IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: WOODBRIDGE GROUP OF COMPANIES, LLC, *et al.*,[1] Debtors.	Chapter 11 Case No. 17-12560 (KJC) (Jointly Administered) **Dkt. Nos. 1563, 1826**

DEBTORS' REPLY (I) TO CONTRARIAN FUNDS LLC'S RESPONSE TO DEBTORS' OBJECTION TO PROOF OF CLAIM 1216, AND (II) IN FURTHER SUPPORT THE DEBTORS' CLAIM OBJECTION

Woodbridge Group of Companies, LLC and its affiliated debtors and debtors in possession (collectively, the "Debtors") in the above-captioned chapter 11 cases (the "Chapter 11 Cases") hereby reply (this "Reply") to *Contrarian Funds LLC's Response to Debtors' Objection to Proof of Claim 1216* [Docket No. 1826] (the "Response") and in further support of the *Debtors' (I) Objection to Proof of Claim No. 1216 Asserted by Putative Transferee Contrarian Funds, LLC Without Prejudice to Right of Putative Transferors Elissa and Joseph Berlinger to Assert Such Claim; and (II) Request for a Limited Waiver of Local Rule 3007-1(f)(iii), to the Extent Such Rule May Apply* [Docket No. 1563] (the "Claim Objection").[2]

[1] The last four digits of Woodbridge Group of Companies, LLC's federal tax identification number are 3603. The mailing address for Woodbridge Group of Companies, LLC is 14140 Ventura Boulevard #302, Sherman Oaks, California 91423. Due to the large number of debtors in these cases, which are being jointly administered for procedural purposes only, a complete list of the Debtors, the last four digits of their federal tax identification numbers, and their addresses are not provided herein. A complete list of such information may be obtained on the website of the Debtors' noticing and claims agent at www.gardencitygroup.com/cases/WGC, or by contacting the undersigned counsel for the Debtors.

[2] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in the Claim Objection or the Response.

I. INTRODUCTION

1. Contrarian has done an about-face. After months of soliciting Noteholders with offers to purchase their "notes,"[3] after filing a proof of claim that specifies the "basis of claim" as "PROMISSORY NOTES" that are secured by real property, after filing a motion styled *Motion of Contrarian Funds, LLC for Authority to Acquire Promissory Notes Against the Debtors* [Docket No. 890] (the "Note Motion"), after complaining repeatedly about the Debtors' *Notice Regarding Transfers of Notes or Units* [Docket No. 799] (the "Note Notice"), and after seeking relief from this Court in a discovery motion that repeatedly states Contrarian has "acquired Notes," *Motion to Quash of Contrarian Funds, LLC* [Docket No. 1585] (the "Motion to Quash") ¶¶ 1 & 13, Contrarian now tries to take the position that it did not purchase any Notes after all—it merely purchased "claims or causes of action relating to the Notes." Response, ¶ 2.

2. Contrarian's about-face is too clever by half. The transaction by which Contrarian purportedly acquired these "claims or causes of action relating to the Notes," *id*., was the very transaction in which Contrarian claimed to have purchased the Notes themselves—and that transaction is, to use the crystal clear language of the Notes and the Loan Agreements associated therewith, "null and void," *see* Note § 14 (any "attempted assignment without [the Debtors'] consent is null and void"), and wholly ineffective to convey "any of [the Berlingers'] rights [t]hereunder," Loan Agreement § 4(d).[4] An attempted transaction that is "null and void" conveys no rights. Legal title to the Notes that Contrarian attempted to acquire continues to reside with the Berlingers because they never validly transferred them.

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3 *See* Contrarian "Dear Noteholder" Letter dated January 24, 2018 (attached hereto as **Exhibit A**) ("[Contrarian] would like to purchase your secured promissory note ….").

4 Each Loan Agreement follows the promissory notes in Exhibits 1, 2, and 3 to the Guffy Declaration appended to the Response.

