IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	Chapter 11
SCRIPSAMERICA, INC.,	:	Case No. 16-11991 (LSS)
Debtor.	:	
OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF SCRIPSAMERICA, INC.,	:	
Plaintiff,	:	
v.	:	Adv. Pro. No: 17-50010 (LSS)
ANDREW R. VARA, Acting United States Trustee for Region 3, and SCRIPSAMERICA, INC.,	:	
Defendants.	:	

BRIEF OF SCRIPSAMERICA, INC. IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT AND IN SUPPORT OF CROSS-MOTION FOR SUMMARY JUDGMENT

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Dated: February 3, 2017

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In support of the opposition of ScripsAmerica, Inc., debtor and debtor in possession (the "Debtor"), to the former, disbanded Official Committee of Unsecured Creditors' (the "Disbanded Committee") motion for summary judgment and the Debtor's cross-motion for summary judgment, the Debtor submits:

PRELIMINARY STATEMENT

The Disbanded Committee has moved for summary judgment, claiming (i) first, that there is no genuine issue of material fact regarding the authority of Andrew R. Vara, the Acting United States Trustee for Region 3 (the "U.S. Trustee"), to disband the Committee, and (ii) second, that summary judgment is appropriate as a matter of law. While the Disbanded Committee is correct on the first point – there is no genuine issue of material fact regarding the U.S. Trustee's authority – its contention that the U.S. Trustee does not have the authority to act is erroneous. The U.S. Trustee undoubtedly has the authority to monitor membership on official committees and, with respect to an official committee of unsecured creditors appointed under 11 U.S.C. § 1102(a)(1), remove members where the circumstances warrant such removal. Whether the U.S. Trustee's appointment and removal of committee members is subject to review by this Court does not change the U.S. Trustee's authority to act in the first instance.

The U.S. Trustee's authority to disband an official committee appointed under 11 U.S.C. § 1102(a)(1) is incident to his authority to monitor official committee membership. The record regarding the two Disbanded Committee members here – a rogue chief executive officer who, post-committee appointment, was sued by the Debtor for causing the Debtor's slide into bankruptcy; and a "vulture" lender to micro-cap companies whose principal is being sued for fraud in an unrelated California bankruptcy case – provide sufficient grounds to conclude that the U.S. Trustee would not have acted arbitrarily or capriciously by removing either or both members.

Accordingly, regardless of whether the U.S. Trustee ultimately determined to remove one or both Disbanded Committee members, it was entirely appropriate for the U.S. Trustee to disband the committee, given that the Disbanded Committee consisted of only two members. Accordingly, the Disbanded Committee's motion for summary judgment should be denied, and the Debtor's motion for summary judgment should be granted.

STATEMENT OF THE FACTS

On September 7, 2016 (the "Petition Date"), the Debtor filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code, thereby commencing the above-captioned chapter 11 case. The Debtor continues to possess its assets and operate its business as a debtor in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

No trustee or examiner has been appointed in the Debtor's case.

On November 3, 2016, the U.S. Trustee filed a notice of appointment of the Disbanded Committee in the above-captioned case [Docket No. 71]. Ettinger Decl. Ex. A (notice). The Disbanded Committee consisted of two members: Ironridge Global Partners, LLC ("Ironridge Partners") and Robert Schneiderman ("Schneiderman").

Until January 22, 2015, Ironridge Partners was the parent of Ironridge Global IV, Ltd. ("Ironridge IV"). Ettinger Decl. Ex. B (SEC filing).

On November 18, 2016, the Debtor filed the complaint which initiated a civil action against Schneiderman, its former chief executive officer, in the United States District Court for the Eastern District of Pennsylvania (*The Estate of ScripsAmerica, Inc. v. Robert Schneiderman*, No. 16-cv-6081-PD) (the "Schneiderman Post-Petition Complaint").

