UNITED STATES BANKRUPTCY COURT

DISTRICT OF DELAWARE

In re) Case No. 01-01430
) Chapter 7
WINSTAR COMMUNICATIONS, INC.,)
et al.,)
Debtors.)
)
)
CHRISTINA C. SHUBERT, CHAPTER 7) Adversary Proceeding No. 01-01063
TRUSTEE OF WINSTAR)
COMMUNICATIONS, INC., and)
WINSTAR WIRELESS, INC.,)
)
Plaintiff,)
)
vs.)
)
LUCENT TECHNOLOGIES, INC.,)
)
Defendant.)
)
)

DO NOT PUBLISH

OPINION CONCERNING MOTION TO DISMISS SECOND AMENDED COMPLAINT

I. INTRODUCTION

This is a bankruptcy adversary proceeding. Rule 7001, Fed. R. Bankr. P. The original complaint was filed by Plaintiffs Winstar Communications, Inc., (Winstar) and Winstar Wireless, Inc., (Wireless), then chapter 11 debtors in possession in the underlying reorganization case.

After the case was converted to a liquidating bankruptcy under chapter 7 of the Bankruptcy Code, the chapter 7 trustee, Christina C. Shubert, was substituted for the debtors, as plaintiff.

Defendant Lucent Technologies, Inc., (Lucent) moves for dismissal of most of the relief sought in the Second Amended Complaint.

Winstar and Wireless filed voluntary petitions for relief under chapter 11 on April 18, 2001. The complaint in this adversary proceeding was filed on the same day. Discovery was expedited. Twenty-one depositions were taken, and hundreds of thousands of pages of documents were produced.

Winstar and Wireless filed an amended complaint on October 26, 2001.

On January 24, 2002, the reorganization case under chapter 11 was converted to a liquidating bankruptcy under chapter 7.

By order of July 15, 2002, the chapter 7 trustee was allowed to file a second amended complaint, provided that such document shall be the last amendment to the complaint in this matter.[1]

The second amended complaint, the subject of the current motion to dismiss, was filed on September 27, 2002. This complaint seeks 'compensatory' and punitive damages for Defendant's alleged breaches of contracts with the debtors, damages for breaches of implied covenants of good faith and fair dealing, equitable subordination, and the avoidance of a preferential transfer.

Defendant's motion seeks dismissal of requests for: 'consequential' damages - Counts One through Seven and Count Nine; punitive damages - Counts Three and Nine; any damages related

[1] The order was electronically filed as docket no. 66, but was not signed by the judge to whom this adversary proceeding was then assigned. It is believed that the parties do not question the effectiveness of the order.

to alleged breach of covenants of good faith and fair dealing - Count Nine; the avoidance of a preferential transfer - Count Ten; equitable subordination - Count Eleven; and damages for breach of a contract known as the Master Service Agreement (MSA) - Count Eight.

II. FACTS

This is a summary of the relevant allegations of the 62-page second amended complaint.

Winstar provided high-speed voice, data and Internet services to businesses. Its use of wireless technology, in addition to fiber wiring, was thought to give Winstar a competitive advantage in the marketplace in terms of cost and speed of deployment, plus the ability to deliver broadband capacity.

In 1998, Winstar sought funding for its attempt to use its advanced technology to create one of the world's most widely available networks. At that time, financial markets had deteriorated, so Winstar sought a 'strategic partner' capable of providing two things: long term financing and the building out of Winstar's anticipated global network. Such assistance from the strategic partner would enable Winstar to focus on operations and marketing.

Starting in October, 1998, Winstar and Lucent entered into a series of agreements, the Network Agreements which, in Plaintiff's view, established the strategic partnership. Lucent agreed to provide $2 billion in financing and to build, on a turnkey basis, Winstar's global telecommunications network.

For purposes of this litigation, important features of the main contracts are (1) New York choice of law provisions, and (2) liability limitation clauses, precluding claims for indirect, consequential, special or punitive damages.

The relationship between the parties started smoothly, but a change in management personnel at Lucent, coupled with an alleged decline in Lucent's financial position, led Lucent to conclude that performance by Lucent of the Winstar agreements was not in the best interests of Lucent. Accordingly, while leading Winstar to believe that Lucent's performance would continue, Lucent determined to and did discontinue its compliance with the terms and spirit of the agreements.

As Winstar's problems with Lucent grew, Winstar's financial situation became increasingly desperate. Winstar hoped to alleviate some of its problems when, in December, 2000, it was able to obtain a $200 million loan from Siemens Financial, as senior secured debt. Of those funds, $194 million was pre-paid to Lucent on account of sums owing, but not yet due. The pre-payment was made in anticipation of continued performance by Lucent. The payment to Lucent was made several days outside of the 90 day preference avoidance window of 11 U.S.C. § 547(b)(4)(A), but within the one year reach-back period for the avoidance of preferential transfers . to insiders in § 547(b)(4)(B).

Winstar's expectation that Lucent would use the prepaid $194 million for the benefit of the strategic partnership was disappointed. Lucent did not apply those funds in a way that would be helpful to Winstar.

From Plaintiff's perspective, the final blow came in March and April, 2001, when Lucent's refusal to make certain payments to Winstar rendered Winstar unable to make a scheduled April 16, 2001 interest payment on its bonds, triggering a default on $1.6 billion of bond debt and creating cross-defaults on $1.3 billion of outstanding secured debt. The voluntary chapter 11 petitions of Winstar and Wireless followed two days later, on April 18, 2001.

III. DISCUSSION

Defendant moves to dismiss pursuant to Fed. R. Bankr. P. 7012, which incorporates Fed. R. Civ. P. 12. In a Rule 12(b)(6) motion, the court must accept all facts alleged in the complaint to be true, draw all reasonable inferences in the light most favorable to the plaintiff, and dismiss the complaint only if no relief could be granted under any set of facts the plaintiff could prove. Green v. America Online (AOL), 318 F. 3d 465, 470 (3d Cir. 2003).

The parties agree that relevant contract law is the law of the State of New York.

A. CONSEQUENTIAL DAMAGES

Two issues are presented by Defendant's motion to dismiss the portions of the complaint seeking to recover consequential damages: First, does the second amended complaint seek recovery of consequential damages? Second, are the contractual provisions excluding liability for consequential damages enforceable under the law of the State of New York?

Different kinds of contract damages are "well defined", but the application of the definitions to specific contracts is "usually more elusive." American List Corp. v. U.S. News & World Report, Inc., 549 N.E.2d 1161, 1164 (N.Y. 1989). General or direct contract damages compensate a plaintiff for the value of the promised performance. Consequential or special contract damages compensate a plaintiff for additional losses that are incurred as a result of the defendant's breach. Schonfeld v. Hilliard, 218 F.3d 164, 175-76 (2d Cir. 2000).

Plaintiff denies that the Second Amended Complaint seeks consequential damages. (Memorandum in Opposition to Motion to Dismiss, p. 24) However, examples of requests for consequential damages are not hard to find. For example, it is alleged in Count One that Lucent's breach of its financing obligation in the Supply Agreement "would severely harm the Winstar entities, and prevent them from meeting their obligations to Winstar's bondholders." (Second Amended Complaint, ¶ 157) Similarly, in Count Three, "Due to Lucent's unlawful termination of the Supply Agreement, the Winstar Entities were unable to continue the build-out of their network, and suffered extensive harm to their businesses for which Lucent is liable in damages." (Second Amended Complaint, ¶ 168)

These allegations are broad enough to encompass both direct and consequential damages. Therefore, it must be assumed that the Second Amended Complaint seeks the recovery of consequential damages.

The next issue is whether the damage limitation clauses, precluding recovery of consequential damages, are effective.

Three of the agreements contain damage limitation provisions, the October 21, 1998, Supply Agreement (Counts One through Four); the "early 1999" (Second Amended Complaint, ¶68) Subcontract, titled "Agreement for Network Build-Out Services" (Count 7); and the May 4, 2000, Second Credit Agreement (Counts Five and Six).

The damage limitation provisions are:

> "IN NO EVENT, WHETHER IN CONTRACT OR IN TORT(INCLUDING BREACH OF WARRANTY, NEGLIGENCE AND STRICT LIABILITY IN TORT), SHALL A PARTY BE LIABLE FOR INDIRECT ON CONSEQUENTIAL, EXEMPLARY, PUNITIVE OR SPECIAL DAMAGES EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES IN ADVANCE." Supply Agreement, § 16.2(a).
>
> "IN NO EVENT WILL EITHER PARTY BE LIABLE FOR SPECIAL, INDIRECT, INCIDENTAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, EVEN IF IT HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. EACH PARTY'S

> MAXIMUM LIABILITY TO THE OTHER UNDER THIS AGREEMENT SHALL BE THE RECOVERY OF ACTUAL DAMAGES UP TO THE AMOUNT PAYABLE BY LUCENT UNDER THE APPLICABLE TASK ORDER SUBJECT OF THE CLAIM." Subcontract, § 5.
>
> "To the extent permitted by applicable law, neither the Parent nor any Borrower shall assert, and each of them hereby waives, any claim against any Indemnitee, on any theory of liability for special, indirect, consequential or punitive damages (as opposed to direct or actual damages) arising out of, in connection with, or as a result of, this Agreement or any agreement or instrument contemplated hereby, the Transactions, any Loan or the use of the proceeds thereof." Second Credit Agreement, § 9.03(d).

Damage limitation clauses applicable to consequential damages are enforceable under New York law, and allegations that the consequential damages were caused by the defendant's self-interest or bad faith will not render such clauses ineffective. Metropolitan Life Insurance Company v. Noble Lowndes International, Inc., 643 N.E.2d 504, 509 (N.Y. 1994).

The classification of damages as consequential, actual, direct, or something else, is ordinarily a fact issue, not a pleading issue. McNally Wellman Co. v. New York State Elec. & Gas Corp., 63 F.3d 1188, 1195 (2d Cir. 1995). Plaintiff should be permitted to present proof of damages at trial, and the court can then apply the proper classification. See, e.g., United States, ex rel. Roby v. Boeing Co., 79 F. Supp.2d 877, 894-95 (S.D. Ohio 1999). Accordingly, no attempt will be made in ruling on this motion to dismiss, to classify the damages allegedly suffered by Winstar and Wireless.

The Second Amended Complaint does seek to recover consequential damages, and the damage limitation provisions are valid and enforceable under New York law. Therefore, the motion to dismiss claims for consequential damages will be granted as to all counts. The classification of damages will be a proof issue for another day. Classification of damages will not be a discovery issue. The court will not entertain objections to discovery, which are based on a party's position that the question to be answered or the document to be produced relates to consequential damages. As noted above, the classification of damages is a proof issue. It is not a discovery issue.

B. PUNITIVE DAMAGES

Two opinions of the New York Court of Appeals have limited the availability of punitive damages in breach of contract cases. Those cases are Rocanova v. Equitable Life Assurance Society of the United States, 634 N.E.2d 940 (N.Y. 1994) and New York University v. Continental Insurance Co., 662 N.E.2d 763 (N.Y. 1995). "Punitive damages are not recoverable for an ordinary breach of contract as their purpose is not to remedy private wrongs but to vindicate public rights. However, where the breach of contract also involves a fraud evincing a 'high degree of moral turpitude' and demonstrating 'such wanton dishonesty as to imply a criminal indifference to civil obligations', punitive damages are recoverable if the conduct was 'aimed at the public generally.'" Rocanova, 643 N.E.2d at 613 (citations omitted).

According to New York University, the pleading elements required to state a claim for punitive damages as an additional and exemplary remedy when the claim arises from a breach of contract are: (1) defendant's conduct must be actionable as an independent tort; (2) the tortious conduct must be of the egregious nature set forth in Walker v. Sheldon, 179 N.E.2d 497 (N.Y. 1961), (3) the egregious conduct must be directed to plaintiff; and (4) the conduct must be part of a pattern directed at the public generally. 662 N.E.2d at 767.

The Second Amended Complaint fails to meet any of these requirements. The essential conduct alleged includes breaches of contracts, inducing prepayment of a debt, and failure to disclose Lucent's true intent to get out of its contractual relationships with the Winstar entities.

First, there is no pleading of an independent tort. The closest allegation claims, in general terms, fraudulent inducement of prepayment of an admitted debt. Taking the allegation to be true, for purposes of this motion to dismiss, it is not independent of the contract which created Plaintiff's indebtedness to Defendant.

Second, Defendant's conduct, as alleged in the Second Amended Complaint, is not 'egregious'. The term 'egregious' as used in New York cases, means criminal or quasi-criminal behavior. In Walker v. Sheldon, supra, the complaint in a fraud and deceit action charged that defrauding the general public into entering publishing contracts was the very basis of the defendant's business. 179 N.E.2d at 500. While punitive damages have been refused in the 'ordinary' fraud and deceit case, recovery is available in a fraud and deceit case where the defendant's conduct evinces a high degree of moral turpitude and demonstrates such wanton dishonesty as to imply a criminal indifference to civil obligations. 179 N.E.2d at 498-99. The conduct attributed to Lucent in the Second Amended Complaint does not rise to this level. New York cases that have allowed attempts to recover punitive damages in 'egregious' situations, including those of an elderly widow whose jewelry was taken by the defendant (Muhlfield v. Bak, 664 N.Y.S.2d 427 (N.Y. Sup. Ct. 1997)); and a fired whistle-blower, who was fired after discovering and reporting the laundering of drug money at a brokerage house, his former employer (Mulder v. Donaldson, Lufkin & Jenrette, 623 N.Y.S.2d 560 (N.Y. App. Div. 1997)), do not undermine this conclusion. Those cases, instead, demonstrate that 'egregious' behavior must be criminal or something very close to it.

Finally, Lucent's conduct is not sufficiently alleged to be part of a pattern of conduct directed at the public generally. First, there is no pattern of conduct. The unsupported general statement that there was a pattern of conduct harmful to Winstar and other companies dependent on Lucent's vendor financing commitments is insufficient for the third complaint in this lawsuit. This is the first complaint filed by the bankruptcy trustee, but there must be some substance to the charge, in order to overcome a motion to dismiss.

Second, Lucent's interest in terminating the contracts was directed at Winstar and Wireless, not at the public generally. Plaintiff suggests that the requirement of action contrary to the public interest is met because of the interest of public investors in Winstar's stock and the even broader public interest in free competition in telecommunications. This suggestion is not supported by case law. In the cases, as demonstrated by the cases cited above, the plaintiff seeking punitive damages is a member of the public class being victimized by defendant's conduct. In the present case, Winstar's stockholders and the members of public who use telecommunications are not plaintiffs, and any damages inflicted upon Winstar or Wireless did not injure those corporations as members of the public. The conduct of Defendant was directed toward the Winstar entities, and some potential residual impact upon the investing public and end users of telecommunications is too remote to convert these parties' disputes into "conduct directed at the public generally."

Defendant's motion to dismiss will be granted as to any request for punitive damages in the Second Amended Complaint.

C. THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

Count Nine of the Second Amended Complaint seeks both compensatory and punitive damages for acts of Defendant, which are alleged to be in violation of the implied covenant of good faith and fair dealing.

The alleged violations of the implied covenant are numerous. For ease of reference, the two charging paragraphs of Count Nine are quoted in full text:

> "190. The Winstar Entities fulfilled their duties of good faith and fair dealing. Since the summer of 2000, however, Lucent repeatedly and consistently acted in violation of its duty of good faith and fair dealing to the Winstar Entities by, among other things:
>
> (a) refusing to finance the services that Winstar Wireless was performing in Lucent's stead, in clear and knowing violation of its obligations under the Supply Agreement and the parties' long standing practice, and with full knowledge of the severe impact that its decision would have on Winstar;
>
> (b) refusing, without cause, to perform those same services as it had agreed to do in the Supply Agreement and further committed to doing in its September 2000 correspondence to Winstar;
>
> (c) refusing to issue a purchase order to Winstar Wireless for those services in a badly disguised effort to avoid paying for them;
>
> (d) refusing to apply approximately $47 million in credits it had agreed to provide as a remedy for its own failures in performance;
>
> (e) issuing a refinancing notice when it knew that Winstar did not have the ability to refinance the entire Lucent loan, and that it would be unable to exercise its conversion rights thereunder, and for the sole purpose of obtaining unfair advantage and leverage over Winstar;
>
> (f) demanding drastic and draconian changes to the parties' contractual relationship as an implied condition of fulfilling its own contractual obligations under the Network Agreements;
>
> (g) refusing to abide by the Hubs and Business Sites pricing to which it had agreed;
>
> (h) promising Winstar that the $194 million it paid to Lucent in December 2000 would remain available to Winstar under the Lucent credit facility, and then reneging on that commitment;

(i) fraudulently inducing Winstar to prepay its debt by misrepresenting to Winstar that if Winstar procured additional financing, Lucent would perform its obligations, compelling Winstar to obtain and turn over such funds, and then nevertheless breaching the Network Agreements;

(j) refusing to relinquish or waive its conversion rights when it knew those rights to be worthless and had no intention of exercising them, and when it knew that its refusal was severely damaging Winstar;

(k) concealing from Winstar and potential investors the fact that it had no intention of exercising its conversion rights;

(l) failing to take any action in the financial markets to quell damaging rumors regarding Lucent's support for Winstar;

(m) refusing to consider at any time the impact of its actions on Winstar, and by acting with direct knowledge of, and disregard for, the harm to Winstar that it knew itself to be committing;

(n) fabricating pretextual reasons for refusing to finance, and for terminating, the Network Agreements, in March and April 2001; and

(o) foisting unjustified demands upon Winstar that had no basis in the parties' contracts.

191. Upon information and belief, Lucent concealed its plans to abandon the Network Agreements and continued to induce the Winstar Entities to negotiate with Lucent, and to carry on the network build-out, even though it had no intention of proceeding with a transition agreement or of fulfilling its obligations under the Network Agreements."

Both parties agree that New York law imposes an implied covenant of good faith and fair dealing on all contracts. Nevertheless, Defendant presents a threefold argument in support of dismissal of Count Nine: (1) allegations that duplicate other breach of contract claims should be dismissed; (2) the implied covenant cannot impose additional duties, which are inconsistent with the express contract terms; and (3) the implied covenant cannot be imposed beyond the scope of the contracts.

1. Duplication of Other Breach of Contract Claims

Defendant's memorandum in support of this motion, pages 16 - 18, provides a side-by-side comparison of how ¶¶ 190(a), (b), (c), (d), (i), (n) and 191 duplicate breach of contract claims in other counts of the Second Amended Complaint. Where a claim for breach of the implied covenant involves conduct which is also alleged in a breach of contract claim or count, the claim for breach of the implied covenant will be dismissed. Sauer v. Xerox Corp. 95 F. Supp.2d 125, 131 (W.D.N.Y. 2000); New York University v. Continental Insurance Co ., 87 N.Y.2d 308; 319, 662 N.E.2d 763 (N.Y. 1995).

The claims, of course, need not be word for word. In the Second Amended Complaint, there is sufficient duplication between claims for breach of contract and breach of the implied covenant, that ¶¶ 190(a), (b), (c), (d), (i), (n) and 191 will be dismissed.

2. Additional Duties Inconsistent with Express Contract Terms

Three of Plaintiff's implied covenant claims, ¶¶ 190(e), (h) and (j), fail to state a claim, because Plaintiff seeks to impose new duties on Defendant, in conflict with the express terms of the contracts. The principal flaw in Plaintiff's arguments is the failure to distinguish between Defendant's contractual and Defendant's contractual duties. The implied covenant does not impose limits on the exercise by a party of its contractual rights.

In ¶ 190(h), Plaintiff argues that when Defendant induced Winstar to pre-pay $194 million owing to Defendant, Defendant breached the implied covenant by not making those funds available to Winstar. The allegations in ¶¶ 190 (e) and (j) deal with Defendant's issuance of a refinance notice, which would require Winstar to make a partial repayment under the Credit Agreement, and with Defendant's failure to relinquish or waive certain conversion rights. All three of these sub-paragraphs in the Second Amended Complaint seek to impose duties upon

Defendant that are not in the contracts, a misuse of the implied covenant. Defendant was entitled to, and did, exercise its express contractual rights.

The implied covenant "cannot be used to insert new terms that were not bargained for . . . ." Lorenz v. CSX Corp., 1 F.3d 1406, 1415 (3d Cir. 1993) (applying New York law). "The parties' contractual rights and liabilities may not be varied, nor their terms eviscerated, by a claim that one party has exercised a contractual right but has failed to do so in good faith." Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R. 438, 509 (S.D.N.Y. 1994) (quoting National Westminster Bank U.S.A. v. Ross, 130 B.R. 656, 679 (S.D.N.Y. 1991), aff'd, 962 F.2d 1 (2d Cir. 1992).

Travellers International, A.G. v. Trans World Airlines, Inc., 41 F.3d 1570 (2d Cir. 1994), is not helpful to plaintiff's position, for it concerned the requirement of good faith exercise of a contractual duty, not a contractual right. That case dealt with a contract which called for TWA to generate tour clientele by producing and distributing promotional brochures. The court stated that the implied covenant was not being "invoked to create a new obligation, but to measure compliance with an explicit contract obligation . . . ." 41 F.3d at 1576.

Defendant's motion to dismiss will be granted as to ¶¶ 190(e), (h), and (j), which seek to impose duties upon Defendant, which duties are inconsistent with Defendant's contractual rights.

3. The Implied Covenant Cannot Impose Additional Duties, Beyond the Contract Terms

Defendant argues that paragraphs 190(f), (g), (k), (l), (m), (o) and 191 must be dismissed, because they seek to impose the implied covenant beyond the scope of the relevant contracts.

Defendant is correct. Paragraphs 190(f), (g), (o) and 191[2] deal with Defendant's efforts to negotiate changes in the existing or future contracts. For example, in Village on Canon v. Bankers Trust Co., 920 F. Supp. 520 (S.D.N .Y. 1996), the court rejected a good faith and fair dealing claim, where the plaintiff alleged that the defendant failed to negotiate a loan extension in good faith. Absent a preliminary agreement to negotiate in good faith, "there is no duty to negotiate in good faith that can be enforced against a party to the negotiations." 920 F. Supp. at 535.

Paragraphs 190(k) and (l) suggest that Defendant should have provided information to potential investors and financial markets, in support of Winstar. These suggested duties are not in the contracts, so Winstar was not denied any contractual 'fruits' for which it might have bargained. Plaintiff is not entitled to use the implied covenant of good faith and fair dealing to create additional benefits for which Winstar did not bargain. Metropolitan Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1519 (S.D.N.Y. 1989).

Paragraph 190(m) is a general complaint that Defendant refused to consider the negative impact upon Winstar of Defendant's conduct. Plaintiff offers no support for the proposition that Defendant's general state of mind or acting in its own self-interest is an actionable breach of the implied covenant.

Defendant's motion to dismiss Count Nine of the Second Amended Complaint will be granted.

D. PREFERENTIAL TRANSFER

[2] Paragraph 191 is also subject to dismissal for duplication of breach of contract claims. See p. 13, supra.

Count Ten of the Second Amended Complaint seeks to recover the $194 million paid to Defendant by Winstar, in December, 2000. That payment is alleged to have been preferential and avoidable under 11 U.S.C. §547. For purposes of this motion to dismiss, the only issue is whether or no Lucent was an 'insider' at the time of the payment.

The transfer was made more than ninety days, but less than one year before the filing Winstar's bankruptcy petition. Therefore, an essential element of Plaintiff's case is to prove that Lucent was an insider. 11 U.S.C. §547 (b)(4)(B). The term 'insider' is defined in § 101(31), and includes a person in control of a corporate debtor. § 101(31)(B)(iii). Lucent, a corporation is a 'person' for bankruptcy code purposes. § 101(41).

The definition of an insider is inclusive, so Plaintiff is not limited to the examples given in the Bankruptcy Code. Paragraph 198 of the Second Amended Complaint alleges that Defendant was an insider for Bankruptcy Code purposes, by reason of its being a 'person in control.' The 'control' allegation is based upon Defendant's financial domination of the Winstar entities, critical position as turnkey agent for the build out of Winstar's global network, close relationship as Winstar's strategic partner, leverage as Winstar's only significant source of financing, and as a supplier of critical goods and services. Lucent argues that 'control' means managerial or operational control, as opposed to leverage or financial power. Plaintiff's reply is that while a person in control is a per se insider by virtue of the statutory definition, that it is appropriate to look at the totality of the circumstances of the particular case before deciding the 'insider' issue.

The issue is 'insider' status, which may be broader than having 'control'. The allegations of strategic partnership and turnkey responsibilities, among others, may be sufficient to establish insider status. The concept of 'strategic partnership' is not, in this lawsuit, to be confused with a traditional partnership, in which parties engage in a business venture, with an understanding that they will share the profits and losses. Winstar's global network, if and when completed, was to belong to Winstar. Lucent's responsibilities were to provide financing and build-out services.

Establishing insider status for Defendant may be a hurdle which Plaintiff cannot clear, for the duties of strategic partners toward one another would not be at the level of general partners. Nevertheless, there should be an opportunity to present its proof on this novel issue. The motion to dismiss Count Ten of the Second Amended Complaint will be denied.

E. EQUITABLE SUBORDINATION

Section 510(c) authorizes a bankruptcy court to use principles of equitable subordination to subordinate one claim to another claim, for purposes of distribution. In other words, equitable subordination is a device for the use of equitable principles to establish priority of payment.

Count Eleven of the Second Amended Complaint seeks to expand equitable subordination into a new trustee's avoiding power. Paragraph 205 of the Second Amended Complaint asserts that in order "to return the parties to the status quo, Lucent must be compelled to return the Siemens loan proceeds to the estate". The 'Siemens loan proceeds' is the same $194 million that Count Ten seeks to recover as an avoidable preference in Count Ten.

The Bankruptcy Code expressly gives to bankruptcy trustees the power to avoid certain pre-petition transactions, including unperfected security interests (§ 544), preferential payments (§ 547), and fraudulent transfers (§ 548). The use of equitable subordination to recover pre-petition payments to creditors is not to be found in the Bankruptcy Code.

Plaintiff cites no meaningful authority in support of its position. Section 105(a) does not authorize a court to fabricate new, non-statutory avoiding powers. The only case supporting Plaintiff, In re Carolee's Combine, Inc., 3 B.R. 324 (Bankr. N.D.Ga. 1980), was decided under the former Bankruptcy Act, and has no support in subsequent cases or in the present Code. Section 510(c) equitable subordination is, by its terms, a device for establishing priority between or among creditors and nothing more.

The motion to dismiss Count Eleven of the Second Amended Complaint will be granted. This result is to be in respectful disagreement with Carolee's Combine, Inc., supra.

F. BREACH OF THE MASTER SERVICE AGREEMENT

The Second Amended Complaint adequately states a claim for breach of contract and damages. There are issues of fact concerning Defendant's entitlement to terminate the contract and the amount of damages, if the termination by Defendant was a matter of breach. However, those are not issues for determination in the context of a motion to dismiss.

The motion to dismiss Count Eight will be denied.

G. CONCLUSION

For the reasons stated above, Lucent's motion to dismiss will be granted in part and denied in part. An order will be entered denying Defendant's motion to dismiss, as to Count Eight - Breach of the Master Service Agreement, and Count Ten - Recovery of Preferential Transfers. The balance of the motion will be granted.

May 29, 2003

Lloyd King

Lloyd King
United States Bankruptcy Judge