3. That Contrarian deemed it necessary to lead with such a patently counter-factual position speaks volumes about the strength of its remaining arguments—none of which has any merit. The Claim Objection rests on Bankruptcy Code section 502(b)(1), which renders objectionable any claim that is "unenforceable against the debtor… under ***any agreement*** or applicable law …." 11 U.S.C. § 502(b)(1). (emphasis added). The Loan Agreement is "an[] agreement" within the scope of Bankruptcy Code § 502(b)(1), and it pellucidly provides that the Berlingers "shall not assign, voluntarily, by operation of law or otherwise, ***any of [their] rights [t]hereunder*** without the prior written consent of Woodbridge and any such attempted assignment without such consent shall be null and void." Loan Agreement § 4(d) (emphasis added). The "rights [t]hereunder" are broader than the Notes themselves, and they include the right to repayment and the right to file a proof of claim in these Chapter 11 Cases. None of those rights were validly transferred to Contrarian.

4. At bottom, it is the Berlingers who are owed $75,000 on account of their Notes. Contrarian owns nothing and is owed nothing. The Claim Objection should be sustained.

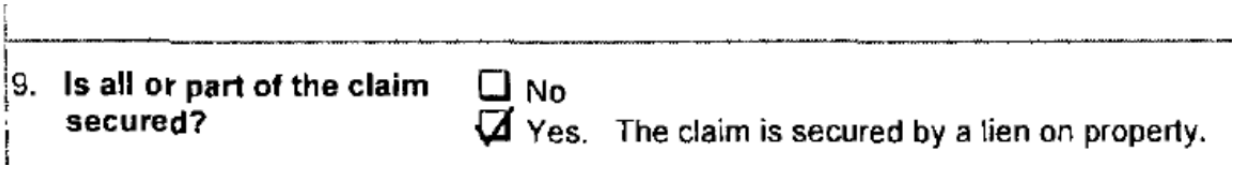
II. ARGUMENT

A. Contrarian Attempted to Purchase the Berlingers' Notes—and That Attempt Was "Null and Void" and Conferred No Rights

5. In the proof of claim that is the subject of the Debtors' Claim Objection, Contrarian was required to specify (under penalty of perjury) the "basis of [its] claim." It specified "PROMISSORY NOTES":

8. **What is the basis of the claim?**	Examples: Goods sold, money loa Attach redacted copies of any doc Limit disclosing information that is PROMISSORY NOTES

And lest there be any doubt, Contrarian further averred that its claim was "secured by a lien on property":


9. **Is all or part of the claim secured?**
☐ No
☑ Yes. The claim is secured by a lien on property.

6. Contrarian's proof of claim for secured "PROMISSORY NOTES" is subject to disallowance under Bankruptcy Code section 502(b)(1) because Contrarian did not actually acquire any Notes. The transaction by which it attempted to do so was, in the words of both the Notes and the associated Loan Agreement, "null and void," Note § 14; Loan Agreement § 4(d), and therefore altered no rights, alienated no legal title, and conferred no lawful authority to file a proof of claim. Even had Contrarian filed a claim for something beyond "Promissory Notes" (it did not), Contrarian's slippery distinction between the "Notes" owned by the Berlingers and "claims or causes of action relating to the Notes," Response, ¶ 2, does not change that fact. The Loan Agreement renders "null and void" any attempted alienation of any of the Berlingers' "rights [t]hereunder," Loan Agreement § 4(d)—including the right to repayment and the right to make a claim for non-payment:

> **(d)** This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns, provided, however, that Lender shall not assign, voluntarily, by operation of law or otherwise, any of its rights hereunder without the prior written consent of Woodbridge and any such attempted assignment without such consent shall be null and void;

7. Finally, to the extent Contrarian claims to have purchased only "causes of action relating to the Notes," Response, ¶ 2, rather than the Notes themselves, that argument raises two distinct and serious problems:

a. *Champerty.* Taking Contrarian's position at face value, the assignment may well constitute champerty under New York law,[5] *see Justinian Capital SPC v. WestLB AG*, 65 N.E.3d 1253, 1256 (N.Y. 2016) ("New York's champerty doctrine … prohibits the purchase of notes, securities, or other instruments or claims with the intent and for the primary purpose of bringing a lawsuit."), or maintenance under Delaware law, *see Hall v. State*, 655 A.2d 827, 829 (Del. Super. Ct. 1994) (defining maintenance as "the intermeddling in a suit by a stranger, one having no privity or concern in the subject matter and standing in no relation of duty to the suitor"). There is a fundamental difference between the legitimate acquisition and enforcement of a legal right to payment (something Contrarian could not have done here, because its attempt was null and void) versus the purported acquisition of a "right" to stir up litigation with respect to a transaction to which Contrarian is a legal stranger (here, the Loan Agreements and the Notes).

