estate assets were expended to retain Westinghouse to conduct the post-explosion damage investigation.

by the Debtor-subrogor should be precluded based on Hudson's estoppel and standing arguments, the court must also conclude that IRI's state court action is similarly precluded. Moreover, Hudson asserts that because Ideal and Elliot neither knew or had reason to know of IRI's indemnification and subrogation rights, that the release language used in the Debtor's Plan released any subrogated claim against Elliott and Ideal.

Third, Hudson argues that the Debtor released any claims against Elliott and Ideal in the "broad language of the releases" used in the Debtor's Plan. Hudson Motion, at 21. Specifically, Hudson asserts that "the fact that the term coventurers is used establishes the fact that the parties to the releases intended that third-parties with merely a contractual relationship to Hudson would also be protected under the wide-swath of this language." *Id.* at 22. Moreover, in its Supplemental Memo, Hudson asserts that the Global Settlement Term Sheet itself "expressly released all disputes and claims relating to the case." Hudson Supplemental Memo, at 2.

The general crux of the Debtor and IRI's opposition to the Hudson Motion is that none of the arguments set forth by Hudson are applicable to the state court cause of action because the subrogation rights vested in IRI prior to confirmation of the Plan, thus any release language used in the Plan cannot be said to preclude any action maintained by IRI. Furthermore, IRI asserts that the Plan itself does not limit IRI's right to pursue claims against Ideal and Elliott as they were not named as released parties, did not pay consideration for any release and do not "constitute any class of persons set forth in the [Plan's] release language." IRI Opposition Memo, at 7.

In addition, IRI asserts that none of the preclusion defenses raised by Hudson are applicable to this motion because there is no evidence that the Debtor was aware of any possible claims against Ideal and Elliott since those claims were not discovered until IRI's post-

confirmation removal and inspection of the steam turbine generator string in April 1998. IRI contends that Hudson's non-disclosure argument fails simply because the Debtor had no knowledge of any claims against Ideal or Elliott to disclose. In addition, because no claims were made against Ideal or Elliott in bankruptcy, IRI argues that it cannot be said that any inconsistent position is now being taken against those parties nor has any claim been litigated against those parties, thus both estoppel and *res judicata* are unavailable to Elliott, Ideal and Hudson. Finally, IRI contends that Hudson's standing argument fails for the simple reason that even if claims against Elliott and Ideal were property of the estate, these claims were effectively removed from the estate when they vested in IRI upon payment of the Court-approved insurance settlement.

In its Supplemental Opposition, IRI asserts that the release language used in the Plan cannot be said to apply to Elliott and Ideal because they do not fall under the definition of "coventurers" as that term has come to be defined in New York jurisprudential usage. Additionally, IRI argues that even if it can be said that Elliott and Ideal were coventurers of Hudson, then Elliott and Ideal are bound by the provisions of the Plan which gave actual notice of IRI's indemnification, thus eliminating any lack of knowledge defense on the part of Elliott and Ideal.

Elliott joins Hudson's argument that the language of the Plan "constitute[s] a complete waiver and release by the Debtor and IRI of claims against Elliott arising from or relating to the Facility." Elliott Brief, at 4. However, Elliott also argues that the Debtor's Plan's release language is inapplicable to Elliott's indemnification claim against Hudson if the state court action is permitted to continue because Elliott "was neither a party to the bankruptcy case, nor a signatory to the GSTS [Global Settlement Term Sheet], and it never released any claims against

Hudson...". Elliott Brief, at 9. So it can generally be said that Elliott's position is that the release language is broad enough to preclude IRI's claim against Elliott but should not be read so broad as to preclude Elliott's indemnity claim against Hudson. To put it another way, Elliott's position can be characterized as arguing that Elliott *is* a coventurer of Hudson for the purposes of releasing it from liability to IRI but *is not* a coventurer of Hudson for the purpose of precluding an indemnity claim against Hudson.[4] In its Supplemental Brief, Elliot further joins Hudson it its argument that the Debtor's failure to disclose the existence of possible causes of action against Elliott constitutes a release and waiver of those claims in the post-confirmation state court action. Of note in its Supplemental Brief is Elliott's contention that it "does not take any position with respect to Hudson's argument that Elliott might be construed as a 'co-venturer,' as that term is used in the subject release or in the common law." Elliott Supplemental Brief, at 1.

