UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF NEW YORK

BOOTH OIL SITE ADMINISTRATIVE GROUP,

Case No. 98-CV-0696A(Sr)

Plaintiff,

-vs-

GEORGE T. BOOTH, JR.
GEORGE T. BOOTH III
LONSDALE SLATER SCHOFIELD
JOSEPH CHALHOUB
AHSEN YELKIN
BOOTH OIL COMPANY, INC.
SCHOFIELD OIL LIMITED
118958 CANADA LIMITED
SPEEDY OIL SERVICES, INC.
BRESLUBE INDUSTRIES LIMITED
EC HOLDINGS CORP.
KATHERINE STREET PROPERTIES, INC. now known as Eventures Ltd.
SAFETY-KLEEN CORP.

Defendants.

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AGAINST GEORGE T. BOOTH III AND KATHERINE STREET PROPERTIES, INC.

Preliminary Statement

Plaintiff has moved for summary judgment against George T. Booth III for (1) violation of the confirmed Liquidating Plan of Reorganization, (2) a fraudulent conveyance in the amount of $275,000, and (3) breach of his fiduciary duty to the Contingency Fund beneficiaries. Based on the undisputed facts, this Court should grant Plaintiff summary judgment on each of these claims against George T. Booth III. Plaintiff incorporates herein by reference the evidence and authority cited in Plaintiff's reply memoranda in response to the Yelkin defendants, Joseph Chalhoub, and Lonsdale Schofield (filed herewith) as well as the Affirmation of R. Hugh Stephens (filed herewith) and Plaintiff's Reply Statement of Facts Pursuant to Local Rule 56.1

(filed herewith).

The defendants have admitted that Booth Oil paid EC Holdings $450,000, Katherine Street Properties, Inc. $300,000, and George T. Booth III $275,000. Tax returns produced by Booth Oil in connection with an order of this Court show Booth Oil had profits of at least $2.8 million between 1990 and 1992. Defendants neither admit nor dispute this fact. Under the clear terms of the Liquidating Plan, surplus was to be preserved for the Contingency Fund beneficiaries.

Instead of preserving surplus for the benefit of the Contingency Fund beneficiaries, Booth III transferred $450,000 to EC Holdings and $300,000 to Katherine Street Properties, Inc., and then received an additional $275,000 for himself from Booth Oil in connection with a settlement agreement with Booth Oil.

These transfers were violations of the Liquidating Plan and Booth III's fiduciary duty to the Contingency Fund beneficiaries, as they represented payments of surplus which was to be preserved for the Contingency Fund beneficiaries under the terms of the Liquidating Plan. The payment of $275,000 constituted a fraudulent conveyance as a payment for less than fair value by an insolvent corporation. Booth Oil did not owe Booth III $275,000. The $275,000 was paid in order that Joseph Chalhoub and Lonsdale Schofield could deliver the Booth Oil permit to Safety-Kleen for less than fair value without interference from George T. Booth III. Finally, the payment of $300,000 to Katherine Street Properties and the $275,000 payment to Booth III constituted payments to George T. Booth III based on his status as a shareholder, and were violations of the Liquidating Plan on that basis. Katherine Street Properties, Inc. should return the $300,000 it received from Booth Oil with interest as a fraudulent conveyance and as a

violation of the Liquidating Plan.

George T. Booth III, like Lonsdale Schofield and Ahsen Yelkin, disputes the existence of a fiduciary duty running from himself personally to the Contingency Fund beneficiaries and seeks to benefit from the statute of limitations in order to defeat Plaintiff's motion. As is set forth below, officers and directors of corporations which act as trustees, as does Booth Oil in connection with the Contingency Fund required under the Liquidating Plan, are liable for participating in breaches of the fiduciary duty owed by the corporation to the trust beneficiaries. Even third parties who have no relationship to the corporation or its officers and directors are liable for knowingly participating in a breach of that fiduciary duty. These liabilities exist even in the absence of a bankruptcy proceeding or a court order.

The Court's power to make orders in connection with a confirmed plan such as the confirmed Liquidating Plan at issue in this litigation is extremely broad. Since the confirmed Plan is a Court Order, relief can take the form of a contempt order which can be made against those who fail to abide by its terms whether or not they are parties to the action. Finally, the attempt by George T. Booth III, Ahsen Yelkin, Joseph Chalhoub, or Lonsdale Schofield to use the statute of limitations against the Contingency Fund beneficiaries is significantly limited.

