IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

THE LITIGATION TRUST OF MDIP, INC. (formerly known as Mosler, Inc.) AND ITS AFFILIATES AS ASSIGNEE OF CERTAIN CLAIMS PURSUANT TO THE SECOND AMENDED JOINT PLAN OF LIQUIDATION OF MDIP, INC. AND ITS AFFILIATES,	)	Civil Action No. 03-779-GMS
Plaintiffs,	)	
MICHAEL RAPOPORT, *et al.*,	)	
Defendants.	)	

MEMORANDUM

I. INTRODUCTION

Presently before the court are six motions: a motion to dismiss Counts I and II of the Amended Complaint for lack of subject matter jurisdiction (D.I. 67), a motion for partial summary judgment as to Counts I and II (D.I. 84), a motion to strike the plaintiff's summary judgment affidavits (D.I. 114), a motion to strike the plaintiff's jury demand (D.I. 127), a motion *in limine* requesting the court to exclude evidence and testimony not disclosed in plaintiff's responses to contention interrogatories (D.I. 124), and a motion *in limine* requesting the court to preclude evidence of events that took place prior to August 6, 1998 (D.I. 125). For the following reasons, the court will grant the motion to dismiss Counts I and II, and deny the remaining motions as moot insofar as they pertain to Counts I or II.

II. STANDARD OF REVIEW

A motion to dismiss under Federal Rule of Civil Procedure 12(b)(1) may present either a facial or factual challenge to subject matter jurisdiction. *Mortensen v. First Fed. Sav. and Loan*

Ass'n, 549 F.2d 884, 891 (3d Cir. 1977). The present motion presents a facial challenge to the complaint because the jurisdictional facts are not in dispute. Such a motion requires the court to consider the allegations of the Amended Complaint as true and to make all reasonable inferences in the plaintiff's favor. *See id.*

III. BACKGROUND

The following facts are alleged in the Amended Complaint, which the court assumes to be true for the purpose of deciding this motion. Mosler, Inc. ("Mosler"), a Delaware corporation, traces its roots back to 1867, when the Mosler-Bahmann Safe Company was founded by Gustav Mosler. (D.I. 28 ¶ 17.) From 1967 to 1990, Mosler went through a series of buyouts that ultimately resulted in 59% of Mosler's stock being held by Kelso & Co., Inc. ("Kelso") and a few of Mosler's senior managers. (Id. ¶¶ 21-23.) This permitted Kelso to "install" defendants William Marquard, Thomas Wall, and Robert Young (collectively, "the Kelso Directors") on Mosler's Board of Directors. (Id. ¶ 2.) During its first few years under this ownership structure, Mosler flourished – its sales increased every year from 1992 to 1995. (Id. ¶ 26.)

Then, in February 1995, Mosler's Chairman and CEO sent a memo to the Kelso Directors requesting their "concurrence to" the hiring of Michel Rapoport as the next CEO, "which [is] consistent with our succession planning." (Id. ¶ 27.) However, succession planning had not been discussed at either of the two board meetings prior to February 1995, and the memo contained minimal information regarding Rapoport himself. (Id. ¶¶ 28-30.) Although no alternative candidates were considered, the inexperienced and unqualified Rapoport was hired as Mosler's CEO. (Id. ¶¶ 31-33.) Mosler subsequently entered a period of decline, precipitated by "numerous reckless and misinformed decisions" and mismanagement by Rapoport and the Kelso Directors. (Id.

¶ 35.)

For example, in October 1998, Mosler acquired a security equipment business known as LeFebure. (Id. ¶ 36.) However, during the acquisition process, Rapoport failed to hire outside consultants to assist with due diligence and valuation. Instead, he relied upon numbers provided by LeFebure's parent company, De La Rue,[1] and by Mosler's internal personnel. (Id. ¶ 39.) Furthermore, the Kelso Directors did not inform themselves as to the adequacy of Rapoport's due diligence and valuation. (Id. ¶ 41.) Then, at a special meeting of Mosler's Board in September 1998, the LeFebure acquisition was approved. This occurred in spite of the fact that no tangible information concerning the acquisition was provided to the Kelso Directors; the minutes of the special meeting merely reflect "extensive discussion" about the acquisition. (Id. ¶ 40.) As it turned out, De La Rue overstated LeFebure's financial condition and, as a result, Mosler "grossly overpaid" for LeFebure. (Id. ¶ 42.)