b. *Claim splitting.* If Contrarian bought the claims but not the Notes, then the Berlingers would still own the Notes, while Contrarian would hold whatever other litigation rights arose from the Notes. Such a result would violate "[t]he long-standing rule against improper claim splitting [that] prohibits a plaintiff from prosecuting his case piecemeal and requires that all claims arising out of a single alleged wrong be presented in one action." *Prewitt v. Walgreens Co.*, 2013 WL 6284166, at *5 (E.D. Pa. Dec. 2, 2013) (citing *United States v. Haytian Republic*, 154 U.S. 118, 125 (1894)); *Wilson v. Brown*, 36 A.3d 351 (Del. 2012) (same).

8. The obvious answer to both the preceding problems is that the distinction that Contrarian is seeking to make is untenable and without factual or legal support. There probably was no champerty or claim splitting, because there was an unauthorized transfer of Notes.

[5] The Transfer of Claim Agreement has a New York choice of law provision. Guffy Decl., Ex. 4 ¶ 9.

B. The Anti-Assignment Clause in the Notes Expressly Renders any Assignment Null and Void Absent Consent by the Debtors, as Required by Applicable Law

9. Next, Contrarian asserts that anti-assignment provisions must be narrowly construed in Delaware, the governing law under both the Notes (¶ 13) and the Loan Agreement (§ 4(b)). Perhaps. But "narrow construction" does not mean "wholesale obliteration," as the very Delaware case law Contrarian relies on makes clear.

10. Contrarian's narrow-construction argument begins with *Southeastern Chester County Refuse Authority v. BFI Waste Services of Pennsylvania, LLC*, 2017 WL 2799160 (Del. Super. Ct. June 27, 2017) ("*Southeastern*"), which Contrarian quotes for the proposition that Delaware courts construe anti-assignment provisions "'narrowly because of the importance of free assignability.'" Response, ¶ 15 (quoting *Southeastern*, 2017 WL 2799160, at *5). This carefully plucked language appears in the first sentence of the following two paragraphs of the *Southeastern* decision, which need to be read in their entirety:

> While Delaware courts recognize the validity of clauses limiting a party's ability to subsequently assign its rights, courts generally construe such provisions narrowly because of the importance of free assignability. Accordingly, the modern approach to assignment clauses is to distinguish between the power to assign and the right to assign.
>
> When a provision restricts a party's ***power*** to assign, it renders any assignment void. However, in order for a court to find that a contract's clause prohibits the ***power*** to assign, there must be express language that any subsequent assignment will be void or invalid. Without such express language, the contract merely restricts the ***right*** to assign. When a contract limits a party's ***right*** to assign instead of the ***power*** to do so, the assignment is valid and enforceable but generates a breach of contract action that the non-assigning party may bring against the party assigning its interest.

Southeastern, 2017 WL 2799160, at *5 (emphasis in original).

11. The Delaware Superior Court in *Southeastern* relied on the absence of language in the notes at issue there disempowering the original holder from assigning (*i.e.*, there was no

language rendering an assignment null and void) to distinguish earlier cases that had enforced anti-assignment clauses. *Id*. at *6-*7. Here, by contrast, both the Notes and the Loan Agreements expressly restrict the noteholder's ***power*** to assign by providing that "any such attempted assignment without such consent shall be null and void." Note § 14; Loan Agreement § 4(d). Different contractual language leads to a different result. *See, e.g.*, *Paul v. Chromalytics Corp.*, 343 A.2d 622, 625 (Del. Super. Ct. 1975) ("The validity of such clauses [*i.e.*, those rendering null and void assignments made without required consent] has invariably been upheld."); *Univ. Mews Assocs. v. Jeanmarie*, 471 N.Y.S.2d 457, 461 (N.Y. Sup. Ct. 1983) ("[A] contractual clause forbidding or restricting an assignment of rights thereunder … must specifically eliminate the ***power*** as well as the right to assign the contract in violation of its bar or restrictions, otherwise the original obligor is given only the right to damages for its breach, but does not render the assignment ineffective." (emphasis added)).

