

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

IN RE No. C-14-5161 EMC
SIGNET SOLAR, INC., No. C-14-5162 EMC
Debtor.

ANDREA A. WIRUM, Trustee,
Appellant,

ORDER ON APPEAL

v.

PRABHAKAR GOEL, *et al.*,
Appellee.

ANDREA A. WIRUM, Trustee,
Appellant,

v.

BHUPENDRA B. PATEL,
Appellee.

Currently pending before the Court are two appeals of bankruptcy adversary proceedings. The debtor in bankruptcy (Chapter 7) was the company Signet Solar, Inc. (“Signet”). The trustee for Signet filed claims for relief against two of Signet’s founders and members of the board of directors, namely, Prabhakar Goel and Bhupendra B. Patel. According to the trustee, Mr. Goel and Mr. Patel breached their fiduciary duties to Signet. The trustee also asked that any claims of Mr. Goel (and an

1 affiliated company) and Mr. Patel against Signet be equitably subordinated because of their alleged
2 misconduct. The bankruptcy court granted Mr. Goel and Mr. Patel’s motions to dismiss and denied
3 leave to amend. The trustee now appeals that order.

4 **I. FACTUAL & PROCEDURAL BACKGROUND**

5 As a formal matter, there are two complaints filed by the trustee – one against Mr. Goel (and
6 an affiliated company) and one against Mr. Patel. The complaints, however, are substantially the
7 same. For convenience, the Court largely cites to the allegations in the Goel complaint.

8 As alleged, Signet was a company “formed in 2006 to market a new form of thin-film silicon
9 panel to the solar photovoltaic industry. . . . Signet developed, manufactured, and deployed the
10 world’s largest thin-film silicon photovoltaic modules, lowering the cost of installed solar arrays
11 without the use of toxic or rare materials.” FAC (Goel) ¶ 10. Signet itself was a holding company.
12 It operated its manufacturing and sales activities through a wholly owned German subsidiary, which
13 shall hereinafter be referred to as “German Signet.” FAC (Goel) ¶ 11. Both Mr. Goel and Mr. Patel
14 were founders of Signet as well as members of the company’s board of directors. In fact, Mr. Goel
15 was the chairman of the board. *See* FAC (Goel) ¶ 8; SAC (Patel) ¶ 8.

16 From the outset, Signet had a specific business plan. Initially, Signet’s manufacturing
17 facility (owned by German Signet) would be operated at 20 megawatt production levels “until it
18 obtained a foundation of customers and orders which would allow it to expand to 40 megawatt
19 production.” FAC (Goel) ¶ 16. It was expected that Signet would have a negative cash flow,
20 “which would only turn positive upon the upgrade of its manufacturing facility to a 40 megawatt
21 production level.” FAC (Goel) ¶ 17. “[T]o reach this capacity, . . . additional capital would need to
22 be raised from investors, and . . . Signet would need to maintain [a] Bank of America line of credit at
23 a level in excess of \$15,000,000.” FAC (Goel) ¶ 17. Signet had a line of credit with Bank of
24 America in the amount of \$16,500,000. As a formal matter, the line of credit was taken out in the
25 names of the company’s founders, but Signet guaranteed the line of credit. *See* FAC (Goel) ¶ 14.

26 Although in liquidation terms Signet was formally insolvent at all relevant times (*i.e.*, if
27 liquidated, its liabilities would exceed its assets), *see* FAC (Goel) ¶ 19, the company was as a
28 practical matter successful, securing over \$30 million in equity financing by 2008. *See* FAC (Goel)

1 ¶ 13. By October 2009, Signet began to look for additional outside investment in order to advance
2 funds to German Signet, which, as noted above, owned and operated Signet’s manufacturing
3 facilities. “The purpose of the cash infusion was to provide funds to German Signet to pay current
4 obligations and to allow German Signet to begin the process of increasing its manufacturing plant to
5 40 megawatt capacity.” FAC (Goel) ¶ 18.

