



SO ORDERED.

SIGNED this 09 day of February, 2004.


LEIF M. CLARK
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

IN RE:

MARK NUTRITIONALS, INC.,

DEBTOR.

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CASE NO. 02-54469
CHAPTER 7

**ORDER APPROVING COMPROMISE AND SETTLEMENT
BETWEEN THE STATE OF TEXAS AND THE CHAPTER 7 TRUSTEE**

On the 27th day of January, 2004, came on to be considered the “Joint Motion of the State of Texas and the Chapter 7 Trustee For Approval of Compromise and Settlement” (Docket No. 409, “the Motion”).

1. The Court notes that an Objection to the proposed settlement was filed by counsel for the Consumer Class Action (Docket No. 432), but has been resolved and withdrawn by agreement.
2. Having heard evidence and the arguments of Counsel, and noting that the settlement is

now unopposed, the Court finds the motion has merit and approves the proposed settlement, and grants the Motion in its entirety.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

3. The Court conducted an evidentiary hearing on the motion to approve the settlement and makes the following findings of fact and conclusions of law.

4. From 1999 through early 2003, Debtor, Mark Nutritionals, Inc., was engaged in the business of selling weight loss products, notably the “Body Solutions Evening Weight Loss Formula,” which is estimated to have generated 90% of its sales revenue. Pre-petition, the Texas Department of Health (“TDH”) and the Texas Attorney General’s Office (“OAG”) (collectively, “the State”), conducted an investigation of Mark Nutritionals, Inc. for alleged violations of the Texas Food, Drug and Cosmetic Act (“TFDCA”), TEX. HEALTH AND SAFETY CODE ANN. §§ 431.001 *et seq.* (Vernon 1992 & Supp. 2000), and the Texas Deceptive Trade Practices-Consumer Protection Act (“DTPA”), TEX. BUS. & COM. CODE § 17.41 *et seq.* (West 2002). The State’s investigation was conducted in cooperation with the Federal Trade Commission (“FTC”) and the states of Illinois and Pennsylvania. TDH inspected and observed Debtor’s facilities, products, promotional literature, and internet website, and observed what it alleges to have been false and misleading health or drug claims. TDH also observed what it alleges were incomplete labeling and misbranded products. The State alleged both pre-petition and post-petition violations of the TFDCA and the DTPA.

5. On September 17, 2002, Mark Nutritionals, Inc. filed its voluntary Chapter 11 bankruptcy petition.

6. Post-petition, the State continued to seek enforcement of applicable state laws against the

Debtor-in-Possession. On December 5, 2002, acting in its police and regulatory capacity pursuant to 11 U.S.C. § 362(b)(4), the State of Texas sued the Debtor-in-Possession in state district court in Dallas County, Texas (*State of Texas v. Mark Nutritionals, Inc. et al*, Cause No. 02-11369, in the 162nd District Court of Dallas County, Texas).

7. In February 2003, post-petition, TDH detained over 255,598 bottles of Debtor-in-Possession's product alleged to have been misbranded under §§ 431.082 and 431.021 of the TFDCA.

8. On April 2, 2003, the Court heard motions to convert the case to Chapter 7. An agreement to convert the case was announced, and an Agreed Order to convert the case was signed and entered on April 4, 2003 (Docket No. 217).

9. The State presented evidence that post-petition, during the pendency of the Chapter 11 proceedings in this case (September 17, 2002 through April 2, 2003), the Debtor-in-Possession may have committed numerous and continuous violations of state law with respect to product labeling and deceptive advertising.

10. On April 29, 2003, the State filed a formal Adversary Complaint against the Bankruptcy Estate (Adversary No. 03-05074). In the Adversary Complaint, the State sought a declaratory judgment that pursuant to 11 U.S.C. § 503, civil fines and penalties incurred by a Debtor-in-Possession for violations of state law committed by the Debtor-in-Possession during the pendency of the Chapter 11 proceedings are to be afforded Chapter 11 administrative priority status. Subsequently, the State filed two separate administrative claims asserting claims for (1) post-petition consumer restitution, and (2) civil fines and penalties (Docket Nos. 371 and 407).