Ideal generally sets forth and joins with Hudson's subrogation, *res judicata* and estoppel arguments as well as Hudson's argument that the release language in the Plan applies to Ideal and Elliott. In addition, Ideal argues that the release language not only covered the parties to the state court action but released the subject matter of the state court action. Finally, Ideal argues that equity demands that Elliott and Ideal be included in the release language as "necessary and essential" to effectuate the intent of the Plan. Ideal Memo, at 14.

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[4]Elliott argues in its Brief in Support of Hudson Motion that "[u]nder no circumstances should the Liquidating Plan be interpreted to abrogate Elliott's right to receive the benefit of Hudson's settlement with the Debtor." Elliott Brief, at 5. This question, however, is not currently before this Court and any arguments on damages, contribution or indemnification by and between the parties to the state court action should properly be argued in that tribunal, rather than before this Court.

DISCUSSION

Res judicata

In determining whether the doctrine of *res judicata*, or claim preclusion, bars a subsequent action, the Court must consider four factors: whether the prior decision was a final judgment on the merits, whether the prior decision was issued by a court of competent jurisdiction, whether the litigants were the same parties and whether the causes of action are the same. *Corbett v. MacDonald*, 124 F.3d 82, 88 (2d. Cir. 1997) *citing In re Teltronics Servs., Inc.*, 762 F.2d 185, 190 (2d Cir.1985). When the question arises in bankruptcy, a court must additionally consider whether a judgment in the separate action "would 'impair, destroy, challenge, or invalidate the enforceability or effectiveness' of the reorganization plan." *Corbett*, 124 F.3d at 88 *quoting Sure-Snap Corp. v. State Street Bank and Trust Co.*, 948 F.2d 869, 875-76 (2d Cir.1991). The additional inquiry required in the context of bankruptcy "may also be viewed as an aspect of the test for identity of the causes of action." *Corbett*, 124 F.3d at 88 *citing Herendeen v. Champion Int'l Corp.*, 525 F.2d 130, 133 (2d Cir.1975).

1. Final Judgment in a Court of Competent Jurisdiction

It is well-established that a bankruptcy court's confirmation order "has the effect of a judgment rendered by a district court...and any attempt by the parties or those in privity with them to relitigate any of the matters that were raised or could have been raised therein is barred under the doctrine *res judicata*." *Miller v. Meinhard-Commercial Corp.*, 462 F.2d 358, 360 (5th Cir. 1972) (internal citation omitted) *citing Cromwell v. County of Sac*, 94 U.S. 351, 352 (1876); 9

COLLIER ON BANKRUPTCY ¶ 9.25 p. 335 (14th Ed. 1971) *quoted with approval in Sure-Snap Corp.,* 948 F.2d at 872. Moreover, "bankruptcy courts are courts of competent jurisdiction which render final judgments on the merits and [a] Confirmation Order [is] a final judgment adjudicating the [debtor's] bankruptcy petition." *U.S. v. Alfano*, 34 F.Supp. 2d 827, 832 (E.D.N.Y. 1999). Thus, *res judicata* will bar post-confirmation action by a debtor on a claim which was either raised or could have been raised in bankruptcy against creditors or their parties in privity. *See Sure-Snap Corp.,* 948 F.2d at 872.

On January 27, 1998, this Court issued an Order confirming the Debtor's Plan, thereby precluding the Debtor from raising any claims that were raised or that could have been raised in bankruptcy. However, two distinct facts specific to this case prevent the Court from concluding that the state court action is effectively relitigating adjudicated claims. First, the claims asserted in the state court action were not litigated in nor contemplated under the Debtor's confirmed Plan. This is so not only because the parties were unaware that the claims existed, but also because the Debtor's rights had been subrogated to IRI at the time the Plan was confirmed and as such were not property of the estate at confirmation, as discussed more fully below. Second, the state court action is maintained by IRI, as subrogee of the Debtor, rather than the Debtor in its own right, thus IRI has yet to litigate its subrogated rights against any party and as discussed hereafter, privity of parties is not an element that is present in this case.

