

In re Peregrine Systems, Inc., et al.

Bankruptcy No. 02-12740JKF (Debtor), Chapter 11 Jointly Administered, Re: Dkt. No. 2927, Motion Pursuant to Section 510... to Subordinate... Claims as Class 9 Claims ...Dkt. No. 3048, Creditor Barry Ariko's Objection to Motion ... to Motion to Subordinate....

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF DELAWARE

2004 Bankr. LEXIS 346; 42 Bankr. Ct. Dec. 229

March 30, 2004, Decided

JUDGES: Judith K. Fitzgerald, U.S. Bankruptcy Judge.

OPINION BY: Judith K. Fitzgerald

OPINION

MEMORANDUM OPINION AND ORDER

Before the court is the Motion Pursuant to [Section 510 of the Bankruptcy Code](#) to Subordinate, Reclassify and Treat certain claims (proofs of claim numbers 1126 and 1128) filed on behalf of Barry Ariko as Class 9 Claims under the confirmed plan of reorganization of Peregrine Systems, Inc. and Peregrine Remedy, Inc. Class 9 is comprised of claims subordinated pursuant to [11 U.S.C. § 510\(b\)](#) as incident to the purchase and sale of securities of the Debtors.

The court's jurisdiction is not at issue. This Memorandum Opinion and Order constitute my findings of fact and conclusions of law.

Briefing and argument are complete. At the conclusion of the argument on March 15, 2004, I ruled that proof of claim number 1128 should not be part of Class 9 and indicated that I would so order when the parties submitted an order. Thus, this memorandum and order will deal only with proof of claim number 1126.

----- Footnotes -----

It appears from the docket that no such order has been submitted.

----- End Footnotes-----

Also during the argument on March 15, 2004, I ruled that the portion of Ariko's claim number 1126 based on his employment agreement properly belonged in Class 9. Having

reviewed the record and the case law, I now find that the remainder of the claim, based on a noncompetition agreement Ariko entered into with Peregrine Systems, Inc., also is properly classified in Class 9.

The facts underlying the relationship between Ariko and the Debtor are not in dispute. Ariko owned Extricity, Inc., a company that Debtor wanted to acquire. As part of the merger transaction that the parties agreed upon, Ariko exchanged all of the stock of Extricity for stock of Peregrine. Ariko was Extricity's sole shareholder and board member and he signed the agreement for Extricity.

Peregrine would not agree to the merger unless Ariko also signed a six-month employment agreement and a non-compete agreement. Ariko did so and was employed for the six-month period. He was paid the cash and benefits required by that agreement. In addition, Ariko was given the position of Vice-President of Peregrine Systems, Inc. The terms of the employment agreement were memorialized in a letter dated March 11, 2001. See Creditor Barry Ariko's Supplement to Objection to Debtors' Motion Pursuant to [Section 510](#)... to Subordinate ...Claims, Dkt. No. 3221, at Exhibit 1. The Noncompetition Agreement executed the same day begins:

"NONCOMPETITION AGREEMENT

This Noncompetition Agreement is being executed and delivered as of March 11, 2001 by Barry Ariko (the "Stockholder") in favor of and for the benefit of Peregrine Systems, Inc., a Delaware corporation ("Parent"), and Extricity, Inc., a Delaware corporation (the "Company").

RECITALS

A. As an employee and stockholder of the Company, Stockholder has obtained

Dkt. No. 3221 at Exhibit 3.

Thereafter, each reference in the noncompetition agreement to Barry Ariko is to his position as "Stockholder." Moreover, the only consideration for the agreement was the exchange of the shares of stock in Extricity for shares of the common stock of Peregrine.

Thus, it is clear from the face of the document that the noncompetition agreement was entered into as part and parcel of the merger and for no other purpose or consideration. As a result, this transaction falls squarely within the types of transactions required to be subordinated by [11 U.S.C. § 510\(b\)](#).

In [Baroda Hill Inv., Inc. v. Telegroup, Inc. \(In re Telegroup, Inc.\), 281 F.3d-133, 141 \(3d Cir. 2002\)](#), our court of appeals indicated that [§ 510\(b\)](#) represents Congress' judgment that claims of shareholders of a corporate debtor that arise from their purchase or sale of stock must be subordinated to the claims of creditors. Thus, [§ 510\(b\)](#) "prevents disappointed shareholders from recovering their investment by asserting claims for

damages on parity with general unsecured creditors." [In re Alta+Cast, LLC ,301 B.R. 150, 154 \(Bankr. D. Del. 2003\)](#). Telegroup makes clear that [§ 510\(b\)](#) applies both to conduct that occurred at the time of the issuance of stock and to conduct that occurred after the issuance of stock because the nature of the claim, i.e., to recover a portion of the claimant's equity investment, is of more significance than the timing of the conduct. Thus, subordination cannot be defeated merely by attempting to classify a claim as a breach of contract rather than a breach incident to a stock purchase or sale agreement.

In [In re Alta+Cast, LLC, 301 B.R. at 155](#), Judge Walrath dealt with a situation similar to the instant one. There, Hays sought damages for alleged breach of an employment agreement caused by the debtor's failure to repurchase his membership interest in the debtor. Judge Walrath had no difficulty in finding, despite Hays' characterization of his claim, that the claim had a causal connection to the repurchase requirement and was a claim arising from an agreement for the sale or purchase of a security of the debtor. Here, Barry Ariko's alleged \$ 15 million claim is based on the fact that he entered into the merger agreement, through which he allegedly lost money. Regardless of the fact that he now contends he was defrauded into making the exchange, in reality his complaint is tied to the stock transaction. He admits that he would not have been offered employment, or a position as Vice-President, or a non-compete agreement had he not agreed to merge his equity interest in Extricity with Peregrine.

For these reasons, proof of claim number 1126 shall be classified in Class 9 and subordinated pursuant to [§ 510\(b\)](#).

IT IS SO ORDERED, THIS 30th DAY OF MARCH, 2004.

Judith K. Fitzgerald

U.S. Bankruptcy Judge