6 In October 2009, Signet received funding proposals backed by two different entities, EMCO
7 Group and NCM Strategic Partners, LLC. *See* FAC (Goel) ¶¶ 21-22. Both of these proposals
8 “required the founding shareholders, including Goel and Patel, to make certain concessions,
9 including an agreement to extend the due dates on loans made by the founders to Signet.” FAC
10 (Goel) ¶ 25. On November 8, 2009, at a Signet board meeting, Mr. Goel and Mr. Patel suggested an
11 alternative sponsored by themselves. *See* FAC (Goel) ¶ 26.

12 On November 12, 2009, EMCO delivered a new funding proposal to Signet. Under the
13 EMCO term sheet, EMCO would “provide financing to Signet totaling \$12,500,000 from EMCO
14 and \$4,000,000 from other investors pursuant to a Series C stock offering.” FAC (Goel) ¶ 27. Mr.
15 Goel and Mr. Patel, however, did not approve of the EMCO term sheet because it “would have
16 subordinated loans made by Goel and Patel to Signet, would have changed control of the board of
17 directors and would have required the resignations of Goel and Patel from the board of directors.”
18 FAC (Goel) ¶ 27.

19 On November 17, 2009, another Signet board meeting was held, where management
20 recommended approval of the EMCO term sheet. Mr. Goel and Mr. Patel voiced opposition and
21 again proposed an alternative. More specifically, Mr. Goel and Mr. Patel proposed that they would
22 provide \$4,000,000 in cash to the company and thereafter raise an additional \$16,000,000 from other
23 investors. *See* FAC (Goel) ¶ 32. On November 22, 2009, Mr. Goel circulated the Goel/Patel term
24 sheet for consideration. *See* FAC (Goel) ¶ 35. On November 23 or 24, 2009, Signet held another
25 board meeting, without Mr. Goel and Mr. Patel being present, and classified the Goel/Patel term
26 sheet as secondary. *See* FAC ¶ 37.

27 On November 27, 2009, German Signet gave notice to the German government (as required
28 by German law) that it was insolvent. German Signet had to cure the insolvency within three weeks

1 or it would have to begin insolvency proceedings (again, as required by German law). German
2 Signet needed approximately \$5 million to cure the insolvency. *See* FAC (Goel) ¶¶ 36, 39.

3 On December 3, 2009, the Signet board met yet again, this time with all members present.
4 At that meeting, the board ultimately agreed to the Goel/Patel term sheet (over the EMCO term
5 sheet), largely based on Mr. Goel and Mr. Patel’s “unqualified promise to each contribute
6 \$2,000,000 to Signet to cover its immediate needs.” FAC (Goel) ¶ 42. “A key part of the board’s
7 decision to accept the Goel and Patel proposal was the fact that it provided much needed short term
8 funding in the form of Patel and Goel’s agreements to each loan \$2 Million to the company.” FAC
9 (Goel) ¶ 43.

10 Although Mr. Goel fully funded his \$2 million promise, *see* FAC (Goel) ¶ 63, Mr. Patel did
11 not – instead advancing only \$300,000. *See* FAC (Goel) ¶ 64. Mr. Patel knew or should have
12 known that he could not fund the full \$2 million at the time of his promise. Moreover, Mr. Goel
13 knew or should have known the same at the time of his promise because Mr. Patel had been heavily
14 borrowing from Mr. Goel. *See* FAC (Goel) ¶¶ 45-46, 93. Furthermore, on December 19, 2009, Mr.
15 Patel explicitly advised Mr. Goel that he could not fund the \$2 million to Signet. *See* FAC (Goel) ¶
16 58.