11. Another claim sought to be resolved by this settlement is that filed by the Texas

Comptroller of Public Accounts (“Comptroller”) (proof of claim No. 187) for sales and use tax in the amount of \$309,077.47.

SETTLEMENT TERMS

12. The Trustee and the State have proposed settling their claims and disputes as follows, and the Court hereby Orders:

13. In accordance with the Bankruptcy Code priority scheme, first priority is given to Chapter 7 administrative expenses. Subject to payment of (or sufficient reserve for) allowed Chapter 7 administrative expenses, the following distributions shall be made. The State shall have an allowed Chapter 11 administrative claim for post-petition consumer restitution in an amount not to exceed \$1,212,416.00 (“State’s Post-Petition Consumer Restitution Claim”). Distribution to post-petition consumers shall be made by the Trustee, or by a third party as agreed by the State and the Trustee, to be paid from the reserved amount in either case, upon entry of a further Order of this Court.

14. The State shall have an allowed Chapter 11 administrative claim for fines and penalties in the amount of thirteen million dollars (\$13 million) (“State’s Post-Petition Penalty Claim”), which under the terms of this Settlement shall be subordinated as follows:

15. First, to the post-petition consumer restitution claims of up to \$1,212,416.00. The State and the Trustee are authorized to administer restitution out of the \$1,212,416.00 allotted to restitution under this Order.

16. Second, to the allowed Chapter 11 administrative claim of Counsel for the Official Committee of Unsecured Creditors, William B. Kingman, P.C. (See Docket No. 456 Order Allowing Compensation for William B. Kingman.)

17. Third, to the ad valorem taxing authorities (Bexar County, the City of San Antonio, and the local school district), which shall receive cash payment of \$30,000, according to the terms of a separate settlement reached by the Trustee.

18. Fourth, to the Texas Comptroller so that the State shall receive a cash payment of \$300,000 to be first applied to the Comptroller's Claim (Proof of Claim No. 187).

19. Fifth, in accordance with the settlement agreement, the State shall subordinate its allowed \$13 million Post-Petition Penalty Claim to all other creditors. Under the terms of this Settlement, the State has agreed to those claims specifically set forth above.

20. Nothing in this Order shall, however, prejudice the State's standing to be heard on any other matters in this case, including inter alia claims on behalf of consumers for pre-petition restitution.

21. In addition to the division of Bankruptcy Estate assets, the Trustee and the State have proposed non-monetary conditions of settlement, and the Court hereby Orders:

22. First, so as to prevent their potential misuse by unscrupulous businesses, the Trustee and the State have agreed that under the terms of this settlement, the Trustee shall transfer to the State all of the Bankruptcy Estate's interest, ownership, and control in the Bankruptcy Estate's internet domain names, web-sites, and associated passwords. The State is authorized to accept or not accept such transfer, as may be permitted under applicable law. Conditional upon accepting the transfer, the State is authorized to use such web-sites at its sole discretion, for governmental purposes including but not limited to consumer education.

23. Second, so as to prevent any risk that consumers might be victimized were the customer list sold or transferred to an unscrupulous person or entity, the Trustee and the State have agreed

and it is accordingly Ordered that at the close of the administration of this case, the Trustee shall destroy, erase, and/or render irretrievable all customer lists, databases, credit card information, addresses, financial information, and any other personal information of Mark Nutritionals customers in whatever format (computerized, hard paper copy, and/or other format), which are in possession of the Bankruptcy Estate, and shall file with the court an affidavit, to be signed by the person(s) engaged by the Trustee to accomplish this task, certifying to the court that this task has been accomplished.

24. Third, the Trustee and the State have agreed that the Trustee shall sign and enter an “Agreed Final State Court Judgment and Permanent Injunction,” granting permanent injunctive relief sought by the State of Texas in its state court civil enforcement action (*State of Texas v. Mark Nutritionals, Inc. et al*, Cause No. 02-11369, in the 162nd District Court of Dallas County, Texas).