I. Inducing or Participating in a Breach of Fiduciary Duty

A. Third Parties (Including Officers, Directors and Shareholders as Well as Any Other Third Parties) Can Be Held Liable for a Fiduciary's Breach of Trust Where They Had Actual Knowledge of and Knowingly Participated in the Breach

A non-fiduciary third person (whether the third person is an officer, director or any other third person) can be held liable for loss caused by breach of trust if that third person knows about and participates in the breach.

> A third person who, although not a transferee of trust property, has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust.

Restatement (Second) of Trusts § 326 (1959).

New York courts have imposed liability on officers, directors and non-fiduciary third persons based on their knowledge of and participation in a breach of trust. The Second Circuit in S & K Sales described

> "New York courts' longstanding acceptance of the principle that 'anyone who knowingly participates with a fiduciary in a breach of trust is liable for the full amount of the damages caused thereby to the cestuis que trust.'" Wechsler v. Bowman, 285 N.Y. 284, 291, 34 N.E.2d 322, 326 (1941); Rosen v. Rosen, 78 A.D.2d 911, 912, 432 N.Y.S.2d 921, 923 (3d Dep't 1980); Cornale v. Stewart Stamping Corp., 129 N.Y.S.2d 808, 814 (Sup. Ct. 1954).

S & K Sales Co. v. Nike, Inc., 816 F.2d 843, 848 (2d Cir. 1987).

The "well-settled" elements of a claim for inducing or participating in a breach of fiduciary duty that a plaintiff must prove are "'(1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that the plaintiff suffered damages as a result of the breach.'" S & K Sales at 847-848 (quoting Whitney v. Citibank, N.A., 782 F.2d 1106, 1115 (2d Cir. 1986)). S & K Sales further noted that

> most authorities on the participation claim indicate that the third party's degree of involvement in the fiduciary's breach of duty must amount to 'knowing participation,' Whitney, 782 F.2d at 1115; Wechsler, 285 N.Y. at 291, 34 N.E.2d at 326, 'knowing assistance,' Restatement (Second) of Torts § 874 comment c, or 'substantial assistance or encouragement,' id.,§ 876(b).

S & K Sales at 849.

Officers and directors of a corporate trustee have a specific duty to the beneficiaries of a trust administered by the corporation not to cause the corporation to misappropriate trust property. Schwadron v. Freund, 69 Misc.2d 342, 348, 329 N.Y.S.2d 945 (Sup. Ct. Rockland

County 1972). Although officers and directors have a specific duty, "any person who knowingly causes misappropriation of trust property by a corporation is personally liable for participation in a breach of trust." Id., 69 Misc.2d at 348, 329 N.Y.S.2d at 953 (emphasis supplied).

> The inquiry is whether any of the defendants were actively 'participating' in the wrong of the corporation or had knowledge of use of trust moneys in the corporate business (citation omitted). It is not essential that the misuse of the trust funds should be for the exclusive benefit of the person making such unlawful use, although benefit to the corporation is inseparable from the benefit to those financially interested in the corporation (citation omitted). Furthermore, to find 'participation', the individual need not be an officer, director or shareholder. (Citations omitted).

Id. at 954.

B. "Actual Knowledge"

In Kolveck, the court stated that "actual knowledge" of the primary violator's wrongdoing is required to impose liability for participating in a breach of fiduciary duty:

> [C]ourts in this district applying New York law have held that actual knowledge is necessary to impose liability for participating in a breach of fiduciary duty. See Samuel M. Feinberg Testamentary Trust v. Carter, 652 F.Supp. 1066, 1082 (S.D.N.Y. 1987) ("Actual knowledge, not mere notice or unreasonable awareness, is . . . essential."); Marine Midland Bank v. Smith, 482 F.Supp. 1279, 1290 (S.D.N.Y. 1979) (no liability for aiding and abetting breach of fiduciary duty where defendant was "not aware of conduct which it knew to constitute a breach of duty"), aff'd 636 F.2d 1202 (2d Cir. 1980).