17 In the meantime, Signet circulated a detailed description of a Series C Preferred Stock
18 offering (technically, a convertible debt offering). *See* FAC ¶¶ 50, 53. The Series C solicitation
19 stated that “the purpose of the solicitation was to raise funds to meet Signet’s equity obligations
20 sufficient to trigger a German government grant critical to the facility upgrade, as well as providing
21 Signet sufficient capital to qualify for lease financing for the 40 megawatt upgrade.” FAC (Goel) ¶
22 52. German Signet’s success was key to Signet’s success because, in December 2009, “Signet’s
23 only asset other than its bank account balances, was its investment in German Signet.” FAC (Goel)
24 ¶ 44; *see also* FAC (Goel) ¶ 19 (alleging that, “at the November 8, 2009 meeting of the Signet board
25 of directors, the company reported cash of only \$27,000 and \$4.4 million dollars of delinquent
26 (German Signet) accounts payable”). However, as of December 2009, “Signet’s investment in
27 German Signet was worthless unless Signet carried out its Business Plan, because all of Signet’s
28 loans to German Signet were subordinate to grants made by the German government (approximately

1 25 million Euros) to German Signet.” FAC (Goel) ¶ 44. Ultimately, the Series C solicitation
2 secured \$3,238,000 in investment by January 2010. *See* FAC (Goel) ¶ 54. Most of the funding
3 came from friends and associates of the founders. *See* FAC (Goel) ¶ 55.

4 Signet treated the \$3 million as a loan and then loaned those funds to German Signet, but
5 later Signet was told that the funds loaned were not enough to avert German Signet’s insolvency.
6 *See* FAC (Goel) ¶¶ 54, 61-62, 65, 100. On January 25, 2010, Signet informed German Signet that it
7 would not be able to provide the necessary additional funds. *See* FAC (Goel) ¶ 68. Subsequently,
8 Mr. Goel contacted German Signet and falsely stated that Signet did have more funds. *See* FAC
9 (Goel) ¶ 70.

10 Throughout this time, Mr. Goel was motivated to maintain control of Signet and/or keep
11 Signet “propped up” because he had another venture, Gold Solar Energy, LLC, which had applied
12 for a permit to build a solar farm in the state of Nevada, and, in the attempt to secure approval of the
13 permit, he falsely represented to the state that Gold Solar had a ready supply of solar units pursuant
14 to a joint agreement with Signet. There was in fact no such agreement with Signet. *See* FAC (Goel)
15 ¶¶ 82-85, 92. Mr. Goel was also motivated to get funds to German Signet and keep it “propped up”
16 so that he could divert its inventory to his own solar farm companies at below cost. *See* FAC (Goel)
17 ¶ 101. Mr. Patel went along with Mr. Goel, apparently because he was indebted to Mr. Goel – Mr.
18 Patel had both heavily borrowed and sought investment funds from Mr. Goel. *See* FAC (Goel) ¶ 93.

19 In February 2010, Mr. Goel learned that he had failed to get Nevada’s approval for the
20 permit. Thereafter, he and Mr. Patel began to withdraw financial support from Signet. *See* FAC
21 (Goel) ¶ 72. Mr. Goel and Mr. Patel even went so far as to reduce the Bank of America line of
22 credit from \$16,500,000 to \$7,000,000. *See* FAC (Goel) ¶ 73. They also withdrew investor checks
23 that had been delivered to Signet but not yet cashed. *See* FAC (Goel) ¶ 74.

24 In March 2010, EMC offered Signet a new term sheet pursuant to which it EMCO agreed to
25 inject 13 million Euro into Signet and German Signet, conditioned on German Signet not
26 transferring or encumbering its intellectual property. *See* FAC (Goel) ¶ 75. But because Mr. Goel
27 and Mr. Patel refused to provide any more funds to Signet – including the balance of the \$2 million
28 that Mr. Patel had previously promised to provide – Signet was “forced to enter into an agreement to

1 lease all of the intellectual property of German Signet to raise immediate funds to pay German
2 Signet’s short term obligations.” FAC (Goel) ¶ 78. This led to the withdrawal of the EMCO term
3 sheet and the collapse of Signet and German Signet. *See* FAC (Goel) ¶ 79.