12. None of the seven cases cited by Contrarian in the Response are to the contrary:

- *Vermont Agency of Natural Resources v. U.S. ex rel. Stevens*, 529 U.S. 765 (2000), *see* Response, ¶ 14, did not involve a contract assignment at all. The Supreme Court was analogizing a *qui tam* relator to a contractual assignee. 529 U.S. at 773.

- *Industrial Trust Co. v. Stidham*, 33 A.2d 159 (Del. 1942), *see* Response, ¶ 15, merely stands for the proposition that causes of action are generally assignable—it did not involve a contract with an anti-assignment provision. 33 A.2d at 160–61. What is more, the purported assignment was not honored in any event because the "entire transaction of the purported assignment, in all its details, was wholly conceived and executed in fraud." *Id*. at 162.

- *Lone Mountain Production Co. v. Natural Gas Pipeline Co.*, 984 F.2d 1551 (10th Cir. 1992), *see* Response, ¶ 15, concerned contracts that expressly permitted assignment and involved a course of dealing in which such assignments were recognized. *Id.* at 1556–57.

- *Charles L. Bowman & Co. v. Erwin*, 468 F.2d 1293 (5th Cir. 1972), *see* Response, ¶ 17, involved an anti-assignment clause that restricted the right but not the power to assign. 468 F.2d at 1297. The court relied on the general "rule requiring the

plainest words to bar assignment" and ultimately determined that "the contract as a matter of law permitted assignment of [the] right to the royalties." *Id.* at 1298.

- *TAP Holdings, LLC v. ORIX Finance Corp.*, 2014 WL 6485980 (N.Y. Sup. Ct. Nov. 20, 2014), *see* Response, ¶ 18, similarly involved an anti-assignment clause that restricted the right but not the power to assign: "The contractual language upon which defendants rely contains no provision that assignments made in contravention thereof … should be void or result in no acquisition of rights by reason of such assignment." 2014 WL 6485980, at *5.

- *Zazzali v. Alexander Partners LLC*, 2016 WL 10537011 (D. Idaho July 26, 2016), *see* Response, ¶ 18, involved the prosecution by a Plan Trustee of creditor-assigned claims for securities fraud, breach of contract, common law fraud, negligence and breach of fiduciary duty. 2016 WL 10537011, at *2. The defendants moved to dismiss based on "an anti-assignment provision in the subscription agreement." *Id.* at *4. Their—and the Court's—focus was solely on the securities claims. *Id.* at *6–7. Although the Court recited the general disfavor for anti-assignment provisions (which the opinion never quoted), given the claims assigned (generally non-contractual) and the absence of any discussion of the contract count, the case has little or no value here.

- *Avery Outdoors LLC v. Outdoors Acquisition Co.*, 2016 WL 8738242 (W.D. Tenn. Dec. 6, 2016), *see* Response, ¶ 18, involved a lender liability claim relating to alleged overpayment on a note by a borrower, which had been placed in receivership. 2016 WL 8738242, at *1–2. The note prohibited assignment but did not make one null, void or ineffective. *Id.* at *1. The Receiver sold the claim to the plaintiff, which filed suit. *Id.* at *2. In denying the motion to dismiss for lack of standing, the Court construed Tennessee law as providing that "a contractual provision prohibiting assignment is enforceable; however, an anti-assignment provision does not prohibit the assignment of a right to sue under the contract." *Id.* at *3.