2. Litigant Privity.

It is well established that in the context of bankruptcy a confirmed plan has "full preclusive effect and is binding on ***all parties thereto***." *Bonwit Teller, Inc. v. Jewelmasters, Inc.*

(In re Hooker Investments, Inc.), 162 B.R. 426, 433 (Bankr. S.D.N.Y. 1993)(emphasis added) *citing* Code § 1141(a); *Sure-Snap Corp. v. State Street Bank and Trust Co.*, 948 F.2d 869, 873 (2d Cir.1991); *Eubanks v. Federal Deposit Insurance Corporation*, 977 F.2d 166, 169 (5th Cir.1992); *Sanders Confectionery Products, Inc. v. Heller Financial Inc.*, 973 F.2d 474, 480 (6th Cir.1992), *cert. denied*, 506 U.S. 1079, 113 S.Ct. 1046, 122 L.Ed.2d 355 (1993). "As an initial consideration, the party asserting *res judicata* has the burden of establishing privity with the parties to the prior adjudication." *Alfano*, 34 F.Supp. 2d at 833.

In the instant proceeding, Hudson has failed to meet its burden, at least with respect to IRI. That the Debtor in bankruptcy is the same party, albeit the subrogated party, named as a plaintiff in the state court action is so obvious it merits no discussion. Clearly this element of *res judicata* is necessarily applicable to the Debtor since it goes without saying that the Debtor named as plaintiff in the state court action is the same party whose Plan was confirmed in bankruptcy. However, this element is just as unequivocally inapplicable to IRI. Hudson has failed to sufficiently establish how IRI and the Debtor share privity of interests with regard to the claims asserted in the state court action and those administered in the bankruptcy case. IRI is clearly a non-debtor plaintiff, was a non-party to the Debtor's bankruptcy Plan and is asserting rights it acquired from the estate prior to confirmation against other non-party entities. Rights which ostensibly could not have been contemplated in the Plan since they no longer were the Debtor's to assert. Thus, it has not been established that privity of party exists among IRI, Elliott and Ideal.

3. Sameness of Claims

The sameness of claims inquiry requires a determination of whether the subsequent

litigation involves the same "'nucleus of operative fact.'" *Alfano*, 34 F.Supp. 2d at 833 *quoting Interoceanica Corp. v. Sound Pilots, Inc.*, 107 F.3d 86, 90 (2nd Cir. 1997). "[T]he test for deciding the sameness of claims requires that the same transaction, evidence and factual issues be involved." *Corbett*, 124 F.3d at 89 *citing N.L.R.B. v. United Technologies Corp*., 706 F.2d 1254, 1260 (2d Cir.1983). This is not to say that every factual occurrence bearing some relation to the debtor in bankruptcy will necessarily operate from the same nucleus of facts. To the contrary, while two claims may both bear a relation to the debtor, facial dissimilarity in the claims asserted and in the underlying transactions may constitute non-parity of claims. *See Alfano*, 34 F.Supp. 2d at 833

IRI's state court action is based, *inter alia*, on breach of warranty and products liability against product providers that were not parties to the bankruptcy. The bankruptcy case was a concerted effort to reorganize or, alternatively, to liquidate a corporate debtor. The transaction in question in the state court action, namely the manufacture and purchase of the steam turbine generator string, was not contemplated in the bankruptcy Plan. Nor is the evidence likely to be presented in state court regarding the manufacture and sale of the string presented in the bankruptcy case. Finally, the factual issues to be determined in the state court action are not likely to involve the issues contemplated in the Debtor's bankruptcy case, namely the reorganization and/or liquidation of an insolvent corporate entity. It is clear in the circumstances underlying Hudson Motion that the "claims asserted and the underlying transactions are facially dissimilar" and do not constitute the same claims. *Id.*

4. Vitiating Effect on the Plan

The final element of *res judicata* requires the Court to analyze whether allowing IRI to proceed with its state court action would "impair, destroy, challenge, or invalidate the enforceability or effectiveness of the original reorganization plan." *Sure-Snap Corp.*, 948 F.2d 869, 875-876. This necessitates a review and analysis of the facts that provoked this motion.