The subsequent integration of LeFebure's business did not go well either. Without any objection from the Kelso Directors, Rapoport fired many key LeFebure employees who were essential to the integration process. (Id. ¶¶ 43-44.) Consequently, "many of the former LeFebure accounts were understaffed and poorly serviced, and Mosler had significant difficulty synchronizing LeFebure's business practices with its own, further minimizing the benefits that Mosler recognized from the LeFebure Acquisition." (Id. ¶ 43.) Rapoport and the Kelso Directors also failed to heed specific warnings, given to them before the acquisition, pertaining to "systems issues that would arise from the need to integrate LeFebure's systems with Mosler's," resulting in a "serious

---

[1]The precise details of the relationship between LeFebure and De La Rue are not set forth in the complaint, but those details are unimportant here.

deterioration of Mosler's liquidity." (Id. ¶ 45.)

Then in 1999, Mosler attempted to update the software it used to process orders, collect accounts receivable, etc. (Id. ¶ 46.) Rapoport and the Kelso Directors were advised by Mosler's in-house IT employees, among others, that outside specialists would be required for a project of this type. (Id. ¶ 47.) Nevertheless, Rapoport did not hire outside specialists, and without objection from the Kelso Directors, endeavored to complete the project using only Mosler's in-house IT employees. (Id. ¶ 48.) But because these employees were not qualified to make the updates, the project became "a disaster." Thereafter, Mosler was unable to "timely and accurately invoice customers and collect receivables, accurately track its inventory and timely provide needed parts to its customers, and generate the reliable financials required to access its operating credit facilities." (Id. ¶ 50.) As a result, Mosler's financial condition further deteriorated. (Id. ¶ 51.)

During this time, Rapoport and the Kelso Directors also failed to institute standard business controls. For example, they did not "address sustained and systemic flaws in Mosler's inventory management system," resulting in untimely deliveries to customers, and hence, damage to Mosler's goodwill. (Id. ¶ 53.) Mosler's accounts receivable were also rapidly increasing, but neither Rapoport nor the Kelso Directors instituted standard internal control procedures to ensure timely invoicing. (Id. ¶ 54.) Moreover, the problems with the accounts receivable were not discussed at either the February or May 1999 Board meetings. (Id. ¶¶ 56-57.) Mosler's contemporaneous SEC statements further reflect the financial troubles the company was experiencing. Between 1995 and 1999, Mosler reported an increase in uncollected accounts receivable from $46 million to nearly $100 million. (Id. ¶ 55.) Between 1998 and 1999, Mosler saw its net income go from the black to the red, and between 1998 and 2000, its earnings[2] declined while its net sales increased.

The deterioration of Mosler did not go unnoticed. On two occasions, in 1999 and 2000, Mosler's outside auditor advised the Board of "reportable conditions" and "material weaknesses" regarding the company's internal controls. However, neither Rapoport nor the Kelso Directors took any corrective action. (Id. ¶¶ 65-73.) Furthermore, in addition to experiencing "unreasonably high turnover of certain officers and key employees" (id. ¶ 59), Mosler also suffered from internal unrest. On at least ten occasions between the end of 1997 and the beginning of 2001, certain Kelso Directors were told by senior Mosler employees that the company had "serious business problems" and that Rapoport was mismanaging the company. (Id. ¶ 60.) Yet, the Kelso Directors failed to investigate these complaints and defended Rapoport after he took retaliatory action against two of the senior employees. (Id. ¶¶ 60-61.)

By the end of 2000, Mosler began to default on loans and on interest payments due on its bonds. (Id. ¶ 77.) Although Mosler pursued potential buyers, it ultimately filed a voluntary petition under Chapter 11 in the United States Bankruptcy Court for the District of Delaware. (Id. ¶¶ 78-79.) Mosler, since renamed MDIP, Inc. ("MDIP"), sold its assets at auction for nearly $28 million, but the proceeds were insufficient to pay all of its creditors. (Id. ¶¶ 79-80.) Therefore, pursuant to the approved Chapter 11 plan, the MDIP Litigation Trust, Inc. (the "Trust") was created for the benefit of the unpaid creditors to pursue certain claims. (Id. ¶¶ 1, 5.) More specifically, the Trust "is required to prosecute all causes of action assigned to the Trust by Mosler . . . for the benefit of holders of Allowed Class 3 and Allowed Class 4 Claims." (Id. ¶ 7.) "Moreover, under the Plan,

[2]The earnings referred to here are the earnings before interest, taxation, depreciation, and amortization, commonly known as EBITDA.

each holder of such a Claim is a Litigation Trust Beneficiary, each of whom has received a beneficial interest in the Litigation Trust Assets in accordance with the Plan." (Id.)