With respect to the final two cases, it deserves additional mention that the applicable law in neither was Delaware and both involved court-approved transfers of claims. Thus, these cases provide little, if any, contrary authority in the face of explicit Delaware law that, as noted in ¶¶ 10–11, *supra*, "recognize[s] the validity of clauses limiting a party's ability to subsequently assign its rights." *Southeastern*, 2017 WL 2799160, at *5 (citing *Paul*, 343 A.2d at 625)).

13. Finally, Contrarian relies on the Restatement, but, like the case law Contrarian cites, it needs to be read *in toto*, not selectively excerpted. The Restatement's comment a to section 322 is instructive:

> In the absence of statute or other contrary public policy, the parties to a contract have power to limit the rights created by their agreement. The policy against restraints on the alienation of property has limited application to contractual rights. *Compare* Restatement of Property §§ 404–17. A term in a contract prohibiting assignment of the rights created may resolve doubts as to whether assignment would materially change the obligor's duty or whether he has a substantial interest in personal performance by the obligee (*see* §§ 317–19); or it may serve to protect the obligor against conflicting claims and the hazard of double liability (*see* §§ 338–43). But as assignment has become a common practice, the policy which limits the validity of restraints on alienation has been applied to the construction of contractual terms open to two or more possible constructions.

RESTATEMENT (SECOND) OF CONTRACTS § 322 cmt. a; *see also id.* cmt. d (citing a Delaware decision, *Paul*, discussed in ¶ 11, *supra*, for the proposition that "a waiver by the obligor must be clear and unequivocal.").

14. In context, the Restatement does not condemn to invalidity all anti-assignment provisions. It merely requires, like Delaware law, that they be unambiguous. As the anti-assignment provisions in the Notes and the Loan Agreements are clear, the Restatement supports enforcing them as written.

C. The Anti-Assignment Clause is Enforceable Notwithstanding the Debtors' Breach

15. Contrarian claims that "the Anti-Assignment Clause … ceased to bar transfers of the Notes when the Debtors breached their obligations to the Berlingers." Response, ¶ 20. But the cases Contrarian cites do not support that contention, and other cases Contrarian does not cite solidly reject it.

16. First, the cases Contrarian cites. *TAP Holdings*, *see* Response, ¶ 21, refused to enforce anti-assignment language because there was "no provision that assignments made in contravention thereof … should be void or result in no acquisition of rights by reason of such assignment." 2014 WL 6485980, at *5. It is of a piece with *Southeastern*, discussed in ¶ 10

supra, and is inapplicable here for the same reason: The Notes and Loan Agreements render attempts to assign without proper consent "null and void" and of no effect whatsoever. The balance of the cases—*Christiana Care Health Services, Inc. v. PMSLIC Insurance Co.*, 2015 WL 6675537, at *4 (D. Del. Nov. 2, 2015), *see* Response, ¶ 20, *DW Last Call Onshore, LLC v. Fun Eats & Drinks LLC*, 2018 WL 1470591, at *3 (S.D.N.Y. Mar. 23, 2018), *see* Response, ¶ 21, and *Allied Irish Banks, P.L.C. v. Bank of America*, 2006 WL 278138, at *5 (S.D.N.Y. Feb. 2, 2006), *see* Response, ¶ 21—are generally of no utility here because they rely upon the *per se* alienability of post-loss benefits under insurance contracts, which present a special case. *See* Response, ¶ 21 n.7; *accord Globecon Grp., LLC v. Hartford Fire Ins. Co.*, 434 F.3d 165, 171 (2d Cir. 2006) (acknowledging "the general rule permitting transfer of a cause of action notwithstanding a 'no-transfer' clause in an insurance policy").

17. To be sure, the Berlingers, as the result of the Debtors' payment default, would be excused, as a matter of contract law, from making further loans to the Debtors if the Notes had required them. "Under basic contract principles, when one party to a contract feels that the other contracting party has breached its agreement, the non-breaching party may either stop performance and assume the contract is avoided, or continue its performance and sue for damages. Under no circumstances may the non-breaching party stop performance ***and*** continue to take advantage of the contract's benefits." *S & R Corp. v. Jiffy Lube Int'l, Inc.*, 968 F.2d 371, 376 (3d Cir. 1992) (emphasis in original); *see also McCausland v. Wagner*, 78 A.3d 1093, 1102 (Pa. Super. 2013) ("In a breach of contract suit, the plaintiff either may rescind the contract and seek restitution or enforce the contract and recover damages based on expectation. In such a case, the inconsistent nature of those actions is obvious – ***one cannot attempt to terminate his contractual obligations and, at the same time, seek to enforce the contract and enjoy its full***

benefits in an action for breach." (emphasis added)); *Chilton Ins. Co. v. Pate & Pate Enters.*, 930 S.W.2d 877, 887-88 (Tex. App. 1996) ("Where one party materially breaches a contract, the non-breaching party is forced to elect between two courses of action—continuing performance or ceasing performance…. Treating a contract as continuing, after a breach, deprives the non-breaching party of any excuse for terminating their own performance…. ***Seeking to recover damages under the contract, as Pate did, is evidence that Pate considered the contract as continuing.***" (emphasis added)).

18. The two cases that Contrarian offers to address this point, Response, ¶ 23, do not assist it. The court in *BioLife Sols., Inc. v. Endocare, Inc.*, 838 A.2d 268, 278 (Del. Ch. 2003), concluded that one party's failure to timely deliver certain assets under the parties' agreement was not a material breach that would excuse the other party's performance, *id.* at 278-82, reasoning that "a slight breach by one party, while giving rise to an action for damages, will not necessarily terminate the obligations of the injured party to perform under the contract." *Id.* at 278. In *Hipcricket, Inc. v. mGage LLC*, 2016 WL 3910837 (Del. Ch. July 15, 2016), a salesman (Stansbury) had entered into an agreement with Hipcricket that granted him commissions but disabled him from competing with it. *Id.* at *1. In its bankruptcy case Hipcricket rejected its agreement with Stansbury and then sought in Chancery Court an injunction against Stansbury and his new employer (mGage) premised on the non-compete provisions of the rejected agreement. *Id.* The Chancellor denied the injunction "see[ing] no equity in this argument," *id.* at *13, unsurprisingly as Hipcricket had decided not to employ Stansbury while simultaneously trying to deny him the ability to earn a living, something he could have done before he ever entered into his agreement with Hipcricket. The Berlingers, by contrast, could not have assigned their rights under their Notes before entering into them, as they didn't have the Notes; nor are the

Debtors here seeking affirmative relief. They are merely defending against a claim based on the Notes, much like the alleged debtors in *In re Diamondhead Casino Corp.*, 2016 WL 3284674 (Bankr. D. Del. June 7, 2016).

19. Notably, Contrarian declines to address Judge Silverstein's decision in *Diamondhead*. There, the involuntary debtor asserted that one of the petitioning creditors' claims was the subject of a bona fide dispute because, *inter alia*, the claim was based on a promissory note that was assigned to it in violation of an anti-assignment provision in the note. *Id.* at *14. The petitioning creditors argued that the debtor was in material breach of the note based on its failure to pay and therefore could not enforce the anti-assignment provision in the note. *Id*. at *15. Judge Silverstein rejected this argument as "untenable," reasoning that the debtor's breach did not improve its counter-party's contractual rights. *Id.*[6]

20. In this instance, Contrarian, an interloper into this case, is seeking to enforce a contract to which it is not even a party, *i.e.*, the Notes, by seeking payment of them. As a result, on the principles set forth above, there is no basis to excuse its failure to comply with the covenant against assignment by seeking the Debtors' consent, as there is no basis—and certainly no precedent—that excuses it.

D. The Uniform Commercial Code Does Not Override the Anti-Assignment Clause

21. Contrarian next argues that the UCC renders the anti-assignment clauses unenforceable. Although it dismisses the Debtors' authorities, it cites no contrary authority in support of its assertion that "Section 9-408 of the UCC renders ineffective a contractual

[6] Judge Silverstein also gave short shrift to an argument similar to the lead contention made by Contrarian, "that [a creditor] assigned to [one of the petitioners] its causes of action against [the debtor] (independent of the 2010 Note)," rejecting "the distinction [creditors] are drawing or how the assignment of a 'cause of action' without assignment of the underlying note, gives [a creditor] a 'right to payment,'" *id.* at *46, *i.e.*, a claim. Bankruptcy Code § 101(5)(A).

provision that requires the consent of the maker of a promissory note before the note may be transferred." Response, ¶ 28. Contrarian appears to rely solely on its (strained) interpretation of section 9-408 of the UCC.

22. The Debtors do not ignore section 9-408, both the statutory text and the official comments, but, as Contrarian is well aware, they also rely on case law and another relevant section of the UCC (§ 9-406),[7] all of which make clear that section 9-408 applies only to transactions involving the grant or transfer of a security interest in a promissory note, not an outright sale of a promissory note.

23. Section 9-408(a) of the Delaware Uniform Commercial Code provides:

> Except as otherwise provided in subsection (b), a term in a promissory note [that] prohibits, restricts, or requires the consent of the person obligated on the promissory note … to the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note … is ineffective to the extent that the term:
>
> (1) would impair the creation, attachment, or perfection of a security interest; or
>
> (2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note ….

Del. Code Ann. tit. 6, § 9-408(a).

24. Section 9-408(b), in turn, limits the scope of section 9-408(a): "Subsection (a) applies to a security interest in a payment intangible or promissory note …." *Id.* § 9-408(b).

25. The Response misleadingly suggests that the purchase of a promissory note is always a "security interest" within the meaning of UCC Section 1-201(b)(35). The definition has two sentences. *See* Response, ¶ 27 n.10. The first states what the term security interest

[7] Although the Debtors cited and discussed section 9-406 in the *Debtors' Objection to Motion to Quash of Contrarian Funds* [Docket No. 1656] ¶ 36, and the Response is replete with references to that pleading (*e.g.*, Response, ¶¶ 8, 13, 22, 25, 29, 32), Contrarian studiously ignores section 9-406 in its Response.

"means," and the second what the term may "include[,]" depending on the circumstances and the context.

26. The problem with Contrarian's overly broad view of section 9-408 is that it renders section 9-406 superfluous. Section 9-406 specifically provides—and has as part of its title—that "restrictions on assignment of accounts, chattel paper, payment intangibles, and promissory notes [are] ineffective."[8]

27. Section 9-406 deals with assignments of promissory notes and generally, although not always, overrides a restriction that "prohibits, restricts, or requires the consent of the … person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the … promissory note…." Del. Code Ann. tit. 6, § 9-406(d). Significantly, invalidation does not occur here by virtue of subsection (e): "Subsection (d) does not apply to the sale of a payment intangible or promissory note, other than a sale pursuant to a disposition under Section 9-610 or an acceptance of collateral under Section 9-620." *Id.* § 9-406(e).[9] Thus, the relevant provision in the UCC that Contrarian neglects to cite (§ 9-406) upholds the enforceability of anti-assignment provisions in the sale of promissory notes, and the provision on which Contrarian rests its argument (§ 9-408) applies only to grants of security interests. To read Section 9-408 in conjunction with Section 1-201(b)(35) to invalidate all restrictions on transfers violates a cardinal rule of statutory construction, "render[ing] language superfluous." *Zahner v. Sec'y Pa. Dep't of Human Servs.*, 802 F.3d 497, 514 (3d Cir. 2015). Contrarian's reading makes section 9-406 unnecessary in

[8] Sale and assignment are synonymous. *Cinicola v. Scharffenberger*, 248 F.3d 110, 124 n.15 (3d Cir. 2001) ("The synonymous definitions of assignment and sale add further weight for considering the terms together.").

[9] The referenced sections, 9-610 and 9-620, pertain to sales by a secured party post-default and retention of collateral by a secured party post-default, respectively. Del. Code Ann. tit. 6, §§ 9-610 & 9-620. Neither is implicated here.

violation of the principle that "the canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme." *Marx v. Gen. Revenue Corp.*, 568 U.S. 371, 386 (2013).