In the state court proceeding, IRI, as subrogee of the Debtor, is pursuing claims against Elliott and Ideal whose only connection with the bankrupt estate is that they were the product providers to the contractor who constructed the Debtor's Facility, namely Hudson. In essence, a non-party to the bankruptcy, IRI, is suing two other non-parties to the bankruptcy, Elliott and Ideal on claims that were in effect sold to IRI upon its indemnification of the Debtor with the approval of both the Court and Hudson. The fact that Elliott might, in turn, seek indemnification from Hudson at some point in the future bears no consequence on the Debtor's Plan. As a result, the state court action can have no conceivable effect on the enforceability or effectiveness of the Debtor's Plan and Hudson's argument must fail for this and the aforementioned reasons. *See id.*

Equitable Estoppel

"The essential elements of equitable estoppel...relating to the party to be estopped are: 1) conduct which amounts to false representation or concealment of material facts or which give the impression that the facts are other than as asserted, 2) an intention or expectation that such conduct would be relied upon by the other party, and 3) actual or constructive knowledge of the real facts." *Hotel Syracuse*, 155 B.R. at 835 *quoting In re Delta Hotel of Syracuse, Inc.*, 10 B.R. 585, 598 (Bankr. N.D.N.Y. 1981) *citing United States v. Bedford Associates*, 491 F.Supp. 851,

866-67 (S.D.N.Y. 1981). In addition, the essential elements of equitable estoppel relating to the party seeking estoppel are " 4) lack of knowledge of the real facts, 5) reliance on the conduct of the party to be estopped, and 6) action based thereon resulting in a prejudicial change of position." *Hotel Syracuse*, 155 B.R. at 835 *quoting In re Delta Hotel of Syracuse Inc.*, 10 B.R. 585, 598 (Bankr. N.D.N.Y. 1981).

In the instant case, Hudson asserts that the Debtor and IRI conspired to conceal the causes of action from the creditors and the bankruptcy court. *See* Hudson Motion, at 21 ("Elliott and Ideal were not parties to the negotiations which led to the formulation of the releases contained in the confirmed Chapter 11 plan. That is attributable to what can only be described as the Debtor's and IRI's intentional nondisclosure of claims against these third parties."). However, there is simply nothing in the record indicating that either IRI or the Debtor took any affirmative steps to conceal or falsely represent the existence of possible causes of action against Elliott and Ideal. Nor does it seem that IRI and the Debtor intentionally misled creditors into voting for the Plan. To the contrary, the terms of the Plan were negotiated well in advance. Hudson, the Debtor and all the parties to the bankruptcy case seemed to have equal knowledge of the facts and circumstances of the explosion. All of the creditors were aware of and consented to the Debtor's final settlement with IRI. In the wake of what has been described by Hudson as "encyclopedic negotiations" it is disingenuous to now contend that all the creditors simply expected IRI to walk away from its subrogated rights after having lived up to its obligations under the comprehensive risk policy for the benefit of those creditors to the tune of over ten million dollars. *See* Hudson Motion, at 7. Consequentially, a finding that IRI is equitably estopped from pursuing its subrogated claims against Elliott and Ideal would be equally disingenuous.