Pursuant to this directive, the Trust, in its own name, brought the present action against the Kelso Directors, Rapoport, and Kelso. Count I, based on the allegations outlined above, seeks to recover damages from the Kelso Directors for breach of the fiduciary duties of due care, good faith, and loyalty. (Id. ¶¶ 81-84.) Count II, also based on the allegations outlined above, seeks to recover damages from Rapoport under the same theory. (Id. ¶¶ 85-88.) Counts III and IV are avoidance and recovery of constructively fraudulent transfer claims against Kelso, under 11 U.S.C. § 548(a)(1)(B) and 11 U.S.C. § 544(b), respectively. (Id. ¶¶ 89-101.) However, the parties have since stipulated to the dismissal of Count III, and to a reduction in the damages sought in Count IV from $800,000 to $450,000. (D.I. 99.)

IV. DISCUSSION

The defendants argue that Counts I and II, which are state law claims, should be dismissed for lack of subject matter jurisdiction because (1) there is incomplete diversity, and (2) the exercise of supplemental jurisdiction would be inappropriate. Each of these arguments is addressed below.

A. Diversity of Citizenship

The diversity jurisdiction statute provides, in relevant part:

> The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds the sum or value of $75,000, exclusive of interest and costs, and is between . . . citizens of different States[.]

28 U.S.C. § 1332(a)(1) (2004). Since *Strawbridge v. Curtiss*, 3 Cranch 267 (1806), the Supreme Court has "interpreted the diversity statute to require 'complete diversity' of citizenship." *C.T. Carden v. Arkoma Assoc.*, 494 U.S. 185, 187 (1990). That means the citizenship of every plaintiff

must be diverse from the citizenship of every defendant, unless an independent basis for original jurisdiction exists between the non-diverse parties. *See Romero v. Int'l Terminal Operating Co.*, 358 U.S. 354, 381 (1959). For an artificial entity, unless that entity is a corporation, its citizenship "depends on the citizenship of . . . 'each of its members.'" *Id.* at 195-96 (citations omitted). In *C.T. Carden*, the Supreme Court established that this is a bright-line rule only to be modified by Congress, even where strong policy considerations would favor an exception. *See C.T. Carden*, 494 U.S. at 196-97.[3] However, no such statutory modification exists in this case.[4]

---

[3]Where an artificial entity is the named party whose citizenship is in question, the court may not look to the citizenship of unnamed parties. *C.T. Carden*, 494 U.S. at 187 n.1. Thus, in the case of a litigation trust, even if application of the "real party to the controversy" test, *see generally Navarro Sav. Ass'n v. Lee*, 446 U.S. 458 (1980), would dictate that the citizenship of the trustees should be determinative for the purpose of diversity, the court may not consider their citizenship unless they are named parties, *C.T. Carden*, 494 U.S. at 187 n.1.

[4]The Trust argues that *C.T. Carden* is distinguishable because that case involved a partnership rather than a litigation trust. However, as the defendants point out, the Court's broad language leads to the inescapable conclusion that litigation trusts are subject to its holding as well:

> Thus, the course we take today does not so much disregard the policy of accommodating our diversity jurisdiction to the changing realities of commercial organization, as it honors the more important policy of leaving that to the people's elected representatives. Such accommodation is not only performed more legitimately by Congress than by courts, but it is performed more intelligently by legislation than by interpretation of the statutory word "citizen." The 50 States have created, and will continue to create, a wide assortment of artificial entities possessing different powers and characteristics, and composed of various classes of members with varying degrees of interest and control. Which of them is entitled to be considered a "citizen" for diversity purposes, and which of their members' citizenship is to be consulted, are questions more readily resolved by legislative prescription than by legal reasoning, and questions whose complexity is particularly unwelcome at the threshold stage of determining whether a court has jurisdiction. We have long since decided that, having established special treatment for corporations, we will leave the rest to Congress; we adhere to that decision.