4 In essence, the trustee claims that the actions of Mr. Goel and Mr. Patel led Signet to incur
5 debt in excess of \$3,238,000 (*i.e.*, the Series C funding) that it would not have otherwise incurred.
6 *See* FAC (Goel) ¶¶ 100, 110. To the extent the \$3 million was a benefit to Signet, the trustee claims
7 that Signet was not afforded the full benefit of that money because that money went to German
8 Signet and then Mr. Goel essentially poached inventory from German Signet. Finally, the trustee
9 claims that the actions of Mr. Goel and Mr. Patel resulted in a loss to Signet’s “enterprise value.”
10 FAC (Goel) ¶ 110.

11 Mr. Goel and Mr. Patel both moved the bankruptcy court to dismiss the operative complaints
12 asserted against them. A hearing was held before the bankruptcy court on November 6, 2014. At
13 the hearing, the court dismissed with prejudice, concluding that the trustee had failed to adequately
14 plead causation/damages.

15 II. DISCUSSION

16 A. Legal Standard

17 There is no dispute that the claims asserted by the trustee against Mr. Goel and Mr. Patel are
18 adversary proceedings. The Federal Rules of Bankruptcy Procedure specify that Federal Rule of
19 Civil Procedure 12(b) applies in adversary proceedings. *See* Fed. R. Bankr. P. 7012(b). Under Rule
20 12(b)(6), a defendant may move to dismiss for failure to state a claim for relief.

21 “To survive a motion to dismiss, a complaint must contain sufficient
22 factual matter, accepted as true, to ‘state a claim to relief that is
23 plausible on its face.’” A claim is facially plausible “when the plaintiff
24 pleads factual content that allows the court to draw the reasonable
25 inference that the defendant is liable for the misconduct alleged.” The
26 plausibility standard requires more than the sheer possibility or
27 conceivability that a defendant has acted unlawfully. “Where a
28 complaint pleads facts that are merely consistent with a defendant’s
liability, it stops short of the line between possibility and plausibility
of entitlement to relief.” Dismissal under Rule 12(b)(6) is proper only
when the complaint either (1) lacks a cognizable legal theory or (2)
fails to allege sufficient facts to support a cognizable legal theory.

1 *Li v. Kerry*, 710 F.3d 995, 999 (9th Cir. 2013) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678-79
2 (2009); *see also Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007)).

3 This Court applies de novo review in assessing the bankruptcy court’s order granting Rule
4 12(b)(6) dismissal. *See In re Fine*, 158 Fed. Appx. 898, 898 (9th Cir. 2005); *In re Zimmer*, 313 F.3d
5 1220, 1222 (9th Cir. 2002).

6 B. Breach of Fiduciary Duty

7 1. Causation/Damages

8 The parties do not seem to dispute that the trustee’s claim of breach of fiduciary duty is made
9 pursuant to Delaware law.¹ Under Delaware law, “[t]he elements of breach of fiduciary duty that
10 must be proven . . . by the plaintiff are (i) that a fiduciary duty exists; and (ii) that a fiduciary
11 breached that duty.” *Heller v. Kiernan*, No. 1484-K, 2002 Del. Ch. LEXIS 17, at *18 (Del. Ct. Ch.
12 Feb. 27, 2002). However, in order for the plaintiff to recover, the plaintiff must also show that the
13 breach of fiduciary duty caused it damage. *See, e.g., Grace Bros., Ltd. v. Uniholding Corp.*, No.
14 Civ. A. 17612, 2000 Del. Ch. LEXIS 101, at *54 (Del. Ch. July 12, 2000) (stating that “the court can
15 fashion an award of monetary damages that holds the defendant-directors accountable for any *and*
16 *only* the harm that their breaches of fiduciary duty may have caused the plaintiffs”). The trustee
17 does not argue otherwise; in fact, she agrees. *See, e.g., Reply* (Goel) at 4 (“The Trustee does not
18 disagree that damage is an element of the claim.”).

19 What the trustee does argue is that she adequately alleged causation and damages in the
20 operative complaints. More specifically, the trustee claims that Signet was harmed as a result of Mr.
21 Goel and Mr. Patel’s actions because: (1) Signet lost enterprise value (even if technically it was
22 insolvent, *i.e.*, in liquidation terms); (2) Signet incurred debt (more than \$3 million) that it otherwise
23 would not have incurred (*i.e.*, through the Series C solicitation); and (3) any benefit that Signet got
24 from the \$3 million was lost because at least part of that money was diverted by Mr. Goel from

25
26 ¹ *See also* Cal. Corp. Code § 2116 (providing that “[t]he directors of a foreign corporation
27 transacting intrastate business are liable to the corporation, its shareholders, creditors, receiver,
28 liquidator or trustee in bankruptcy for . . . [any] violation of official duty according to any applicable
laws of the state or place of incorporation or organization, whether committed or done in this state or
elsewhere”).

1 German Signet (*i.e.*, inventory was diverted to Mr. Goel to use for his other solar business). The
2 Court addresses each of these arguments in turn.

3 On the first argument, the Court proceeds with the assumption that the term “enterprise
4 value” means the value of a company as a going concern. That is the meaning that the trustee seems
5 to have assigned the term, as reflected in the bankruptcy hearing transcript. *See, e.g.*, Tr. at 13
6 (counsel for the trustee arguing that “the enterprise value that we will establish at trial is going to be
7 based on the yearly evaluations that were prepared by professionals for the coproration that said
8 what the company’s enterprise value was, the most recent one of which was 30 million dollars”); Tr.
9 at 14 (counsel for trustee arguing that “[Signet] had enterprise value while still operating”); Tr. at 34
10 (counsel for the trustee arguing that “the company and its German Signet had established a sufficient
11 basis of customers to trigger the [business] plan for increased – and in furtherance of that, they were
12 raising more money, so the company is still a vital company”). Based on this understanding of the
13 term, the Court agrees with the trustee that, just because a company is insolvent in liquidation terms
14 (*i.e.*, liabilities are greater than assets), that does not necessarily mean that the company does not
15 have any enterprise value. In fact, even if an insolvent company is forced into bankruptcy, that still
16 does not automatically mean that the company lacks enterprise value. For example, a company may
17 be reorganized in bankruptcy (Chapter 13). That being said, the Court cannot say that, in the instant
18 cases, the trustee has adequately pled a loss of enterprise value as a result of Mr. Goel and Mr.
19 Patel’s actions.

20 As the bankruptcy court indicated, the trustee’s contention that Signet had enterprise value
21 which was lost depends on there being a viable alternative to the Goel/Patel deal – an alternative
22 which would have kept Signet a going concern. But, as the bankruptcy court noted, the EMCO and
23 NCM deals were not viable alternatives because each deal required Mr. Goel and Mr. Patel to
24 subordinate the loans they had previously made to Signet, and neither had a fiduciary duty to
25 subordinate. The trustee has not disputed this point in her papers, and therefore the situation Signet
26 was facing was either take the Goel/Patel deal or reject it. If Signet had rejected the Goel/Patel deal,
27 then it would have gone out of business because German Signet was its main asset and German
28 Signet would go out of business without any additional funding from Signet. Thus, in the absence of

1 the Goel/Patel deal, it is not possible to say that Signet had any enterprise value to lose; in the
2 absence of the deal, Signet could not be a going concern. Notably, the trustee did not ever allege
3 that a reorganization under Chapter 11 would have been possible in the absence of the Goel/Patel
4 deal. In short, absent from the record are any facts suggesting some plausible scheme by which
5 Signet could have value as a going concern.

6 The Court now turns to the second argument – *i.e.*, that Signet was harmed because it
7 incurred more debt than it otherwise would have as a result of Mr. Goel and Mr. Patel’s actions.

8 As a preliminary matter, the Court rejects Mr. Goel’s suggestion that “deepening insolvency” can
9 never be a harm. Admittedly, in *In re Troll Communications, LLC*, 385 B.R. 110 (D. Del. 2008), the
10 bankruptcy court did state that, in *In re CitX Corp., Inc.*, 448 F.3d 672 (3d Cir. 2006), “the Third
11 Circuit . . . rejected the use of deepening insolvency as a theory of damages,” *Troll*, 385 B.R. at 122,
12 but the *Troll* court seems to have mischaracterized the Third Circuit’s statements in *CitX*. In *CitX*,
13 the Third Circuit simply noted that “[t]he deepening of a firm’s insolvency [was] not *an*
14 *independent form of corporate damage.*” *CitX*, 448 F.3d at 678 (emphasis added). It was in this
15 context that the appellate court stated: “Where an independent cause of action [such as breach of
16 fiduciary duty] gives a firm a remedy for the increase in its liabilities, the decrease in fair asset
17 value, or its lost profits, *then the firm may recover*, without reference to the incidental impact upon
18 the solvency calculation.” *Id.* (emphasis added).

19 The Court notes, however, that “the [mere] incurrence of debt by itself cannot deepen a
20 company’s insolvency.” *In re Parmalat Secs. Litig.*, 501 F. Supp. 2d 560, 578 (S.D.N.Y. 2007).

21 The district court in *Parmalat* explained why:

22 When, for example, a company borrows cash and receives the
23 full amount of the loan, it receives an asset that directly offsets the
24 newly incurred liability on its balance sheet. In other words, the
25 company “expand[s] debt in *precise* proportion – dollar-for-dollar
26 proportion – to the expansion of assets in the form of new cash. The
27 difference between the company’s assets and liabilities therefore
28 remains the same. Its ability to pay its debts as they become due is no
worse; indeed, it may be better. The company’s insolvency is no
greater than before.

27 *Id.* at 574 (emphasis in original).

28 The *Parmalat* court continued:

1 The point is that a company’s insolvency is not deepened
2 simply by the incurrence of new debt where the company suffers no
3 loss on the loan transaction. The insolvency is deepened when, for
4 example, the proceeds of the loan are squandered or assets otherwise
5 are looted. It is at that point that the gap between liabilities and assets
6 widens and the ability to service outstanding debt is impaired.

5 *Id.* at 574-75.²

6 The Court finds the reasoning of the *Parmalat* court sound. Therefore, to the extent the
7 trustee claims harm to Signet simply by virtue of the \$3 million debt that was incurred, that is not
8 enough to constitute an injury because, in fact, there was a corresponding benefit (*i.e.*, cash) that
9 Signet received.

10 This leads the Court to the third argument presented by the trustee, namely, that to the extent
11 Signet got a benefit from the \$3 million loan, that loan was then “wasted” by Mr. Goel because,
12 even though that money was loaned to German Signet, Mr. Goel ended up diverting German
13 Signet’s inventory to the benefit of his independent solar business. As indicated above, this is a
14 viable claim of harm for the very reasons explained by the *Parmalat* court. In this regard, the
15 bankruptcy court’s point that the \$3 million would not have existed but for Mr. Goel and Mr. Patel’s
16 misrepresentations in the first place may be true; but that does not mean that that \$3 million still was
17 not wasted. This is in contrast to the situation in *CitX*:

18 Assuming for the sake of argument that [the defendant accountant]
19 Detweiler’s financial statements allowed CitX to raise over one
20 million dollars, that did nothing to “deepen” CitX’s insolvency.
21 Rather, it lessened CitX’s insolvency. Before the equity infusion,
22 CitX was \$2,000,000 in the red . . . With the added \$1,000,000
23 investment, it was thereby insolvent only \$1,000,000. This hardly

22 ² The *Parmalat* court also provided further examples of where the incurrence of debt could
23 actually cause harm to a company. For example:

- 24 • “to the extent that bankruptcy is not already a certainty, the incurrence of debt can
25 force an insolvent corporation into bankruptcy, thus inflicting legal and
26 administrative costs on the corporation”;
27 • “[a]side from causing actual bankruptcy, deepening insolvency can undermine a
28 corporation’s relationships with its customers, suppliers, and employees”; and
29 • “prolonging an insolvent corporation’s life through bad debt may simply cause the
30 dissipation of corporate assets.”