Judicial Estoppel

The doctrine of judicial estoppel "prevents a party who has obtained a favorable judgment in one proceeding from subsequently adopting an inconsistent position in another judicial proceeding." *Hotel Syracuse*, 155 B.R. at 836 citing *Chemical Bank v. Aetna Ins. Co.*, 99 Misc.2d 803, 417 N.Y.S.2d 382, 384 (Sup.Ct.1979) (citations omitted); *Young v. United States Dept. of Justice*, 882 F.2d 633, 639 (2d Cir.1989), *cert. denied*, 493 U.S. 1072, 110 S.Ct. 1116, 107 L.Ed.2d 1023 (1990). This Court has held that, while no hard and fast test applies to the application of judicial estoppel, "it appears that the following elements are essential to its invocation: i) an unequivocal assertion of law or of fact by a party in a judicial proceeding; ii) an intentionally inconsistent assertion by that same party in a subsequent judicial proceeding; iii) a purpose to mislead the [c]ourt and thereby obtain unfair advantage against another party and; iv) success in the prior proceeding." *Hotel Syracuse*, 155 B.R. at 836 *citing Merrill Lynch v. Georgiadis*, 903 F.2d 109, 114 (2d Cir.1990) *citing Konstantinidis v. Chen*, 626 F.2d 933, 939 (D.C.Cir.1980). This Court concludes that none of the required elements supporting a claim of judicial estoppel are present in the instant proceeding. Neither the Debtor nor IRI made any assertion, much less an unequivocal assertion of fact or law in the bankruptcy proceeding regarding the claims asserted in the state court action. The position taken by IRI in the state court action is not inconsistent with any position taken in the bankruptcy proceeding. The Court finds nothing in the record to indicate resolve on the part of IRI or the Debtor to dupe the Court. And finally, because the existence of the last element rests on the presence of the preceding three, the final element is similarly absent in this case.

Standing

As Hudson correctly asserts "[c]ourts have held that because an unscheduled claim remains the property of the bankruptcy estate, the debtor lacks standing to pursue the claims after emerging from bankruptcy, and the claims must be dismissed." *Rosenshein v. Kleban*, 918 F.Supp. 98, 103 (S.D.N.Y. 1996) *citing In re Drexel Burnham Lambert Group, Inc.*, 160 B.R. 508, 514 (S.D.N.Y. 1993); *Robinson v. J.A. Wiertel Construction*, 185 A.D.2d 664, 586 N.Y.S.2d 59, 59-60 (1992). "This is so regardless of whether the failure to schedule causes of action is innocent." *Callihan v. Costello (In re Costello)*, 255 B.R. 110, 113 (Bankr. E.D.N.Y.) *citing Dynamics Corp. of America v. Marine Midland Bank, N.Y.*, 513 N.Y.S.2d at 94, 505 N.E.2d 601 (1987). However, "[n]umerous courts have permitted the pursuit of undisclosed claims after confirmation in order to prevent an alleged wrongdoer from obtaining a windfall because the debtor failed to schedule its claims and to ensure that the creditors benefit from any recovery...[and]..courts are in agreement that...debtors in possession may pursue undisclosed claims following confirmation of a plan of reorganization by methods that ensure that the creditors receive the benefit of any recovery." *Rosenshein*, 918 F.Supp. at 103 (holding the debtors lacked standing to pursue undisclosed claims in their own name for their own benefit). Thus, debtors are generally prohibited from pursuing undisclosed claims for their own benefit. *See id.*

In the instant case, IRI's pursuit of the state court action against Elliott and Ideal should not be foreclosed on this basis for several reasons. First, the claims against Elliott and Ideal were no longer property of the estate at the time of confirmation. As discussed more fully, *infra*, these

rights had vested in IRI at the time of IRI's final settlement payment to the Debtor. Thus, there simply were no rights that would either re-vest in the Debtor or remain in the estate at confirmation. Second, the Debtor did not bring the state court action in its own name on its own behalf. IRI brought the state court action as subrogee of the Debtor. Assuming, *arguendo*, the Debtor lacked standing to bring the action on its own behalf, the state court action would not fail for want of a plaintiff as IRI could conceivably maintain the action in its own name. Third, the creditors have already received the benefit of the recovery, to wit, the over ten million dollars distributed to creditors by way of IRI's insurance payout. Finally, if the Court were to foreclose IRI's pursuit of and recovery under the claims against Elliott and Ideal the result would clearly be an inequitable windfall to those two entities and all the creditors receiving a distribution under the Plan.