Consequently, the court must determine the citizenship of the Trust by looking to the citizenship of its "members," i.e., its beneficiaries.[5] *In re A.H. Robins Co., Inc.*, 197 B.R. 575, 579 (Bankr. E.D. Va. June 30, 1995).[6] As such, the citizenship of each creditor-beneficiary must be diverse from the citizenship of each of the Kelso Directors.[7] *Id.* Based on the court's review of the submitted list of creditors, numerous Class 3 and Class 4 creditors are citizens of the same states as the Kelso Directors. (See D.I. 144 Ex. B.)[8] Therefore, as the case is currently captioned, the court

---

C.T. Carden, 494 U.S. at 197. Thus, even if the court were inclined to agree with the Trust's policy arguments as to why the citizenship of the Trust itself should control, the Supreme Court has shut down that line of inquiry and left it up to Congress.

[5]The court's conclusion that it must look to the citizenship of the Trust's beneficiaries may rely on the assumption that the Trust has the capacity to sue in its own name. *See Allegis Group, Inc. Contractors Health Plan Trust v. Conn. Gen. Life Ins. Co.*, No. 04-16, 2004 WL 1289862, at *4 n.3 (D. Md. June 10, 2004). However, since diversity is lacking regardless of whether the citizenship of the beneficiaries or the citizenship of the trustees controls, the court need not address the question of whether there exists a legal basis for making such an assumption, or whether such an assumption is necessary in the first place.

[6]The Trust argues that *A.H. Robins*, in which the court looked to the citizenship of the defendant-trust's beneficiaries, is distinguishable because that case involved a products liability claimants trust rather than a litigation trust. (D.I. 145 at 3.) Once again, since diversity is lacking regardless of whether the citizenship of the beneficiaries or the citizenship of the trustees controls, the court need not address the Trust's argument.

[7]The citizenship of Kelso itself is irrelevant because there is an independent basis for original jurisdiction as to Count IV, namely federal question jurisdiction under 28 U.S.C. § 1331 (1993). *Romero*, 358 U.S. at 381.

[8]Technically speaking, the court's reliance upon "matters outside the pleadings" converts this motion to dismiss into a motion for summary judgment. Fed. R. Civ. P. 12(c). However, if the material facts are not in dispute, then the result is the same regardless of the label attached to the motion. The Trust points out that "there has been no discovery in this action directed specifically to the issue of the citizenship of the beneficiaries," but fails to actually contest the list of creditor-beneficiaries submitted by the defendants. (D.I. 145 at 4.) Since the Trust is presumably in the best position to know the citizenship of its own beneficiaries, and since it does not contest the submitted list, the court has no reason to believe that the material facts are in dispute. Therefore, given the Trust's concession that, based on the list of creditors, "there would not be complete diversity if the citizenship of all beneficiaries were taken into account" (id.), the

does not have diversity jurisdiction over Counts I and II. Moreover, even if the trustees were named plaintiffs and were the "real parties to the controversy," diversity of citizenship would still be lacking because both trustee Julie Dien Ledoux and defendant Wall are residents of New York. (D.I. 28 ¶ 11; D.I. 70 Ex. 1.)

The Trust disagrees with this analysis. Instead, it argues, the Trust's status as a litigation trust arising from a bankruptcy proceeding qualifies it for a "special rule" that "'[i]t is the citizenship of the bankrupt rather than the citizenship of the trustee in bankruptcy that is determinative for diversity jurisdiction.'" *Carlton v. BAWW, Inc.*, 751 F.2d 781, 787 (5th Cir. 1985) (quoting 13B C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3606). However, the "special rule" extracted from Wright & Miller is based on a 1906 Supreme Court interpretation of a statute that was repealed in 1978. *See Bush v. Elliot*, 202 U.S. 477 (1906); 11 U.S.C. § 46 (repealed 1978). The court is cognizant of the fact that, in spite of § 46 being repealed nearly twenty seven years ago, the "special rule" appears to have some continued viability in certain jurisdictions. *See, e.g., Carlton*, 751 F.2d at 787; *Pupo v. Chadwick's of Boston, Inc.*, No. 03-564, 2004 WL 2480399 (S.D.N.Y. Nov. 4, 2004); *Official Plan Comm. of Omniplex Comm. Group, LLC, v. Lucent Tech., Inc.*, 344 F. Supp. 2d 1194 (E.D. Mo. July 9, 2004). *But see Samson v. Allis-Chalmers Prod. Liab. Trust*, No. 90-0139, 1990 WL 87394 (E.D. Pa. June 21, 1990). Nevertheless, it is clear that "the reasoning underlying this rule rests on a shaky foundation," *Lucent*, 344 F. Supp. 2d at 1196, so the court is reluctant to apply it. Bearing that in mind, the Trust admits it is not in fact a bankruptcy trustee that would have been subject to the now-repealed § 46 in the first place. (D.I. 78 at 11.) In essence, the Trust is asking the court not only to apply a repealed statute, but also to

court is justified in its finding.

apply the repealed statute *by analogy*. But if applying a repealed statute is dubious (which it is), then applying a repealed statute by analogy is simply beyond the pale. Furthermore, even if § 46 had not been repealed, the fact that the Trust's "*sole* purpose is to liquidate and distribute MDIP's assets for the benefit of unsecured creditors" (D.I. 78 at 11) may not have been a sufficient reason to apply the "special rule" by analogy anyway. *Cf. In re Resorts Int'l, Inc.*, 372 F.3d 154, 169 (3d Cir. 2004) ("Though the Litigation Trust's assets, the proceeds from the litigation claims, were once assets of the estate, that alone does not create a close nexus to the bankruptcy plan or proceeding sufficient to confer bankruptcy jurisdiction."). Therefore, the court will decline the Trust's invitation to apply the "special rule" in this case.

Thus, diversity jurisdiction is lacking and the court must dismiss Counts I and II unless the exercise of supplemental jurisdiction is appropriate.

B. Supplemental Jurisdiction

The supplemental jurisdiction statute provides, in relevant part:

> (a) Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution. . . .
> . . .
> (c) The district courts may decline to exercise supplemental jurisdiction over a claim under subsection (a) if . . . (2) the claim substantially predominates over the claim or claims over which the district court has original jurisdiction[.]

28 U.S.C. § 1367 (1993).

In this case, the court need not determine whether the state law claims "are so related to" the federal law claim "that they form part of the same case or controversy" because it is abundantly clear that the state law claims "substantially predominate[] over" the federal law claim. In the fifteenpage section of the Amended Complaint captioned "Allegations Relevant To All Claims," nary a word can be found that relates to the allegedly fraudulent transfers from Mosler to Kelso. (See D.I. 28 ¶¶ 17-80.) In fact, it is not until the twenty-fourth page of the Amended Complaint's twenty-six pages that these transfers are vaguely described in Counts III and IV. (Id. ¶¶ 89-101.) Moreover, after the dismissal of Count III, the damages sought in Count IV was reduced from $800,000 to $450,000 (D.I. 99), whereas the damage sought in Counts I and II is in the neighborhood of $200,000,000 (D.I. 78 at 2). Clearly, both in terms of the facts alleged and the damages sought, the state law claims substantially predominate over the federal law claims. Thus, the exercise of supplemental jurisdiction in this case would truly permit the tail to wag the dog, and that is something the court will not permit.

V. CONCLUSION

Because the court does not have original jurisdiction over Counts I and II, and because the court declines to exercise supplemental jurisdiction, subject matter jurisdiction is lacking and the motion to dismiss must be granted.

Dated: May 25, 2005

/s/ Gregory M. Sleet
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

THE LITIGATION TRUST OF MDIP, INC. (formerly known as Mosler, Inc.) AND ITS AFFILIATES AS ASSIGNEE OF CERTAIN CLAIMS PURSUANT TO THE SECOND AMENDED JOINT PLAN OF LIQUIDATION OF MDIP, INC. AND ITS AFFILIATES, Plaintiffs,	)	Civil Action No. 03-779-GMS
MICHAEL RAPOPORT, *et al.*, Defendants.	)	

ORDER

IT IS HEREBY ORDERED THAT:

1. The defendants' motion to dismiss (D.I. 67) be GRANTED;

2. Counts I and II of the Amended Complaint (D.I. 28) be DISMISSED;

3. The defendants' motion for summary judgment (D.I. 84) be DENIED as moot;

4. The defendants' motion to strike the plaintiff's summary judgment affidavits (D.I. 114) be DENIED as moot;

5. The defendants' motion to strike the plaintiff's jury demand (D.I. 127) be DENIED as moot;

6. The defendants' motion *in limine* requesting the court to exclude evidence and testimony not disclosed in plaintiff's responses to contention interrogatories (D.I. 124) be DENIED as moot insofar as it pertains to Counts I or II; and

7. The defendants' motion *in limine* requesting the court to preclude evidence of events that

took place prior to August 6, 1998 (D.I. 125) be DENIED as moot.

Dated: May 25, 2005

/s/ Gregory M. Sleet
UNITED STATES DISTRICT JUDGE