In the Schneiderman Post-Petition Complaint, the Debtor avers as follows: Ironridge IV "was in the business of skirting the securities laws by being paid stock in 'court approved'

transactions which created free trading stock under an obscure and much debated exemption to the securities laws." Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶ 14. In the Schneiderman Post-Petition Complaint, the Debtor avers that Schneiderman entered into the stock transfer agreement "without the Board's approval, nor its consent, nor did he advise the Board of the agreement." Ettinger Decl. Ex. C (Scheiderman Post-Petition Compl.) at ¶ 16. Under the agreement, Ironridge IV was to satisfy approximately $686,000 of the Debtor's debt in exchange for the issuance of shares of the Debtor's stock to Ironridge IV. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶17. Schneiderman delivered an initial 10.2 million shares to Ironridge in November 2013 and February 2014 – said shares having a value of more than $1.2 million. Ettinger Decl. Ex. C (Scheiderman Post-Petition Compl.) at ¶ 18. In or about May 2014, Ironridge demanded another 1.6 million shares, which led Scheiderman to initiate a securities fraud lawsuit by the Debtor against Ironridge IV on May 22, 2014. Ettinger Decl. Ex. C (Scheiderman Post-Petition Compl.) at ¶ 20. Ultimately, a California court enjoined the Debtor's sale of its stock to anyone until Ironridge had received another 87 million shares. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶21. Ironridge filed another action in New Jersey seeking damages, and a separate suit in California on malicious prosecution grounds. Ettinger Decl. Ex. C (Scheiderman Post-Petition Compl.) at ¶ 21. All told, the cost to the Debtor in attorney fees and court-ordered sanctions from litigation with Ironridge Global and Ironridge IV exceeds $2 million. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶ 22.

In the Schneiderman Post-Petition Complaint, the Debtor also averred that, after filing the May 2014 securities fraud lawsuit and making several court filings under penalty of perjury in support of the litigation, on June 26, 2016 Schneiderman signed and gave to Ironridge a

diametrically-inconsistent affidavit stating that Scheiderman had did nothing wrong. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶ 22.

Further, in the Schneiderman Post-Petition Complaint, the Debtor averred that during Schneiderman's tenure as CEO, Main Avenue Pharmacy, Inc. (a direct subsidiary of the Debtor) permitted its marketers to "rubber-stamp" doctors' signatures on prescriptions for painkiller creams in the absence of a physician/patient relationship; effectively, Main Avenue Pharmacy became "a mill for the milking of millions of dollars in insurance monies." Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶ 29. In June 2016, a federal search warrant was executed at Main Avenue's premises in connection with a criminal investigation which, at the time of filing the Schneiderman Post-Petition Complaint, was ongoing. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.) at ¶ 32.

Through the Schneiderman Post-Petition Complaint, the Debtor is seeking damages due to, *inter alia*, Schneiderman's role in the Ironridge litigation and the demise of Main Avenue Pharmacy. Ettinger Decl. Ex. C (Schneiderman Post-Petition Compl.). Schneiderman has filed a motion to dismiss the Schneiderman Post-Petition Action or, in the alternative, to transfer venue of the action to this District; as of the date of filing of this Brief, Schneiderman's motion was pending. Ettinger Decl. Ex. D (*Schneiderman* E.D. Pa. Docket Entries).

The Debtor's position with respect to Schneiderman's actions were detailed in (i) a Form 8-K filed by the Debtor with the Securities and Exchange Commission dated June 27, 2016 (Ettinger Decl. Ex. E) and (ii) my September 7, 2016 declaration in support of the Debtor's initial filings in its bankruptcy case (Ettinger Decl. Ex. F).

Separately, Ironridge Partners and Ironridge IV have been subject to Securities and Exchange Commission scrutiny for the precise business model at issue in the Debtor's case. See

Ettinger Decl. Ex. G (Order instituting administrative and "cease and desist" proceedings dated 6/23/15). During 2012, the chapter 7 trustee for the estate of EPD Investment Company initiated a civil action in the United States Bankruptcy Court for the Central District of California against John Kirkland, the principal of Ironridge. Ettinger Decl. Ex. H (*Rund* complaint). In the latest version of the complaint, the chapter 7 trustee alleges that Kirkland, *inter alia*, made false and misleading statements to the Bankruptcy Court and breached his obligations as counsel to the debtor. Ettinger Decl. Ex. H (*Rund* complaint) at ¶ 32.

On November 4, 2016, the Debtor filed its motion to disband the Disbanded Committee or, alternatively, to remove Ironridge and Schneiderman from the Committee (the "Motion to Disband/Remove") [Docket No. 75]. In the Motion to Disband/Remove, the Debtor averred that Ironridge Partners and Schneiderman were unfit to serve as Committee members on various grounds discussed therein. Ettinger Decl. Ex. I (Debtor motion to disband/remove).

The Disbanded Committee was disbanded by the U.S. Trustee on January 11, 2017 [notice -- Docket No. 143]. Ettinger Decl. Ex. J (U.S. Trustee disbandment notice).

ARGUMENT

Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056, provides that "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a); *see* FED R. BANKR. P. 7056.

The moving party bears the burden of establishing the absence of a genuine dispute to a material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). When the nonmoving party bears the burden of persuasion at trial, the moving party "'may meet its burden . . . by showing that

the nonmoving party's evidence is insufficient to carry that burden.'" *Foulk v. Donjon Marine Co., Inc.,* 144 F.3d 252, 258 n.5 (3d Cir. 1998) (quoting *Wetzel v. Tucker,* 139 F.3d 380, 383 n.2 (3d Cir. 1998)).

Substantive law will determine which facts are material and only disputes over facts that might affect the outcome of the suit will preclude summary judgment. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). Moreover, a dispute over a material fact is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id; see also Delta Mills, Inc. v. GMAC Comm. Fin., LLC (In re Delta Mills, Inc.)*, 404 B.R. 95, 105 (Bankr. D. Del. 2009) (An issue is genuine "when reasonable minds could disagree on the result."). The Court must resolve all doubts and consider the evidence in the light most favorable to the nonmoving party. *See Anderson*, 477 U.S. at 255 ("the evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.").

A. The Disbanded Committee's Motion for Summary Judgment Should Be Denied Because the U.S. Trustee Is Authorized to Monitor a Section 1102(a)(1) Committee's Membership Post-Appointment, and the Power to Disband is Incident to that Authorization.

While the Bankruptcy Code admittedly does not contain an express provision stating that the U.S. Trustee and/or this Court have authority to disband an official committee formed under Code section 1102(a)(1), the Disbanded Committee's complaint and Motion completely miss the boat regarding the U.S. Trustee's power in this area.[1] The U.S. Trustee has the power to review committee membership post-formation of an official committee under section 1102(a)(1) incident to his statutory obligation to appoint the committee and, if the circumstances warrant, remove committee members from the panel. Such circumstances include potential conflicts of interest

[1] The Debtor has taken the position that this Court has the power to disband an official committee in this case. See Debtor's Motion to Disband/Remove [Docket No. 75, filed 11/4/2016]. This Court's power to disband is not directly at issue in the Disbanded Committee's declaratory judgment action, however.

and/or actual conflicts of interest which impair the committee member's ability to represent other unsecured creditors as part of the fiduciary body. *See* Roberta A. DeAngelis and Nan Roberts Eitel, *Committee Formation and Reformation: Best Practices*, AM. BANKR. INST. J. Vol. 30, No. 8 (Oct. 2011) at 20, 58-59.

Section 1102(a)(1) of the Bankruptcy Code provides:

> Except as provided in paragraph (3) [addressing "small business" debtors, which is inapplicable here], as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.

11 U.S.C. § 1102(a)(1).

Under 28 U.S.C. § 586(a)(3)(E), United States trustees "shall … supervise the administration of cases and trustees in cases under chapter 7, 11, 12, 13, or 15 of title 11 by, whenever the United States trustee considers it to be appropriate, monitoring creditors' committees appointed under title 11."

Recent legislative history of the committee appointment power breaks down into three periods: the pre-1986 amendments period; the post-1986 amendments, pre-BAPCPA period; and the present, or BAPCPA period. *See* Roberta A. DeAngelis and Nan Roberts Eitel, *Committee Formation and Reformation: Best Practices*.

During the first period – the pre-1986 amendments phase, and the "pilot" phase of the United States Trustee Program – "old" section 1102(c) gave the bankruptcy court the express authority to add or remove members. *See* DeAngelis and Eitel, *Committee Formation.*

Under the pre-1986 regime, there was some concern that the bankruptcy courts were placed in a position of conflict by "old" section 1102(c) by rendering decisions on positions taken by their hand-picked committees. *See* DeAngelis and Eitel, *Committee Formation.* Accordingly, the 1986

amendments – which established the United States Trustee Program on a nationwide basis, with the exception of the states of Alabama and North Carolina – eliminated "old" section 1102(c) and, by extension, terminated the bankruptcy courts' authority to appoint or modify committees. *See id.* The 1986 amendments took the responsibility of selecting official committee membership and assigned it to the United States trustees. *See id.*

The 1986 amendments created considerable confusion, however, regarding the ability of the courts to review decisions by United States trustees regarding Committee appointments. *See* DeAngelis and Eitel, *Committee Formation.* The majority of courts applied either an "arbitrary and capricious" standard or "abuse of discretion" standard to such decisions. *See id.* A minority of courts determined that they had the ability to review the United States trustees' decisions *de novo*. *See id.; see also In re Barney's, Inc.*, 197 B.R. 431, 438-40 (Bankr. S.D.N.Y. 1996).

The BAPCPA inserted section 1102(a)(4) into the Bankruptcy Code, which returned to bankruptcy courts certain power to review Committee membership

> On request of a party in interest and after notice and a hearing, the court may order the United States trustee to change the membership of a committee appointed under this subsection, if the court determines that the change is necessary to ensure adequate representation of creditors or equity security holders. The court may order the United States trustee to increase the number of members of a committee to include a creditor that is a small business concern (as described in section 3(a)(1) of the Small Business Act), if the court determines that the creditor holds claims (of the kind represented by the committee) the aggregate amount of which, in comparison to the annual gross revenue of that creditor, is disproportionately large.

11 U.S.C. § 1102(a)(4). On proper notice, this Court has the ability under section 1102(a)(4) to review the U.S. Trustee's decisions regarding official committee composition and to direct a change in an official committee's composition if necessary to ensure adequate representation.

BAPCPA did not disturb the power of United States trustees to monitor and adjust official committee membership post-formation. By extension, where there is an official committee

consisting of two (2) members, the proper exercise of the U.S. Trustee's authority in removing one or both members necessarily involves the incidental power to terminate the Committee's existence in those circumstances where he does not have sufficient interest to replace the removed member(s).

The Disbanded Committee's rushed complaint conflates two distinct questions: first, whether the U.S. Trustee has the authority to monitor and adjust official committee membership under Code section 1102(a)(1) post-formation of the committee; second, whether this Court is able to review the U.S. Trustee's decision(s) regarding official committee membership post-BAPCPA and, if it is, what the scope of (and the standard(s) governing) such review are. In order to deny the Disbanded Committee summary judgment, all this Court has to find is that the answer to the first question – whether the U.S. Trustee has the authority to remove committee members post-formation – is "yes." The answer to that question is that the U.S. Trustee undoubtedly has that authority.

B. The Debtor's Cross-Motion for Summary Judgment Should Be Granted Because the U.S. Trustee's Removal of Either/Both Disbanded Committee Members Was Proper Based Upon Undisputed Facts of Record.

This Court should grant summary judgment in the Debtor's favor because, given the record before the Court, there is no genuine issue of material fact as to whether the U.S. Trustee had a sufficient basis to remove either, or both, Disbanded Committee members.

In *In re VentureLink Holdings, Inc.*, 299 B.R. 420 (Bankr. N.D. Tex. 2003), a case remarkably similar to the case at bar, the United States trustee initially formed a five (5)-member committee which included a former insider of the Debtor (the "Insider") (specifically, a chairman of the board of directors of one of the debtors (Pacific USA Holding Corp., or "PUSA"), and either a director and/or officer of other debtors). *See VentureLink*, 299 B.R. at 421-22. The Debtors

made a request to remove the former insider and other committee members, and the United States trustee responded by expanding the committee membership to eight (8) members. *See id.* at 422. Prior to the debtors' bankruptcy filings, the Insider had sued PUSA and its attorneys on a host of grounds, including breach of contract (with regard to PUSA) and breach of fiduciary duty (with regard to the attorneys). *See id.* at 422. PUSA responded by filing counterclaims against Insider for breaches of fiduciary duty and misappropriation of more than $10 million of assets for Insider's personal use. *See id.* In response to the challenge to his remaining on the official committee, Insider argued that it is not unusual for creditors seated on the committee to have disputes with the debtor(s) and that his being "walled off" from committee business pertaining to his claims would resolve the matter. *See id.*

The *VentureLink* court determined that the United States trustee's decision to leave Insider on the official committee would be reviewed under an "arbitrary and capricious" standard, and that it was the moving parties' (the debtors') burden to establish that the United States trustee's refusal to remove Insider from the committee was arbitrary and capricious. *See VentureLink,* 299 B.R. at 423-24. The court sided with the debtors and concluded that the official committee had to be free from both conflicts of interest that would amount to breaches of fiduciary duty as well as the mere appearance or potential for such conflicts. *See id*. at 424; *see also* DeAngelis and Eitel, *Committee Formation* at 58 ("When soliciting creditors, U.S. Trustees seek to elicit information sufficient to evaluate a creditor's eligibility to serve while avoiding appointments of those unsuited or unqualified for service. In addition to considering the size and nature of the creditor's claim, U.S. Trustees seek to determine whether a candidate for committee membership *has a potentially disqualifying conflict or status*.") (emphasis added).

In commenting on Insider's disputes with the debtors' estates, the *VentureLink* court observed:

> PUSA's claims against Horner amount to more than a typical creditor-debtor dispute. PUSA's claims implicate fundamental principles of corporate governance, and directly challenge Horner's exercise of his fiduciary duties while chairman of PUSA's board of directors. Horner concedes that he received millions of dollars from the debtors within two years of the debtors' demise. Horner says he committed no breach of fiduciary duty, but, to the contrary, Horner asserts that PUSA owes him several million dollars more. Horner argues that PUSA and its corporate attorneys knew and approved of the transfers.
>
> *****
>
> The court hastens to observe that it makes no assessment of the merits of the debtors' claims against Horner. Rather, the very nature of the claims compels the conclusion. The very nature of the claims creates the disqualifying conflict.

VentureLink, 299 B.R. at 423. In short, assuming that this Court has the authority post-BAPCPA to review the U.S. Trustee's decisions pertaining to official committee appointments, the Debtor's disputes with Schneiderman closely parallel the estates' disputes with Insider in *VentureLink*. The allegations made by the Debtor in the Schneiderman Post-Petition Action go beyond a typical commercial dispute over nonpayment; the Debtor's allegations go to the precise causes of why the Debtor finds itself under bankruptcy protection. Certainly, a decision by the U.S. Trustee to remove Schneiderman from the Committee would be well within – and a proper exercise of – the U.S. Trustee's discretion.

The removal of Ironridge Partners from the Disbanded Committee by the U.S. Trustee would also be justified. John Kirkland, a principal of Ironridge Partners, is presently a defendant in an action brought by a chapter 7 trustee in the Central District of California alleging that Kirkland, *inter alia*, made false and misleading statements to the Bankruptcy Court and breached his obligations as counsel to the debtor. The U.S. Trustee certainly would have acted within his discretion, and not arbitrarily or capriciously, if he removed Ironridge Partners from the Committee

while the *EPD Investment Company* litigation was pending, given that the allegations in that litigation directly implicate whether Kirkland and, by extension, the firm he controls is fit to serve in a fiduciary capacity. Further, the administrative action taken by the Securities and Exchange Commission with respect to Ironridge Partners and Ironridge IV supports the U.S. Trustee's decision.[2]

CONCLUSION

WHEREFORE the Debtor requests that this Court (i) deny the Disbanded Committee's Motion, (ii) grant the Debtor's Cross-Motion, and (iii) grant such further relief which the Court deems appropriate.

Dated: February 3, 2017
Wilmington, Delaware

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[2] A hearing in the SEC's administrative action against Ironridge Partners and Ironridge IV, File No. 3-16649, is presently scheduled for February 21, 2017.