25. Under Bankruptcy Rule 9019, the Court has discretionary authority to approve a compromise of controversy. See *Protective Comm. of Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968), on remand, *TMT Trailer Ferry, Inc. v. Kirkland*, *TMT Trailer Ferry, Inc. v. Kirkland*, 471 F.2d 10 (5th Cir. 1972); *Continental Airlines, Inc. v. Air Line Pilots' Ass'n Int'l, (In re Continental Airlines, Inc.)*, 907 F.2d 1500, 1508 (5th Cir. 1990). Whether to approve a proposed compromise is a matter within the sound discretion of the bankruptcy court. See *In re Aweco, Inc.*, 725 F.2d 293 (5th Cir. 1984). Bankruptcy settlements are a “normal part of the bankruptcy process” and “desirable and wise methods of bringing to a close proceedings otherwise lengthy, complicated, and costly.” *TMT Trailer*, 390 U.S. at 424; *In re Jackson Brewing Co.*, 624 F.2d 599, 602 (5th Cir. 1980).

26. In deciding whether to approve a settlement, a bankruptcy court should evaluate the following:

(A) the probability of success in litigation, with due consideration for the uncertainty of the facts and the law;

(B) the complexity and likely duration of the litigation and any attendant expense, inconvenience, and delay; and

(C) all other factors bearing on the wisdom of the compromise.

See *Connecticut Gen. Life Ins. Co. v. United Cos. Fin. Corp. (In re Foster Mortgage Corp.)*, 68 F.3d 914, 917 (5th Cir. 1995); *Jackson Brewing*, 624 F.2d at 602. This standard seeks to balance the risks and benefits associated with pursuing a potential claim against the costs associated with the proposed settlement.

27. Whether the settlement is a product of an arms-length negotiation is a factor bearing on the wisdom of the compromise. *Foster Mortgage*, 68 F.3d at 918. Generally, the role of the bankruptcy court is not to decide the issues in dispute when evaluating a settlement.

28. Applying these standards of review, the Court expressly finds that the proposed settlement is fair, equitable and clearly in the best interests of the Bankruptcy Estate. The Court holds that post-petition consumers of Mark Nutritionals products are in the nature of tort claimants under *Reading Co. v. Brown*, 88 S.Ct. 1759 (1968), and that the claims of such consumers are entitled to Chapter 11 administrative priority. Thus, the largest payment from this Bankruptcy Estate shall be to alleged victims of the alleged misconduct of the Debtor-in-Possession. The Court finds that the State has authority under state law to seek restitution for such consumers.

29. The Court finds that the proposed settlement harmonizes several potentially divergent interests: (1) the best interests of the Bankruptcy Estate, and notably the post-petition consumers; (2) the exercise of the State's police power with the best interests of creditors.¹ Accordingly, the Court approves the proposed settlement in its entirety.

¹See e.g., *In re Sensitive Care*, 239 B.R. 117 (Bankr.N.D.Tex. 1999), approving a settlement between the Estate and the State which harmonized the protection of nursing home residents and matters of public fisc with the rights and priorities of creditors under the Bankruptcy Code.

30. The Court holds that pursuant to 11 U.S.C. § 503, civil fines and penalties incurred by a Debtor-in-Possession for knowing and intentional violations of state law committed by a Debtor-in-Possession during the pendency of Chapter 11 proceedings are to be afforded administrative priority status.

31. It is further accordingly Ordered that there shall be no admission of liability or finding entered against the Bankruptcy Estate for liability and/or damages in connection with this settlement. The Court further holds that this Settlement may not be used for or against this Bankruptcy Estate in this bankruptcy case, any currently pending litigation, or any future litigation brought by or against the Bankruptcy Estate.

32. To the extent that they find it necessary, the State and the Trustee are authorized to seek further guidance from the Court on an expedited basis via appropriate motions on matters pertaining to carrying out the terms of this settlement in a manner consistent with this Order.

SO ORDERED.

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This order was prepared and is being submitted by:
JAMES A. HOFFMAN, ESQ.
CLEMENS & SPENCER, P.C.
State Bar No. 09781725
Counsel for Chapter 7 Trustee
112 East Pecan Street, Suite 1500
San Antonio, Texas 78205
P: 210/227-7121
F: 210/227-0732

AND

Hal Morris, Bankruptcy & Collections Division
Joyce Iliya, Consumer Protection Division
Kevin Raymond, Bankruptcy & Collections Division
Assistant Attorneys General
Office of the Texas Attorney General
P.O. Box 12548
Austin, Texas 78711
P: 512/475-4937
F: 512/482-8341