Subrogation Rights

"The doctrine of subrogation is based upon principles of equity [whose]...purpose is to afford relief to those required, as insurers, to pay a legal obligation that ought, 'in equity and good conscience,' to have been met by another." *Gibbs v. Hawaiian Eugenia Corp.*, 966 F.2d 101, 105-106 (2d Cir. 1992) *quoting* 16 COUCH ON INSURANCE 2d § 61:18, at 93 (Rev. ed. 1983). Because it is rooted in equity, an insurer's right of subrogation "does not arise from, nor is it dependent upon, statute or the terms of the contract of insurance." *Gibbs*, 966 F.2d at 106 *citing* 16 COUCH ON INSURANCE 2d § 61:18, at 93 (Rev. Ed. 1983). Furthermore, the insurer's subrogation rights attach by operation of law upon the insurer's payment of the insured claim or loss. *Gibbs*, 966 F.2d at 106 *citing Federal Insurance Co. v. Arthur Andersen & Co.*, 75 N.Y.2d

366, 372, 553 N.Y.S.2d 291, 293, 552 N.E.2d 870, 872 (1990); 16 COUCH ON INSURANCE 2d §§ 61:4, 61:20; 6A APPLEMAN, INSURANCE LAW AND PRACTICE § 4051 (1972). Thus, it is at the time of the insurer's payment to the insured that "the insurer succeeds to all the procedural rights and remedies possessed by the insured." *Gibbs*, 966 F.2d at 106 *citing Phoenix Insurance Co. v. Erie and Western Transportation Co.*, 117 U.S. 312, 320-21, 6 S.Ct. 750, 753 (1886); 16 COUCH ON INSURANCE 2d § 61:4; 6A APPLEMAN, INSURANCE LAW AND PRACTICE § 4051. *See also Allstate Ins. Co. v. Mazzola*, 175 F.3d 255, 260 (2d Cir. 1999)(holding it is well-established that an insurer's subrogation right begins to accrue at indemnification).

Once the insurer is subrogated to the insured's rights though, the insurer's newly vested rights are not completely beyond reproach. Indeed, an insurer's subrogation rights may be compromised and subject to prejudice where, after indemnification, an insured waives or releases a tortfeasor who has no knowledge of or information which would reveal the insurer's right of subrogation. *See Gibbs*, 966 F.2d at 106. But an insured's release of a tortfeasor possessing knowledge of or information which would reveal the existence of indemnity and/or subrogation rights will not preclude the insurer's action against that released tortfeasor. *See Allstate v. Mazzola*, 175 F.3d 255, 260-261 (2d Cir. 1999) ("the authorities are in agreement that a release given to a tort-feasor who has knowledge of the insurer's rights will not preclude the insurer from enforcing its rights against the wrongdoer.") *citing Silinsky v. State-Wide Ins. Co.*, 30 A.D.2d 1, 289 N.Y.S.2d 541, 545-46 (2d Dep't 1968) (citations omitted); *Aetna Cas. & Sur. Co. v. S. Siskind & Sons, Inc.*, 209 A.D.2d 215, 618 N.Y.S.2d 314, 315 (1st Dept. 1994); *Aetna Cas. & Sur. Co. v. Schulman*, 70 A.D.2d 792, 417 N.Y.S.2d 77, 79 (1st Dep't 1979).

The Second Circuit Court of Appeals held in *Gibbs*, quoted *supra*, that "[w]here a third

party obtains a release from an insured with knowledge that the latter has already received payment from the insurer or with information that, reasonably pursued, should give him knowledge of the existence of the insurer's subrogation rights, such a release does not bar the right of subrogation of the insurer." *Gibbs*, 966 F.2d at 106 *citing Hamilton Fire Insurance Co. v. Greger*, 246 N.Y. 162, 167-68, 158 N.E. 60 (1927); *Ocean Accident & Guar. Corp. v. Hooker Electrochemical Co.*, 240 N.Y. 37, 147 N.E. 351 (1925) (holding that once the insurer acquires the subrogated rights of the insured, the rights are "beyond the power of cancellation and destruction by the latter..."); *Home Ins. Co. v. Bernstein,*, 172 Misc. 763, 765, 16 N.Y.S. 2d 45, 48; 16 COUCH, § 61:201; 6A APPLEMAN, § 4092 at pp. 246-49. *See also Allstate Ins. Co.*, 175 F.3d at 260. Thus, there is no destruction of or prejudice to the insurer's subrogation rights where a release is given by an insured to a third party tortfeaser who either knows the insured has already received payment from the insurer or has information that with reasonable investigation would reveal the existence of the insurer's subrogation rights. *See id.*