Kolveck v. LIT Am., Inc., 939 F. Supp. 240, 246-47 (S.D.N.Y. 1996), aff'd, 152 F.3d 918 (2d Cir. 1998).

C. "Participation"

A non-fiduciary may be held liable for participating in another's breach of fiduciary duty if that party provided "substantial assistance" to the primary violator. Kolveck, supra, at 247. Allowing a third party to use office space "does not rise to the level of 'substantial assistance' necessary to state a claim for aiding and abetting a breach of fiduciary duty." DePinto v. Ashley

Scott, Inc., 222 A.D.2d 288, 635 N.Y.S.2d 215, 217 (1st Dep't 1995). A non-fiduciary provides substantial assistance if he "affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables it to proceed." Diduck v. Kaszycki & Sons Contractors, Inc., 974 F.2d 270, 284 (2d Cir. 1992).

Inaction constitutes substantial assistance only when "an independent duty to act was a duty owed to the defrauded investor." Dillon v. Militano, 731 F. Supp. 634, 639 (S.D.N.Y. 1990) The court in Kolveck, supra, stated:

> [I]naction, or a failure to investigate, constitutes actionable participation only when a defendant owes a fiduciary duty directly to the plaintiff; that the primary violator owes a fiduciary duty to the plaintiff is not enough. See generally W. Page Keeton et al., Prosser & Keeton on the Law of Torts Section 46 at 323-324 (5th ed. 1984) ("Since there is ordinarily no duty to take affirmative steps to interfere, mere presence at the commission of the wrong . . . is not enough to charge one with responsibility.") To hold all defendants to a standard of constructive knowledge and subject to a duty of inquiry would mean that all defendants, regardless of their independent obligations to plaintiff, could be liable for inaction. That result is contrary to the law of substantial assistance and confirms that a failure to investigate, i.e. constructive knowledge, is not enough to support a claim for aiding and abetting a fiduciary duty absent the existence of a fiduciary duty running from defendant to plaintiff.

Kolveck, 939 F. Supp. at 247.

In Schwadron v. Freund, supra, Plaintiffs moved for summary judgment in an action to enforce a statutory trust and sought damages for breach of trust, claiming that Defendants "participated" in a diversion of advances held in escrow for the purchase of real property. Defendants were officers, directors and stockholders of the corporate trustee. Summary judgment was granted against Defendant Geller who received wages from the commingled account, where he did not deny having knowledge of the receipt of the advances from corporate trustee and did not deny knowledge of the intended use of the advances. Summary judgment

was denied against Defendants Levy and Freund. Defendant Levy cosigned certain of the disputed checks but denied having personally received or withdrawing any moneys from the corporate trustee and corporate ledger sheets did not reflect any such payments. The court held that "[i]t would not be appropriate to infer knowledge of misuse of trust assets from this evidence alone." Schwadron, 69 Misc.2d at 349, 329 N.Y.S.2d at 954. As to Defendant Freund, the court found that the record was barren of any facts upon which any participation in the breach of trust could be measured.

Of course George T. Booth III, like Joseph Chalhoub and Lonsdale Schofield, knew of his duty under the Liquidating Plan, as is shown in the agreement to set aside $500,000 for future claims and potential liabilities. See Agreement (attached as exhibit 33 to the July 30, 2004 Affirmation of R. William Stephens). The loan of Booth Oil surplus to Ahsen Yelkin for the purpose of purchasing the mortgage on George T. Booth III's residence indicates not only that Ahsen Yelkin and George T. Booth III understood the requirements of the plan, but that they conceived elaborate schemes to avoid the clear terms of the Liquidating Plan, and that one of those schemes was in operation through September 30, 1998 when George T. Booth III exchanged the Yelkin Promissory Note for a discharge of mortgage on his residence from Ahsen Yelkin. Finally, the Settlement Agreement into which Booth Oil entered with the approval of Joseph Chalhoub and upon the signature of Lonsdale Schofield specifically released Booth III from liability for conduct associated with the Yelkin Note. The specific release would be unnecessary if Joseph Chalhoub and Lonsdale Schofield were not aware of the impropriety of the transactions.

