

OCT 24 2006

NOT FOR PUBLICATION

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

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In re:)	BAP No.	NC-05-1510-MaSA1
EXCEL INNOVATIONS, INC.,)	Bk. No.	04-53874-ASW
Debtor.)	Adv. No.	05-05361
<hr/>			
SOLIDUS NETWORKS, INC.; INDIVOS)		
CORPORATION,)		
Appellants,)		
v.)	<u>MEMORANDUM</u> ¹	
EXCEL INNOVATIONS, INC.; NED)		
HOFFMAN,)		
Appellees.)		

Argued and Submitted on June 23, 2006
at San Francisco, California

Filed - October 24, 2006

Appeal from the United States Bankruptcy Court
for the Northern District of California

Honorable Arthur S. Weissbrodt, Bankruptcy Judge, Presiding.

Before: Marlar, Smith and Alley,² Bankruptcy Judges.

¹ This disposition is not appropriate for publication and may not be cited except when relevant under the doctrine of law of the case or the rules of res judicata, including issue and claim preclusion. See 9th Cir. BAP Rule 8013-1.

² Hon. Frank R. Alley III, United States Bankruptcy Judge for the District of Oregon, sitting by designation.

1 **INTRODUCTION**

2
3 The bankruptcy court granted a preliminary injunction to
4 enjoin an arbitration proceeding brought by creditors against a
5 shareholder of the debtor until a chapter 11³ plan was confirmed.

6 The bankruptcy court applied two tests. Under § 105(a), it
7 found that the arbitration could conceivably have a negative
8 effect on the debtor and the bankruptcy estate. The bankruptcy
9 court also applied the traditional test. Pursuant to this test,
10 it determined that the arbitration raised serious questions and
11 the balance of hardships tipped in the debtor's favor because an
12 arbitrator's award could negatively impact the co-defendant
13 debtor, which had already been adjudged liable on an alter ego
14 theory for some of the counts against the shareholder.

15 The creditors, whose chapter 11 plan and disclosure statement
16 are pending in bankruptcy court,⁴ have appealed the order for
17
18

19 ³ Unless otherwise indicated, all section, chapter, and code
20 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, as
21 promulgated before its amendment by the Bankruptcy Abuse
22 Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119
23 Stat. 23 (2005). Rule references are to the Federal Rules of
24 Bankruptcy Procedure, Rules 1001-1096 ("Bankruptcy" Rules), which
25 incorporate the Federal Rules of Civil Procedure ("Federal"
26 Rules).

27 ⁴ We take judicial notice of the chapter 11 liquidating plan
28 and disclosure statement, which were filed on February 2, 2006.
Ned Hoffman, the shareholder/defendant in the arbitration matter,
has filed an objection. See S.E.C. v. Am. Capital Invs., Inc., 98
F.3d 1133, 1142 n.11 (9th Cir. 1996) (appeals court may take
judicial notice of facts if they have a direct relation to matters
at issue); Wetherbee v. Willow Lane, Inc. (In re Bestway Prods.,
Inc.), 151 B.R. 530, 540 (Bankr. E.D. Cal. 1993), aff'd mem., 165
B.R. 339 (9th Cir. BAP 1994) (it is a common practice to take
judicial notice of the trial court's records).

1 injunctive relief.⁵ They maintain that the bankruptcy court
2 applied the wrong legal standard and that the relevant factors
3 weigh in favor of allowing them to proceed against the nondebtor
4 shareholder.

5 We conclude that the bankruptcy court applied the correct
6 legal standard under both § 105 and the traditional test. Finding
7 no abuse of discretion, we AFFIRM.

8
9 **FACTS**

10

11 On June 17, 2004, both the debtor, Excel Innovations, Inc.
12 ("Excel") and its controlling shareholder, president and CEO, Ned
13 Hoffman ("Hoffman"), filed bankruptcy petitions. Hoffman's
14 bankruptcy case was subsequently dismissed on his own motion, in
15 September of 2004. Excel remains in chapter 11, and a
16 reorganization plan has not yet been confirmed. Today, Hoffman is
17 no longer a controlling shareholder, but he promotes Excel's
18 products as its marketing consultant.⁶

19 The bankruptcy filing stayed an arbitration proceeding ("AAA
20 Claim") that had been initiated in 2003 by Indivos Corporation
21 ("Indivos") against both Excel and Hoffman. Prepetition, Excel
22 and Hoffman shared the same defense counsel.

23

24 ⁵ A BAP motions panel has determined that this was a final
25 order under the Federal Arbitration Act ("FAA"), in regards to
26 litigation involving the enforcement of settlement agreements
coming within the broad scope of FAA "commerce." Alternatively,
we granted leave to appeal pursuant to Fed. R. Bankr. P. 8003(c).
See BAP Order (Mar. 9, 2006).

27

28 ⁶ Excel is in the business of patenting and licensing
inventions, including consumer products in sports and fitness,
housewares and homecare accessories, automotive safety, and
computer-based financial services systems. See Disclosure
Statement 11, Feb. 2, 2006.

1 The AAA Claim stemmed from alleged breaches of various
2 settlement agreements executed by Hoffman or Excel and Indivos in
3 2000. The agreements included a Voting Trust and Standstill
4 Agreement, which barred Hoffman from interfering in shareholder
5 votes or the management of Indivos, and a Pledge Agreement, which
6 granted Indivos a security interest in Excel's and Hoffman's
7 shares of stock in Indivos, which were agreed to be held in the
8 Voting Trust as collateral for enforcing Hoffman's obligations
9 under the settlement agreements. Indivos alleged that Hoffman
10 and/or Excel had interfered in the merger of Indivos and Solidus
11 Networks, Inc. ("Solidus") (together "Appellants"), which merger
12 was concluded in 2003.⁷ One way he/it did this was by filing
13 multiple lawsuits against Indivos and Appellants.⁸ In defending
14 these lawsuits, Appellants used money from their stockholders'
15 escrow fund, which had been established to pay for merger
16 litigation expenses. The goal of the AAA complaint was to obtain
17 an order awarding Appellants the pledged stock in payment of their
18 attorneys' fees, in order to replenish the stockholders' escrow
19 fund to its originally allotted \$2.45 million.

20 The AAA Claim contained seven counts:

- 21 1. Breach of contract regarding settlement agreements.
- 22 2. Declaratory relief regarding settlement agreements.
- 23 3. Breach of contract regarding pledged collateral.
- 24 4. Declaratory relief regarding settlement agreements.
- 25 5. Unfair business practices regarding pledged collateral.
- 26 6. Breach of fiduciary duty by Hoffman.
- 27 7. Conspiracy/Alter Ego.

28 Indivos' Amended Statement of Claim, Nov. 19, 2003.

29 ⁷ Indivos is now a wholly owned subsidiary of Solidus
30 Networks, Inc. See Tr. of Proceedings 32:24-25, July 26, 2005.

31 ⁸ Seventeen lawsuits were filed; 14 of those were dismissed
32 or resolved against Hoffman.

1 Prepetition, arbitrator Bruce Methven ("Methven") ruled, on a
2 summary judgment motion, that Hoffman was the alter ego of Excel
3 in connection with a specific lawsuit, while evidence of Excel's
4 liability was insufficient for summary judgment with respect to
5 other lawsuits. Methven stated:

6 I find that Excel is liable as Mr. Hoffman's alter
7 ego with respect to the November 12, 2002, lawsuit that
8 Excel filed against Indivos. There is insufficient proof
9 at this time to determine liability with respect to some
10 of the other lawsuits where Excel was a plaintiff. In
11 particular, no evidence has been presented that the Excel
12 Board did not approve the January 13, 2003, lawsuit filed
13 by Excel against Indivos or did not approve the lawsuits
14 filed in March 2003 where Excel was a plaintiff and
15 Indivos a defendant. (If the Board did not approve those
16 lawsuits, then Excel is liable as Mr. Hoffman's alter ego
17 regarding them as well.) Also, no evidence has been
18 presented as to the exact date(s) in March 2003 that Mr.
19 Silen and Mr. Mendelsohn resigned from the Excel Board.
20 For the lawsuits filed after they resigned—which certainly
21 means the lawsuits filed after March 2003—where Excel was
22 a plaintiff and Indivos a defendant, I also find that
23 Excel is liable as Mr. Hoffman's alter ego.

24 Methven Letter Ruling 11, May 14, 2004.

25 After Hoffman's bankruptcy case was dismissed, in February
26 2005, Appellants sought to revive the arbitration proceedings
27 against him. At an unrelated stay relief hearing, the bankruptcy
28 court and Appellants' counsel exchanged comments concerning
whether the arbitration was stayed. The bankruptcy court stated,
although there was no stay in place against Hoffman, it would need
to entertain a motion before it could opine on whether the
arbitration against Hoffman would violate Excel's automatic stay.
Without an order, the bankruptcy court told Appellants that they
would be proceeding "at their own risk." Appellants, however, did
not file a motion for stay relief, but sought clarification from
Methven.

1 Methven interpreted the bankruptcy court's position as being
2 clear that there was no stay regarding Hoffman. He wrote:

3 There are claims in this arbitration that involve
4 only Mr. Hoffman. As a result, this arbitration is going
to proceed with respect to Mr. Hoffman.

5 Mr. Hoffman has three choices: 1) obtain an order
6 from Judge Weissbrodt staying this arbitration; 2)
7 participate in this arbitration; or 3) refuse to
participate in this arbitration, in which case I will set
8 a "prove-up" hearing where [Appellants' counsel] will
9 present evidence supporting each issue he wishes to prove
and the amount of damages, and I will consider the
evidence and issue an award in favor of one party or the
other.

10 Methven Letter, May 17, 2005.

11 Neither Hoffman nor Excel appeared at the status conference
12 before the arbitrator on June 9, 2005. Therefore, Methven issued
13 a scheduling letter for closing briefs.⁹ See Methven Letter of
14 June 9, 2005.

15 Methven then clarified that the seventh cause of action for
16 conspiracy/alter ego would not be arbitrated further because it
17 involved Excel, and that the remaining six causes of action would

18 _____
19 ⁹ Appellants' counsel described the prepetition status of
the AAA proceedings, in 2004, as follows:

20 On May 19, 2004, the parties began arbitrating (1)
21 Indivos' damages for what the Arbitrator ruled on summary
22 judgment were breaches of a June 2000 settlement
23 agreement, and (2) Excel's and Hoffman's liability for
24 breaches of the settlement agreement for which the
Arbitrator had denied summary judgment. Between May 19
25 and May 28, 2004, four witnesses testified, 110 exhibits
26 were introduced, Indivos had concluded its affirmative
27 case, and Hoffman and Excel had put on a substantial part
of their defense. Ned Hoffman testified for four days, on
May 20, 21, 24, and 25, 2005. . . . The parties were
attempting to schedule additional days of trial on
Hoffman's and Excel's limited defenses when Hoffman and
Excel filed their bankruptcy petitions.

28 Decl. of Kristen A. Palumbo 2, ¶ 2, Oct. 12, 2005.

1 be arbitrated with respect to Hoffman but not with respect to
2 Excel. Methven further invited Excel to seek an injunction from
3 the bankruptcy court. See Methven Letter, June 23, 2005.

4 On July 12, 2005, Excel filed a Complaint for Declaratory and
5 Injunctive Relief ("Complaint") against Appellants and Hoffman.¹⁰
6 Excel sought a declaratory judgment that the continued arbitration
7 would violate Excel's automatic stay and, alternatively, sought an
8 injunction to stop the arbitration against Hoffman.

9 Then Excel, joined by Hoffman, moved the bankruptcy court for
10 a temporary restraining order ("TRO"), which motion was opposed by
11 Appellants. At a July 26, 2005 hearing, Appellants' counsel
12 represented to the court that they were willing to stipulate that
13 the arbitration would have no preclusive effect upon Excel; they
14 would not setoff any award against Excel's claims against the
15 merger proceeds; and that no further evidence by any party would
16 be presented. The bankruptcy court also had serious concerns
17 about conflicting rulings in the arbitration and in any claim
18 proceeding in bankruptcy court, if Hoffman were to seek
19 indemnification from Excel. Appellants' counsel assuaged these
20 fears by indicating that Hoffman had neither filed a proof of
21 claim nor could he do so because it was time-barred.¹¹

23 ¹⁰ Although Excel also named the American Arbitration
24 Association and Methven as defendants, they were dismissed from
25 the suit in open court. See Tr. of Proceedings 33-34, July 26,
2005.

26 ¹¹ We take judicial notice of the fact that on April 21,
27 2006, Hoffman filed a late proof of claim for indemnification
28 against the estate for an unknown amount, along with a motion for
an extension of time in which to file the claim. See Am. Capital
Invs., Inc., 98 F.3d at 1142 n.11; Bestway Prods., 151 B.R. at
540. A continued hearing on the matter was pending at the time of
this writing.

1 The bankruptcy court orally denied the TRO, without
2 prejudice, if certain conditions were met as stipulated to in
3 court, which included the following points:

- 4 1) Indivos could only proceed against Hoffman, but not with
5 respect to certain claims, including the alter ego
6 claim;
- 7 2) the proceeding against Hoffman would be without
8 prejudice to Excel's rights, claim or defenses in the
9 arbitration, and would have no preclusive effect on
10 Excel's claims or defenses in the arbitration;
- 11 3) no new evidence would be presented; and
- 12 4) Indivos would not seek to offset any damages award it
13 obtained against Hoffman against the turnover claim
14 brought by Excel, nor apply it against either the merger
15 proceeds or the indemnity fund attributable to Excel,
16 without further order of the bankruptcy court.

17 See Order Denying TRO, Sept. 16, 2005, and Tr. of Proceedings,
18 July 26, 2005.

19 Significantly, the bankruptcy court made this ruling after
20 balancing the equities. See id. at 36-37.

21 Facing a revived proceeding, Hoffman re-entered the fray and
22 requested that the briefing schedule be vacated, so that he could
23 obtain separate counsel and prepare to present evidence in his
24 defense.

25 Methven set a preliminary hearing for August 29, 2005, at
26 which Appellants and Hoffman appeared through counsel. Following
27 the hearing, Methven issued his decision to allow five days of
28 additional hearings from October 17-21, 2005, or 40 hours of

1 testimony time, split evenly between Appellants and Hoffman. See
2 Methven Letter, Aug. 29, 2005.

3 Hoffman then filed, on August 31, 2005, an ex parte
4 application to reopen the TRO hearing; the bankruptcy court
5 granted the TRO pending the filing of an application for a
6 preliminary injunction hearing by Excel.

7 Excel filed the motion for a § 105(a) preliminary injunction
8 on September 26, 2005, and submitted Hoffman's declaration. The
9 pertinent portions are as follows:

10 2. During the course of the Arbitration in 2004, I
11 was the CEO of the Debtor, the Debtor and I were jointly
12 represented by the same counsel (who was employed by the
13 Debtor), and our defense was closely coordinated. Our
14 defense was coordinated in part because it was our joint
15 position then that all the actions complained of in the
16 Arbitration were undertaken by me either in my capacity as
17 an officer and director of the Debtor or otherwise under
18 taken [sic] as an agent of the Debtor on behalf of and in
19 the best interests of the shareholders of the Debtor and
20 its legitimate creditors. For that same reason, the
21 Debtor had agreed to provide for our common defense and to
22 indemnify me for any award that might result from the
23 Arbitration. Our common defense was designed to jointly
24 protect the interests of both me and the Debtor, including
25 all of its shareholders and legitimate creditors.

26 3. At the time of the events which are the subject
27 of the Arbitration I also was a director and CEO of the
28 Debtor, and in connection with said actions, including
important litigation, I was constantly in communication
with various attorneys for the Debtor I consulted
regularly with such attorneys in my capacity as an officer
and director of the Debtor regarding the actions which are
the subject of the arbitration, the patent infringement
action, all other important lawsuits, and I undertook
those actions on the advice of the Debtor's counsel.

4. In addition to consulting with attorneys for the
Debtor regarding the actions that are the subject of the
Arbitration, I also frequently consulted with and sought
the advice of major shareholders, Board member and
legitimate creditors of the Debtor and kept them informed
as to my actions and the reasons for them.

. . . .

1 6. If, as Indivos proposes, I and the Debtor are de-
2 linked in the Arbitration, several ramifications will
3 adversely impact key assets and legal strategies of the
4 Debtor, as described briefly below without providing any
5 privileged litigation previews:

6 a. First, the Debtor and I could for the first
7 time be compelled to become adversarial, thereby
8 undercutting the efficiency and the effectiveness of the
9 joint defense we have heretofore coordinated and benefited
10 from, both legally and financially. For example, I will
11 be compelled to demand, pursuant to the bylaws of the
12 Debtor and the California Corporations Code § 317 that the
13 Debtor reimburse me for my expenses including attorneys'
14 fees in defending myself in the arbitration and to
15 indemnify me in the event of any award arising from any
16 actions I engaged in as a director, officer or agent of
17 the Debtor.

18 b. Second, my defense will be compelled to
19 focus on protecting my personal interests and not
20 necessarily the interests of the Debtor.

21 c. Third, in order to further detail that my
22 actions were undertaken as a director, officer or agent of
23 the debtor and in accordance with legal advice from
24 attorneys for the Debtor, I will be compelled to reveal
25 the substance of critical privileged communications
26 between myself and attorneys for the Debtor . . . , which
27 can severely jeopardize the Debtor's litigation strengths
28 and strategies. I also am likely to be compelled to call
witnesses, including various shareholders, attorneys and
creditors of the debtor with whom I communicated in
connection with the actions that are the subject of the
Arbitration and the Federal patent infringement case to
provide new evidence that I was acting in their interests
and on their behalf.

Decl. of Ned Hoffman, Nov. 3, 2005.

Appellants opposed the motion, but did not file any
evidentiary objections to Hoffman's declaration.

Following a hearing, where the bankruptcy court announced
that it had considered the issue "with a great deal of
seriousness," it granted the motion for an injunction of limited
duration--enjoining further arbitration against Hoffman pending
confirmation of a plan of reorganization for Excel. Tr. of
Proceedings 8:14, Dec. 2, 2005.

1 First, the court stated that an injunction to stay an action
2 between two nondebtor parties is appropriate when such action
3 "could conceivably have any effect on the administration of the
4 bankruptcy estate," citing Am. Hardwoods, Inc. v. Deutsche Credit
5 Corp. (In re Am. Hardwoods, Inc.), 885 F.2d 621, 624 (9th Cir.
6 1989). Tr. of Proceedings, supra, at 4:21-23.

7 Second, the bankruptcy court stated that "[o]utside the
8 context of Section 105 in the Ninth Circuit to obtain a
9 preliminary [injunction], the moving party must show either a
10 combination of probable success on the merits and the possibility
11 of irreparable injury or, two, if serious questions are raised and
12 the balance of hardships tips sharply in its favor." Id. at 5:20-
13 25. For this test, the bankruptcy court cited Clear Channel
14 Outdoor Inc. v. City of Los Angeles, 340 F.3d 810, 813 (9th Cir.
15 2003).

16 The bankruptcy court found that this case met both standards
17 because: (1) Hoffman would raise a defense of indemnification
18 against Excel; (2) in seeking indemnification, it is likely that
19 Hoffman would disclose attorney-client privilege matters, and
20 there was no way to protect that privilege; (3) Excel's lawyers
21 would likely have to be involved in the arbitration even though
22 Excel is not party, but they would have no control over Hoffman;
23 (4) Excel's new management may not share Hoffman's defense
24 position, which may create inconsistent results between the
25 Hoffman and Excel litigation; (5) Excel will have to pay twice to
26 relitigate the same issues, once on Hoffman's indemnification
27 claim and again in opposing Appellants' claim; and (6) there was
28 no guaranty that the arbitrator will prevent the presentation of

1 such defenses or issues which negatively affect Excel or its
2 alter-ego status.

3 The order enjoining the arbitration was entered on December
4 19, 2005, and Appellants timely appealed. Hoffman has filed an
5 appellee's brief.¹²

6
7 **ISSUE**

8
9 The sole issue is whether the bankruptcy court applied the
10 correct legal standard or standards for granting a preliminary
11 injunction in a chapter 11 case with respect to an ongoing
12 arbitration between two nondebtors.

13
14 **STANDARD OF REVIEW**

15
16 We review the grant of a preliminary injunction for an abuse
17 of discretion. Morgan-Busby v. Gladstone (In re Morgan-Busby),
18 272 B.R. 257, 260 (9th Cir. BAP 2002). A bankruptcy court abuses
19 its discretion if it bases its ruling on an erroneous legal
20 standard or on a clearly erroneous assessment of the evidence.
21 Alcove Inv., Inc. v. Conceicao (In re Conceicao), 331 B.R. 885,
22 889 (9th Cir. BAP 2005). When the bankruptcy court is alleged to

23
24 ¹² Standing is a jurisdictional matter, which we review de
25 novo; we may raise the issue of standing sua sponte. Houston v.
26 Eiler (In re Cohen), 305 B.R. 886, 891 (9th Cir. BAP 2004).
27 Although Hoffman was named as a party defendant in Excel's
28 Complaint, he has aligned himself with Excel throughout these
proceedings and has filed an appellee's brief. As a party to the
bankruptcy court's order, and being directly affected by it
because it enjoined the arbitration action against him personally,
he is "directly and adversely affected pecuniarily" by the order
and, therefore, he has appellate standing. Fondiller v. Robertson
(In re Fondiller), 707 F.2d 441, 442 (9th Cir. 1983).

1 have relied on an erroneous legal premise, we review the
2 underlying issues of law de novo. Earth Island Inst. v. U.S.
3 Forest Serv., 351 F.3d 1291, 1298 (9th Cir. 2003).
4

5 DISCUSSION

7 A. Legal Standards

8
9 Injunctive relief is available in bankruptcy court in two
10 ways: pursuant to the court's discretionary and inherent equitable
11 power under § 105(a) "to issue any order, process, or judgment
12 that is necessary or appropriate to carry out the provisions of
13 this title," or under the auspices of Bankruptcy Rule 7065, which
14 makes Federal Rule 65 applicable in adversary proceedings.

15 Under Federal Rule 65, the traditional criteria for issuing a
16 preliminary injunction are: "1) a strong likelihood of success on
17 the merits, 2) the possibility of irreparable injury to plaintiff
18 if the preliminary relief is not granted, 3) a balance of
19 hardships favoring the plaintiff, and 4) advancement of the public
20 interest (in certain cases)." Morgan-Busby, 272 B.R. at 261
21 (citation omitted).

22 Alternatively, under the traditional test, a preliminary
23 injunction may issue if the moving party demonstrates "(1) a
24 combination of probable success on the merits and the possibility
25 of irreparable harm; or (2) that serious questions are raised and
26 the balance of hardships tips in its favor." Id. (citation
27 omitted). "Probability of success and possibility of irreparable
28 harm can be viewed as two factors on a sliding scale so that as

1 the required probability of success increases, the likelihood of
2 irreparable harm that is required decreases." Alcove Inv., 331
3 B.R. at 889.

4 Appellants contend that the bankruptcy court did not apply
5 the traditional test because both the "success on the merits" and
6 the "serious questions are raised" language refers to questions
7 that involve "fair chance of success on the merits," and the court
8 did not find, nor did Excel demonstrate, that it was likely to
9 succeed on the merits of its complaint. Republic of the
10 Philippines v. Marcos, 862 F.2d 1355, 1362 (9th Cir. 1988).
11 Appellants contend that the "merits" of the complaint was Excel's
12 request for a declaratory judgment that the automatic stay in its
13 bankruptcy case would be violated by continuing the arbitration
14 proceeding against Hoffman.

15 Excel and Hoffman maintain that the bankruptcy court did not
16 have to apply the traditional test but rather had the authority to
17 issue the injunction under § 105. Alternatively, they contend
18 that the bankruptcy court also applied the traditional standard
19 correctly. They argue that the arbitration would threaten the
20 estate and Excel's ability to reorganize. We agree with Excel and
21 Hoffman.

22
23 **B. Section § 105(a)**
24

25 Excel contends that the bankruptcy court had broad discretion
26 under § 105(a) and was not required to apply the traditional test,
27 citing Beck v. Fort James Corp. (In re Crown Vantage, Inc.), 421
28 F.3d 963, 975-76 (9th Cir. 2005).

1 Crown Vantage concerned an action in another forum against
2 the liquidating trustee which violated the Barton doctrine because
3 prior authorization was not obtained. The bankruptcy court had
4 granted a preliminary injunction to halt the action. However, the
5 district court vacated the injunction, finding that the
6 liquidating trustee failed to establish irreparable harm--one of
7 the traditional standards. On appeal, the Ninth Circuit reversed
8 the district court's decision to vacate the injunction.

9 The Ninth Circuit reasoned that under § 105(a) the bankruptcy
10 court did not have to apply the usual preliminary injunction
11 standard, but the "only requirement for the issuance of an
12 injunction under § 105 is that the remedy conform to the
13 objectives of the Bankruptcy Code." Crown Vantage, 421 F.3d at
14 975. It then cited a Seventh Circuit opinion, which held:

15 [A] bankruptcy court can enjoin proceedings in other
16 courts when it is satisfied that such proceedings would
17 defeat or impair its jurisdiction over the case before it.
In other words, the court does not need to demonstrate an
inadequate remedy at law or irreparable harm.

18 Id. at 975-76 (citing In re L & S Indus., Inc., 989 F.2d 929, 932
19 (7th Cir. 1993)).

20 The Ninth Circuit tempered its holding, however, by
21 concluding that the only appropriate remedy for a violation of the
22 Barton doctrine was injunctive relief. "It would thwart the
23 purpose of the Barton doctrine to add an additional requirement
24 that the party show irreparable harm before being able to obtain
25 relief." Crown Vantage, 421 F.3d at 976. Thus, in Crown Vantage,
26 the enjoined action directly infringed one of the traditional
27 tenets of bankruptcy law--the protection of an estate's assets.

28

1 Similar reasoning, but with a different result, was espoused
2 by the Ninth Circuit in Am. Hardwoods. There, a chapter 11 debtor
3 sought to permanently enjoin a creditor from enforcing a state
4 court judgment against the debtor's guarantors. The Ninth Circuit
5 held, at first, that the bankruptcy court had "related to" subject
6 matter jurisdiction over the matter which "could conceivably have
7 any effect on the estate" 885 F.2d at 623. Next, it held
8 that § 105 "empowers the court to enjoin preliminarily a creditor
9 from continuing an action or enforcing a state court judgment
10 against a nondebtor prior to confirmation of a plan" and "to issue
11 both preliminary and permanent injunctions after confirmation of a
12 plan to protect the debtor and the administration of the estate."
13 Id. at 624-25.

14 The Ninth Circuit concluded that the bankruptcy court lacked
15 the power under § 105 to permanently enjoin a creditor, beyond
16 confirmation of the plan, from enforcing a state court judgment
17 against a nondebtor because to do so would be contradictory to the
18 discharge injunction under § 524(e). Id. at 625-26. Thus, it
19 held that § 105 must be exercised consistently with the Bankruptcy
20 Code. Id. at 625.

21 Am. Hardwoods did not discuss the proper legal standard for a
22 § 105 injunction. However, it left the door open for injunctive
23 relief if a court were to be presented with unusual facts, citing
24 Oberg v. Aetna Cas. & Sur. Co. (In re A.H. Robins Co.), 828 F.2d
25 1023, 1026 (4th Cir. 1987), and A.H. Robins Co. v. Piccinin, 788
26 F.2d 994, 1002-03 (4th Cir. 1986). Am. Hardwoods, 885 F.2d at
27 626; see also Menard-Sanford v. Mabey (In re A.H. Robins Co.), 880
28 F.2d 694, 698, 700-02 (4th Cir. 1989). Those courts have applied

1 alternative factors to determine the appropriateness of injunctive
2 relief against nondebtors, for example, where: (1) the nondebtor
3 action would interfere with the reorganization or plan funds; (2)
4 the success of reorganization hinged on the debtor's freedom from
5 indirect claims such as indemnification or contribution claims;
6 (3) the interests of the nondebtor defendants were intertwined
7 with those of the debtor so that it could be deemed a claim
8 against the debtor; (4) the same facts, witnesses, etc. would be
9 presented; and (5) the debtor or its officers would be required to
10 participate.

11 Similar circumstances existed on our facts. Specifically,
12 the bankruptcy court found that the injunction would "protect the
13 debtor's estate and all of the creditors in significant ways that
14 this Court believes are appropriate to allow the debtor to focus
15 on its reorganization." Tr. of Proceedings 7:1-3, Dec. 2, 2005.
16 In addition, the bankruptcy court limited the injunction only
17 until plan confirmation, finding that the continued arbitration
18 would affect the bankruptcy court's jurisdiction over the case.
19 See Fietz v. Great Western Savs. (In re Fietz), 852 F.2d 455, 457
20 (9th Cir. 1988) ("An action is related to bankruptcy if the
21 outcome could alter the debtor's rights, liabilities, options, or
22 freedom of action (either positively or negatively) and which in
23 any way impacts upon the handling and administration of the
24 bankrupt estate.")

25 The Ninth Circuit has not clearly adopted nor applied the
26 "unusual circumstances" or alternative § 105(a) test,

27
28

1 notwithstanding Crown Vantage and Am. Hardwoods.¹³ See also 2
2 Collier on Bankruptcy ¶ 105.02[2], at 105-13-14 (Alan N. Resnick &
3 Henry J. Sommer eds., 15th ed. rev. 2005) (listing alternate
4 factors, but concluding that they are “nothing more than an
5 evolution of the general requirements for a preliminary
6 injunction.”) Nevertheless, to the extent that § 105 is
7 recognized as authority for granting injunctive relief in matters
8 that are related to the bankruptcy case, we hold that the
9 bankruptcy court correctly asserted its § 105(a) authority in
10 enjoining Appellants’ arbitration proceeding.

11 The bankruptcy court did not rely solely on § 105(a),
12 however, nor do we; we will also review the court’s order under
13 the traditional test for injunctive relief. See 2 Collier on
14 Bankruptcy, supra, ¶ 105.02[1], at 105-9 (stating that the
15 majority of courts begin an analysis of whether an injunction
16 under § 105 is appropriate by reciting the traditional standard
17 for issuance of a preliminary injunction).

18 19 **C. The Traditional Standard**

20
21 The bankruptcy court also applied the traditional test,
22 stating that “[o]utside the context of Section 105 in the Ninth
23 Circuit to obtain a preliminary [injunction], the moving party

24
25 ¹³ In fact, the Seventh Circuit, which was cited by the Ninth
26 Circuit for application of the § 105(a) standard, stated that “the
27 court does not need to demonstrate an inadequate remedy at law or
28 irreparable harm. . . . Of course, the moving party must still
establish a likelihood of success on the merits.” L & S Indus.,
989 F.2d at 932. And the Ninth Circuit, in Crown Vantage, noted
that the liquidating trustee was likely to prevail on his claim.
Crown Vantage, 421 F.3d at 974.

1 must show either a combination of probable success on the merits
2 and the possibility of irreparable injury or, two, if serious
3 questions are raised and the balance of hardships tips sharply in
4 its favor." Tr. of Proceedings, supra, at 5:20:25.

5 A preliminary injunction is a provisional remedy. "It is the
6 function of a preliminary injunction to preserve the status quo
7 pending a determination of the action on the merits." King v.
8 Saddleback Junior Coll. Dist., 425 F.2d 426, 427 (9th Cir. 1970)
9 (citation omitted). Therefore, there must be a showing of some
10 chance of success on the merits, which is analyzed on a sliding
11 scale with the irreparable harm component. In other words, the
12 probability of success on the merits must not be "so remote as to
13 render the irreparable injury component irrelevant." Earth Island
14 Inst., 351 F.3d at 1298. "To establish a substantial likelihood
15 of success on the merits, [the movant] must show 'a fair chance of
16 success.'" Rubin v. Pringle (In re Focus Media Inc.), 387 F.3d
17 1077, 1086 (9th Cir. 2004).

18 The "merits" usually refers to some underlying substantive
19 claim. In Morgan-Busby, for example, the chapter 11 debtors
20 scheduled certain shares of stock as assets and claimed the shares
21 exempt. The chapter 11 trustee filed a complaint seeking a
22 turnover of the shares to the estate and to enjoin the debtors
23 from disposing of the shares or interfering with the trustee's
24 investigation of their value pending resolution of the turnover
25 complaint. On the appeal of the order granting the preliminary
26 injunction, the issue was whether the trustee was likely to
27 prevail in the turnover action. The appellate court concluded
28 that the trustee was likely to prevail in the turnover action, and

1 therefore affirmed the order granting the preliminary injunction.
2 272 B.R. at 266.

3 Here, the "merits" are different. Excel's Complaint sought
4 an injunction under § 105(a) to stay an arbitration which it
5 alleged would likely have a negative impact upon Excel and the
6 estate. In the context of a § 105(a) injunction, some courts
7 require the movant to show a likelihood of success in
8 reorganizing. See Fed. Trade Comm'n v. First Alliance Mortgage
9 Co. (In re First Alliance Mortgage Co.), 264 B.R. 634, 653 (C.D.
10 Cal. 2001) (and citing conflicting case law). We therefore
11 conclude that the appropriate "merits" in this case was the
12 likelihood of a successful reorganization.