In the instant case, the total sum of IRI's indemnity payments, $10,657,724 were made on or before December 12, 1997 when IRI issued the final draft in the sum of $7,000,000 to the Debtor's attorney, thus settling the balance of the property damage and business interruption claims under its policy. The Debtor's Plan was confirmed by Order of this Court dated January 27, 1998, thereby giving binding effect to the release clause found in Sections X.C. and X.D.[5]

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[5]The Court notes that it finds unconvincing the argument proposed by Hudson that the terms of the Global Settlement Term Sheet effected a binding waiver on the parties thereto. As the Court noted above, it is clear by the terms of the Global Settlement Term Sheet that it merely provided the framework for the Debtor's Plan and the fact that the parties' signatures are at the end does not negate the contingent nature of the terms contained in the document itself. For example, the subtitle of the document itself reads "Memorialization of Settlement Negotiations-Not Admissible in Evidence Pursuant to FRE 408." *See* Elliott Brief in Support of Hudson

Thus, it is clear under the rule of law in the Second Circuit that IRI's right of subrogation to the Debtor's then-unknown potential causes of action against Elliott and Ideal vested in IRI prior to the effective date of the releases in the Plan. *See generally Gibbs*, 966 F.2d at 106. Consequentially, it can be said that the release in the Debtor's Plan will not preclude an action by IRI to enforce its rights against a released party who had knowledge of indemnification or who possessed information that if reasonably pursued should inform such released party of IRI's subrogation rights. *See Allstate*, 175 F.3d at 260-261. *See also Gibbs*, 966 F.2d at 106. It is clear from the record that Hudson, a released party, was aware of and consented to the Debtor's settlement of its insurance claims with IRI. *See* Plan, § V.A.2. *and* Elliott Brief in Support of Hudson Motion, Exhibit D, at 2. A claim by Hudson that they had no knowledge of the indemnification interim payments or the settlement payment would be inapposite since those funds were administered through the bankrupt estate and constituted a portion of the distribution to creditors. Thus, because the release will not prevent an action by IRI to enforce its rights against Hudson, it will likewise not act to prejudice any subrogated claims of IRI against "Hudson...and [its] respective parents, affiliates, subsidiaries, coventurers and all agents, employees, officers, directors, advisors, representatives, successors, assigns and equity holders...".

Motion, Exhibit D, at 1. *See also* Fed.R.Evid. 408 ("Evidence of conduct or statements made in compromise negotiations is likewise not admissible."). In addition, the Global Settlement Term Sheet uses language such as "proposed Global Settlement," "the compromise of claims described in this Global Settlement Term Sheet" and "The Global Settlement Term Sheet will be effected through a Liquidating Plan of Reorganization..." *See* Elliott Brief in Support of Hudson Motion, Exhibit D, at 1, 2, and 4, respectively. This indicates that the Global Settlement Term Sheet is nothing more than a description of compromised terms wholly contingent upon the Court's confirmation of the final plan of liquidation. In light of this, the Court cannot find that the language in the Global Settlement Term Sheet evidences anything more than the intent of the parties thereto to agree to the final terms of the Debtor's final Plan.

See Plan § X.C. Consequently, because Elliott and Ideal were not the direct beneficiaries of the release and cannot receive the benefit of the release derivatively assuming their status as "coventurers" with Hudson, the Court finds that a determination of whether Elliot and Ideal were, in fact, contemplated as "coventurers" as that term is used in the Plan to be irrelevant.

Based on the foregoing, it is hereby

ORDERED, that Hudson's Motion for an Order Interpreting the Debtor's First Amended Liquidating Plan of Reorganization as releasing Hudson, Elliott and Ideal from any and all liability to IRI as subrogee of the Debtor is denied in all respects.

Dated at Utica, New York

this 30th day of January 2001

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge