NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. NC-05-1510-MaSAl
EXCEL INNOVATIONS, INC.,	Bk. No. 04-53874-ASW
Debtor.	Adv. No. 05-05361
SOLIDUS NETWORKS, INC.; INDIVOS CORPORATION,	
Appellants,	
v.	**M E M O R A N D U M**[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.

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[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.

INTRODUCTION

The bankruptcy court granted a preliminary injunction to enjoin an arbitration proceeding brought by creditors against a shareholder of the debtor until a chapter 11[3] plan was confirmed.

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

The creditors, whose chapter 11 plan and disclosure statement are pending in bankruptcy court,[4] have appealed the order for

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

[4] We take judicial notice of the chapter 11 liquidating plan 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).

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

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

FACTS

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

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

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[5] A BAP motions panel has determined that this was a final order under the Federal Arbitration Act ("FAA"), in regards to 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).

[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.

The AAA Claim stemmed from alleged breaches of various settlement agreements executed by Hoffman or Excel and Indivos in 2000. The agreements included a Voting Trust and Standstill Agreement, which barred Hoffman from interfering in shareholder votes or the management of Indivos, and a Pledge Agreement, which granted Indivos a security interest in Excel's and Hoffman's shares of stock in Indivos, which were agreed to be held in the Voting Trust as collateral for enforcing Hoffman's obligations under the settlement agreements. Indivos alleged that Hoffman and/or Excel had interfered in the merger of Indivos and Solidus Networks, Inc. ("Solidus") (together "Appellants"), which merger was concluded in 2003.[7] One way he/it did this was by filing multiple lawsuits against Indivos and Appellants.[8] In defending these lawsuits, Appellants used money from their stockholders' escrow fund, which had been established to pay for merger litigation expenses. The goal of the AAA complaint was to obtain an order awarding Appellants the pledged stock in payment of their attorneys' fees, in order to replenish the stockholders' escrow fund to its originally allotted $2.45 million.

The AAA Claim contained seven counts:

1. Breach of contract regarding settlement agreements.
2. Declaratory relief regarding settlement agreements.
3. Breach of contract regarding pledged collateral.
4. Declaratory relief regarding settlement agreements.
5. Unfair business practices regarding pledged collateral.
6. Breach of fiduciary duty by Hoffman.
7. Conspiracy/Alter Ego.

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

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

[8] Seventeen lawsuits were filed; 14 of those were dismissed or resolved against Hoffman.

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

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

Methven Letter Ruling 11, May 14, 2004.

After Hoffman's bankruptcy case was dismissed, in February 2005, Appellants sought to revive the arbitration proceedings against him. At an unrelated stay relief hearing, the bankruptcy 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.

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

> There are claims in this arbitration that involve only Mr. Hoffman. As a result, this arbitration is going to proceed with respect to Mr. Hoffman.
>
> Mr. Hoffman has three choices: 1) obtain an order from Judge Weissbrodt staying this arbitration; 2) participate in this arbitration; or 3) refuse to participate in this arbitration, in which case I will set a "prove-up" hearing where [Appellants' counsel] will 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.

Methven Letter, May 17, 2005.

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

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

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[9] Appellants' counsel described the prepetition status of the AAA proceedings, in 2004, as follows:

> On May 19, 2004, the parties began arbitrating (1) Indivos' damages for what the Arbitrator ruled on summary judgment were breaches of a June 2000 settlement agreement, and (2) Excel's and Hoffman's liability for breaches of the settlement agreement for which the Arbitrator had denied summary judgment. Between May 19 and May 28, 2004, four witnesses testified, 110 exhibits were introduced, Indivos had concluded its affirmative 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.

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

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

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

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

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

[11] We take judicial notice of the fact that on April 21, 2006, Hoffman filed a late proof of claim for indemnification 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.

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

1) Indivos could only proceed against Hoffman, but not with respect to certain claims, including the alter ego claim;

2) the proceeding against Hoffman would be without prejudice to Excel's rights, claim or defenses in the arbitration, and would have no preclusive effect on Excel's claims or defenses in the arbitration;

3) no new evidence would be presented; and

4) Indivos would not seek to offset any damages award it obtained against Hoffman against the turnover claim brought by Excel, nor apply it against either the merger proceeds or the indemnity fund attributable to Excel, without further order of the bankruptcy court.

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

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

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

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

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

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

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

> 2. During the course of the Arbitration in 2004, I was the CEO of the Debtor, the Debtor and I were jointly represented by the same counsel (who was employed by the Debtor), and our defense was closely coordinated. Our defense was coordinated in part because it was our joint position then that all the actions complained of in the Arbitration were undertaken by me either in my capacity as an officer and director of the Debtor or otherwise under taken [sic] as an agent of the Debtor on behalf of and in the best interests of the shareholders of the Debtor and its legitimate creditors. For that same reason, the Debtor had agreed to provide for our common defense and to indemnify me for any award that might result from the Arbitration. Our common defense was designed to jointly protect the interests of both me and the Debtor, including all of its shareholders and legitimate creditors.
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> 3. At the time of the events which are the subject of the Arbitration I also was a director and CEO of the 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.
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> 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.
>
> . . . .

> 6. If, as Indivos proposes, I and the Debtor are de-linked in the Arbitration, several ramifications will adversely impact key assets and legal strategies of the Debtor, as described briefly below without providing any privileged litigation previews:
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> a. First, the Debtor and I could for the first time be compelled to become adversarial, thereby undercutting the efficiency and the effectiveness of the joint defense we have heretofore coordinated and benefited from, both legally and financially. For example, I will be compelled to demand, pursuant to the bylaws of the Debtor and the California Corporations Code § 317 that the Debtor reimburse me for my expenses including attorneys' fees in defending myself in the arbitration and to indemnify me in the event of any award arising from any actions I engaged in as a director, officer or agent of the Debtor.
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> b. Second, my defense will be compelled to focus on protecting my personal interests and not necessarily the interests of the Debtor.
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> c. Third, in order to further detail that my actions were undertaken as a director, officer or agent of the debtor and in accordance with legal advice from attorneys for the Debtor, I will be compelled to reveal the substance of critical privileged communications between myself and attorneys for the Debtor . . . , which can severely jeopardize the Debtor's litigation strengths 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.

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

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

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

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

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

ISSUE

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

STANDARD OF REVIEW

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

[12] Standing is a jurisdictional matter, which we review de novo; we may raise the issue of standing sua sponte. Houston v. Eiler (In re Cohen), 305 B.R. 886, 891 (9th Cir. BAP 2004). Although Hoffman was named as a party defendant in Excel's 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).

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

DISCUSSION

A. Legal Standards

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

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

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

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

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

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

B. Section § 105(a)

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

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

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

> [A] bankruptcy court can enjoin proceedings in other courts when it is satisfied that such proceedings would 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.

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

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

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

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

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

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

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

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

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

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

C. The Traditional Standard

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

[13] In fact, the Seventh Circuit, which was cited by the Ninth Circuit for application of the § 105(a) standard, stated that "the court does not need to demonstrate an inadequate remedy at law or 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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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.**