28 *Parmalat*, 501 F. Supp. 2d at 575 (quoting *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 349-50 (3d Cir. 2001)).

1 deepened insolvency. Any increase in insolvency (*i.e.*, the several
2 million dollars of debt incurred after the \$1,000,000 investment) was
3 wrought by *CitX's management*, not by Detweiler.
4 *CitX*, 448 F.3d at 677 (emphasis added). Here, the claim is that assets were effectively diverted
5 from Signet by Mr. Goel.

6 In his papers, Mr. Goel protests that the trustee has failed to explain how he could have
7 diverted the inventory “given that he was not an executive with operational control over either
8 Signet or German Signet.” Opp’n (Goel) at 24. But at this point in the proceedings, it is not
9 implausible that Mr. Goel could have caused the diversion of inventory given his position at Signet
10 and the fact that Signet was funding German Signet. At the very least, the diversion allegations in
11 the operative complaints would make a dismissal with prejudice – as the bankruptcy court ordered –
12 improper because, even if more specificity were needed in the complaints, that does not thereby
13 mean that the claims for breach of fiduciary duty were futile.

14 In his papers, Mr. Patel seems to assert that there could be harm to Signet only if Signet had
15 some assets to begin with, which it did not. *See, e.g.*, Opp’n (Patel) at 15 (arguing that “the Debtor
16 was worth *nothing* and owned *nothing* of any value before the purported breaches of fiduciary
17 duty[;] [i]t was not and could not be damaged any further”). But Mr. Patel has not cited any
18 authority in support of this position. Moreover, he has not explained why an increase in liability
19 should not be considered a harm to the company – even if the company had no assets – at least in a
20 situation where, as here, it is alleged that the benefit concurrent with that liability (*i.e.*, the \$3 million
21 raised through the Series C solicitation or at least a portion thereof) was ultimately wasted.

22 That being said, the Court does note that, as to Mr. Patel at least, it is not clear to what
23 extent, if any, he had a hand in the alleged waste of the \$3 million. The operative complaint against
24 Mr. Patel appears to be silent as to whether Mr. Patel was involved with diverting inventory from
25 German Signet to the benefit of Mr. Goel. However, at the very least, the trustee should be given an

1 opportunity to amend, if she can do so in good faith, to plead allegations regarding Mr. Patel’s
2 involvement.³

3 2. Business Judgment Rule

4 Mr. Goel contends that, even if the trustee adequately pled causation and damages in the
5 operative complaint against him, her claim for breach of fiduciary duty still warrants dismissal
6 because of the business judgment rule.⁴ The business judgment rule ““is a presumption that in
7 making a business decision, the directors of a corporation acted on an informed basis, in good faith
8 and in the honest belief that the action taken was in the best of the company.”” *Benihana of Tokyo,*
9 *Inc. v. Benihana, Inc.*, 906 A.2d 114, 120 (Del. 2006); *see also* 8 Del. C. § 144(a) (providing that
10 “[n]o contract or transaction between a corporation and 1 or more of its directors or officers . . . shall
11 be void or voidable solely for this reason . . . if: (1) the material facts as to the director’s or officer’s
12 relationship or interest and as to the contract or transaction are disclosed or are known to the board
13 of directors or the committee, and the board or committee in good faith authorizes the contract or
14 transaction by the affirmative votes of a majority of the disinterested directors”).