D. Extent of Liability

Non-fiduciaries held liable for breach of fiduciary duty are "liable for the full amount of the damage caused thereby to the cestuis que trust." Wechsler v. Bowman, 285 N.Y. 284, 34 N.E.2d 322 (1941).

II. Bankruptcy Code

A. Section 1141(a) and 1142(b) of the Bankruptcy Code

Defendants George T. Booth III, Lonsdale Schofield, Joseph Chalhoub, and Ahsen Yelkin are individually liable for violations of the Liquidating Plan. Under section 1141 of the Bankruptcy Code "a confirmed plan bind[s] the debtor, . . . any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor." 11 U.S.C. §1141(a). While Lonsdale Schofield and Joseph Chalhoub are not equity security holders simply because they hold shares in corporations which in turn hold shares of Booth Oil, they are and have been directors, officers, and controlling shareholders of Booth Oil since September 14, 1984. Ahsen Yelkin claims he was not an officer or director of Booth Oil, although his answer indicated that he was, and Plaintiff does not dispute that fact on this motion.

Under section 1142(b): "the Court may direct the debtor and any other necessary party to . . . perform any other act . . . that is necessary for the consummation of the plan." 11 U.S.C. §1142(b).

Section 1141(b) of the Bankruptcy Code states: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. §1141(b). In this case, any surplus or surplus accounts receivable was to be maintained in a Contingency Fund for the Contingency Fund beneficiaries. This is a limitation on revesting contained in the Liquidating Plan. As a result of the

confirmation of the Plan, all assets of Booth Oil except any surplus revested in Booth Oil. Typically, the bankruptcy estate is extinguished by confirmation. In this case, the Liquidating Plan limited revesting to all assets of Booth Oil except surplus. Instead of being extinguished, the bankruptcy estate contracted to the point where it consisted only of Booth Oil surplus.

The bankruptcy estate was, in effect, transformed into a liquidating trust for the Contingency Fund beneficiaries. Booth Oil, a debtor in possession with respect to the any surplus and the liquidating trust, and as such is required to take actions consistent with its fiduciary duty relative to the surplus and the requirement that the surplus be placed in the Contingency Fund. In re Pioneer Consol. Mortgage Entities, 248 B.R. 368, 375-76 (Bankr. App. Panel 9th Cir. 2000); see also discussion at Plaintiff's Reply Memo In Further Support of its Motion for Summary Judgment Against Joseph Chalhoub (filed herewith) at 5.

The fiduciary duties of a debtor in possession are described at length in Collier on Bankruptcy ¶1107.02[4]:

> [S]o long as the Debtor remains in possession, it is clear that the corporation bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession. Moreover, the duties which the Corporate Debtor in possession must perform during the proceeding are substantially those imposed upon the Trustee. It is equally apparent that in practice these fiduciary responsibilities fall not upon the inanimate corporation, but upon the officers and managing employees who must conduct the debtor's affairs under the surveillance of the court.

7 Collier on Bankruptcy ¶1107.02[4] (15th ed. rev.) (citing Wolf v. Weinstein, 372 U.S. 633 (1963)).

> Although a mistake of judgment is not, itself, a basis for imposing liability, a mistake that results from a failure to live up to this standard of care is. A debtor in possession is also bound by a duty of loyalty that includes an obligation to refrain from self dealing, to avoid conflicts of interest and the appearance of impropriety, to treat all parties to the case fairly and to maximize the value of the estate . . . . Courts have held that managers of debtors in possession breached their duty of loyalty by inter alia . . . failing to provide

> "voluntary and honest financial information" to creditors and parties in interest; . . . misappropriating estate assets for personal use; . . . failing to maximize the value of estate assets; . . . failing to pursue a preference action because the debtor's principals had personally guaranteed the underlying debt.")).

Id.

B. Civil Contempt

In Krypton, an officer and director attempted to interfere with the transfer of F.C.C. licenses to operate television stations. In re Krypton Broad., 181 B.R. 657, 665 (Bankr. S.D. Fla. 1995). The Court held:

> In sum, the Program Distributors have proved by clear and convincing evidence that Feltner has violated the Confirmation Order. He has done so knowingly, willfully and in bad faith. Civil contempt is an appropriate means of redressing these violations. Among the remedies available to the Court in a civil contempt proceeding is the ability to impose a fine payable to the complainant in compensation for damages sustained as a result of the contumacious conduct.