13 The bankruptcy court found that the injunction would "protect
14 the debtor's estate and all of the creditors in significant ways
15 that this Court believes are appropriate to allow the debtor to
16 focus on its reorganization." Tr. of Proceedings 7:1-3, Dec. 2,
17 2005. In addition, the bankruptcy court granted the injunction
18 only until the time of plan confirmation. Another fact was that
19 Hoffman was actively marketing Excel's products in his consulting
20 position. Enjoining the arbitration would preserve Hoffman's
21 ability to focus on this job. These facts supported an inference
22 that Excel had at least a fair chance of successfully
23 reorganizing. Therefore, although the evidence on this component
24 may arguably have been thin, it was still outweighed by the danger
25 of irreparable harm, especially given the limited duration of the
26 injunction. Thus, the bankruptcy court's finding of possible
27 success on the merits was sufficient and not clearly erroneous.

28

1 Based on Hoffman's declaration, the bankruptcy court found
2 that several serious potential harms existed for Excel if the
3 arbitration proceeded against Hoffman. First, Hoffman could raise
4 a defense of indemnification against Excel. This defense, alone,
5 would have a negative impact on the estate because,
6 notwithstanding the bifurcation of the proceeding, there was a
7 close identity between Hoffman and Excel. See Am. Imaging Servs.,
8 Inc. v. Eagle-Picher Indus., Inc. (In re Eagle-Picher Indus.,
9 Inc.), 963 F.2d 855, 861 (6th Cir. 1992). Second, in seeking
10 indemnification, it was likely that Hoffman could disclose
11 attorney-client privilege matters, and there would be no way to
12 protect that privilege. Excel's lawyers would likely have to be
13 involved in the arbitration, even though Excel was not a party,
14 and they would have no control over Hoffman.

15 Appellants maintain that this was an erroneous conclusion,
16 because Hoffman has no right to waive Excel's privileged
17 communications and the bankruptcy court could enjoin him. The
18 question of who has the privilege, Excel, Hoffman, or both
19 jointly, has never been determined. Moreover, we agree with the
20 bankruptcy court that Excel has no control over what Hoffman might
21 say at the arbitration, unless its attorneys are involved; nor,
22 ultimately, does the arbitrator. If privileged testimony is
23 given, it will be too late to fix the problem.

24 Third, the bankruptcy court found that Excel's new management
25 may not share Hoffman's defense position, which may create
26 inconsistent results. For example, the arbitrator might rule that
27 Hoffman was acting as Excel's agent when he breached the
28 settlement and the bankruptcy court might rule that he was not.

1 Such inconsistent results could complicate Excel's litigation with
2 Appellants, as well as any claim proceedings in respect to
3 Hoffman's proof of claim for indemnification. Such complications
4 would tax judicial resources.

5 Fourth, Excel's resources would doubtless be diminished since
6 it would have to pay twice to relitigate the same issues, once for
7 an indemnification claim and again in litigation with Appellants'
8 claim.

9 Appellants contend that any conflict is merely speculative
10 and such speculative injury does not constitute irreparable
11 injury. Goldie's Bookstore, Inc. v. Super. Ct., 739 F.2d 466, 472
12 (9th Cir. 1984). We disagree because Hoffman has now sought
13 permission to file a proof of claim for indemnification and there
14 is a possibility that it will be allowed by the bankruptcy court.
15 See note 11, infra. Moreover, it is conclusive that Excel has
16 alter ego liability for certain acts of Hoffman. It would be
17 impossible to guarantee that Hoffman, in defending himself, might
18 not also present evidence on Excel's liability as to the remaining
19 counts. The potential for conflicting judgments is therefore not
20 speculative.

21 Appellants further argue that the possibility of conflicting
22 rulings is insufficient as a matter of law to impede claims
23 against nondebtor co-defendants. They cite cases involving the
24 scope of the automatic stay which are not on point in this
25 injunction action. See United States v. Dos Cabezas Corp., 995
26 F.2d 1486 (9th Cir. 1993) and Parker v. Bain, 68 F.3d 1131 (9th
27 Cir. 1995).

28

1 Finally, although unnecessary, the bankruptcy court balanced
2 the harms, and correctly determined that Excel had greater
3 exposure to irreparable harm than would Appellants by postponing
4 the arbitration until after plan confirmation. This was
5 particularly true where Appellants' proposed liquidation plan has
6 been filed and is pending confirmation.

7 Based on the foregoing facts and conclusions, we conclude
8 that the bankruptcy court did not abuse its discretion in granting
9 the preliminary injunction of a limited duration.

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CONCLUSION

The bankruptcy court employed the proper preliminary
injunction standards and apprehended the underlying legal issues
in the case. Its factual findings were not clearly erroneous.
Therefore, the bankruptcy court did not abuse its discretion in
granting a preliminary injunction to enjoin the arbitration
against Hoffman until plan confirmation. The order is **AFFIRMED**.