15 For purposes of this opinion, the Court assumes that the business judgment rule is a defense
16 that may be made by individual directors on a company board and not just the board *qua* board (as
17 the bankruptcy court indicated at the hearing before it). *See* Tr. at 23-24, 26 (bankruptcy court
18 stating that the rule “protects a Board as a Board acting as a Board” and not “an individual member
19 of a Board from deceiving his own company”). But even with this assumption, Mr. Goel’s position
20 lacks merit. To the extent he argues that a majority of the disinterested board members approved the

21
22 ³ Although the Court is reversing the bankruptcy court for the reasons stated above, it is not
23 making any determination as to whether the trustee can adequately establish causation/damages on
24 the merits. For example, there seems to be an argument that, even if the \$3 million was not wasted
25 and put to the use it should have been (*i.e.*, fully to the benefit of German Signet and not also Mr.
26 Goel), German Signet still would have failed because the \$3 million was not enough to get it out of
27 insolvency; therefore, Signet still would have failed as well since German Signet was its main asset.
The trustee has asserted that the funds would *not* have been transferred to German Signet, *see, e.g.*,
Mot. (Goel) at 12 (suggesting that it was pointless to send funds to German Signet “which was
26 hopelessly insolvent and could not survive unless Goel and Patel fulfilled their pledge to provide
financial backing”), but that contention seems problematic – indeed, sustaining German Signet
27 appears to have been the whole point of the Series C solicitation. This issue, however, is not
properly resolved on a motion to dismiss.

28 ⁴ This argument has been raised by Mr. Goel alone.

1 Goel/Patel deal, that may be true, but the trustee has implicitly asserted that the disinterested board
2 members were not presented with all material facts regarding the deal, including the fact that Mr.
3 Goel had a conflicting vested interest in keeping Signet and German Signet alive (*i.e.*, to assist his
4 solar farm project in Nevada and to get the benefit of German Signet’s inventory at below cost). Mr.
5 Goel contends that the trustee failed to allege, in the operative complaint, that the disinterested board
6 members lacked this knowledge, but that is a fair inference that may be made. *See, e.g.*, FAC (Goel)
7 ¶ 86 (alleging that “Signet knew nothing of Goel’s [Nevada] Fish Springs Project venture”). At the
8 very least, the trustee should have been given an opportunity to amend to clarify the point.

9 To the extent Mr. Goel argues that the distribution of the \$3 million in funds from Signet to
10 German Signet was also an act protected by the business judgment rule, there is a similar problem.
11 That is, as above, there is a fair inference based on the allegations in the operative complaint that the
12 disinterested board members lacked knowledge that Mr. Goel intended to use German Signet for his
13 own personal benefit.

14 Accordingly, the Court declines to dismiss the breach of fiduciary claim against Mr. Goel on
15 the basis of the business judgment rule.

16 ///
17 ///
18 ///
19 ///
20 ///
21 ///
22 ///
23 ///
24 ///
25 ///
26 ///
27 ///
28 ///

1 C. Equitable Subordination

2 Finally, the Court addresses the claims for equitable subordination. The bankruptcy court
3 dismissed the claims for equitable subordination because it dismissed the claims for breach of
4 fiduciary duty. *See* Tr. at 43 (bankruptcy court stating the “subordination of the claim goes hand in
5 hand with the first count [for breach of fiduciary duty]”). Because the Court is now reversing the
6 bankruptcy court on the claims for breach of fiduciary duty, it also reverses on the claims for
7 equitable subordination. To the extent Mr. Goel and Mr. Patel have asserted that the trustee has
8 failed to allege any harm to creditors, this contention is problematic for reasons similar to those
9 discussed above regarding harm to Signet.


10 **III. CONCLUSION**

11 For the foregoing reasons, the Court reverses the bankruptcy court and remands for further
12 proceedings consistent with this order.

13 The Clerk of the Court is instructed to enter judgment in favor of the trustee and close the
14 file in this case.

15
16 IT IS SO ORDERED.

17
18 Dated: June 9, 2015

19 
20 _____
21 EDWARD M. CHEN
22 United States District Judge
23
24
25
26
27
28