Id. at 665 (citing In re Spanish River Plaza Realty Co., 155 B.R. 249, 254 (Bankr. S.D. Fla. 1993)). The Spanish River case cites the Second Circuit in Vuitton et Fils for the proposition that "once the complainant proves that damages have occurred as the result of the contumacious behavior, the Court has no discretion and must order that compensatory damages be paid." In re Spanish River Plaza Realty Co., 155 B.R. 259, 254 (Bankr. S.D. Fla. 1993) (citing Vuitton et Fils S.A. v. Carousel Handbags, 592 F.2d 126, 130 (2d Cir. 1979)). In the Merriweather case, the court described the elements of a civil contempt remedy:

> In general, a party moving to hold another in civil contempt must show: (1) that the order the contemnor failed to comply with is clear and unambiguous; (2) that proof of noncompliance is clear and convincing; and (3) that the contemnor has not diligently attempted compliance in a reasonable manner.

Merriweather v. Sherwood, 2003 U.S. Dist. LEXIS 6892 at *4 (S.D.N.Y. March 7, 2003) (citing King v. Allied Vision, Ltd., 65 F.3d 1051, 1058 (2d Cir. 1995)).

III. Statute of Limitations

A. Tolling Until Plaintiff Has Actual or Constructive Knowledge of the Breach

This limitations period does not commence running until Plaintiff has actual or constructive knowledge of the breach. Vasile v. Dean Witter Reynolds, supra at 485-486. See also Waksman v. Cohen, 1998 U.S. Dist. LEXIS 15587, *11 (S.D.N.Y. 1998) ("the breach of fiduciary duty claim has a six year statute of limitations period which is tolled in its entirety until, through the exercise of reasonable diligence, a plaintiff has actual or constructive knowledge of the breach"); In re Argo Communications Corp., supra, at 787:

> [N]umerous New York courts have held that the statute of limitations for breach of fiduciary duty does not commence running until the plaintiff has actual or constructive knowledge of the breach. Public Serv. Co. v. Chase Manhattan Bank, N.A., 577 F. Supp. 92, 109 (S.D.N.Y. 1983); Dumbadze v. Iignante, 244 N.Y. 1, 3-4, 6-9, 154 N.E. 645, 646-47 (1926); Wood v. Young, 141 N.Y. 211, 218, 36 N.E. 193, 194 (189) (dictum); Montgomery Ward & Co. v. Weber, 7 Misc.2d 465, 466, 162 N.Y.S.2d 744, 746 (Supp. Ct. 1957); N.Y. C.P.L.R. § 206(a)(1); 36 NY Jur, Limitations and Laches § 82 (Lawyers Cooperative Publishing Co. 1964).

See also Leung v. Newman, 1996 U.S. Dist. LEXIS 6869, *18 (S.D.N.Y. 1996) ("Given the special nature of a fiduciary relationship, the statute of limitations for a breach of fiduciary duty does not begin to run until plaintiff has actual or constructive knowledge of the breach").

B. Statute of Limitations for Aiding and Abetting Breach of Fiduciary Duty

If the claim for breach of fiduciary duty is timely, the claim for aiding and abetting a breach of fiduciary duty is timely. If the claim for breach of fiduciary duty is barred, the claim for aiding and abetting the breach of fiduciary duty is barred. See Geren v. Quantum Chem. Corp. 832 F. Supp. 728 (S.D.N.Y. 1993) ("Where the primary violation [of breach of fiduciary duty] is barred by the applicable statute of limitations, a claim for aiding and abetting this

primary violation fails to state a claim").

Conclusion

For the reasons set forth herein and upon the affirmations, affidavits, and statements of facts before the Court, the Court should find that George T. Booth III is liable for breach of fiduciary duty and a violation of the Liquidating Plan in connection with the $450,000, $300,000, and $275,000 transfers from Booth Oil addressed on this motion, and with respect to the transfers of $300,000 to Katherine Street Properties and $275,000 to George T. Booth III to set aside the transfers as fraudulent conveyances.

Dated: December 3, 2004
Buffalo, New York

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