28. Read holistically, as they must be, *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 985 (2017), Sections 1-201(b)(35), 9-406 and 9-408 prohibit essentially all restraints on assignments of promissory notes (whatever their terms) as collateral and many restraints on outright assignments, *i.e.*, sales, but the UCC does not render all restrictions on sales of promissory notes unenforceable. Indeed, if it wanted to do so, it could have simply so stated in a single section. Its failure to do so—given the scholarly input into the UCC—suggests that its terms need to be parsed carefully so that courts invalidate contract provisions if and only if the UCC so commands.

29. In this specific instance, Section 9-408(a) does not apply because Contrarian does not hold any security interest in the Notes. Contrarian did not lend money to the Noteholders at all—let alone lend any money for which the repayment obligation is secured by a Noteholder's interest in his or her own Note (as would be required for Contrarian's interest in the Notes to qualify as a security interest, rather than the straightforward title that Contrarian purports to hold). The Debtors dispute that any valid purchase was effected (given that the anti-assignment provision renders "null and void" any purported transfer made without the Debtors' consent), but regardless, Contrarian cannot seriously contend that it holds a security interest in any Notes. Accordingly, section 9-408 has no applicability.

30. Although disregarded by Contrarian, the sparse case law is in accord with the Debtors' view, not Contrarian's. *See Day v. White*, 2017 WL 2563234, at *8 (D.V.I. June 12, 2017) (holding that "§ 9-408 would be implicated if the [Bank] granted or transferred a security

interest in the promissory note to a third party …. In reality, the [Bank] has not granted or transferred a security interest in the [promissory note], it has purportedly assigned, transferred, and set over the Promissory Note to [Plaintiffs].)" (emphasis, internal marks, and alterations omitted).

31. In short, the Uniform Commercial Code does not render all anti-assignment clauses in promissory notes null and void. If it did, then the case law would not be replete with promissory notes containing anti-assignment provisions, *see, e.g.*, *Gragert v. Lake*, 541 F. App'x 853, 858 (10th Cir. 2013) (promissory note's anti-assignment provision rendered it illiquid and thus not an available "resource" for purposes of social insurance program eligibility); *Davis v. United States*, 961 F.2d 53, 55 (5th Cir. 1991); *Dzikowski v. Moreno (In re V.O.C. Analytical Labs., Inc.)*, 263 B.R. 156, 158 (S.D. Fla. 2001), and Contrarian would have some case law authority in support of its UCC argument.

32. Although the Debtors believe the authorities it cites and the arguments it makes are persuasive, they acknowledge—and Contrarian does not appear to disagree—that there is no on-point Delaware authority interpreting the relevant UCC sections, §§ 9-406 and 9-408. If the Court believes the UCC issue is one which is outcome determinative, Delaware Supreme Court Rule 41 permits this Court to certify the relevant question(s) to it.

E. Securities Laws and Representations in the Transfer of Claim Agreement make Assignment a Trap for the Unwary; Policy and Law Support Sustaining the Claim Objection

33. Contrarian premises its argument that there are no securities law issues on the initial argument that it never acquired the Notes. "While a promissory note is arguably a security, a cause of action under such a note is not. Assignment of such claims therefore does not implicate the securities laws." Response, ¶ 4; *see also id.* ¶ 35 (same). But that argument simply makes no sense and is totally contrary to Contrarian's repeated statements in this case. *See supra*

¶¶ 1 & 5–7. Contrarian further argues, without evidence, that in any event, its purchases are exempt. Response, ¶ 37.

34. Finally, although conceding that exempt or not, the securities laws apply to transfers of securities, Contrarian argues that the Berlingers are not in jeopardy because they could not possibly have scienter, *id.*, ¶ 38, which is another way of saying they were not sufficiently aware of what they were representing—the only way they could have been "duped into making inaccurate representations." *Id*. Notably, it is not clear how the Berlingers could escape liability given the First Day Declaration that stated "few, if any, Noteholders have taken proper steps to perfect their interest in the Notes pursuant to either of sections 9-312(a) or 9-313(a) of the Uniform Commercial Code," and that "any security interests held by the Noteholders is [*sic*] avoidable, such that the Noteholders' claims will ultimately be treated as unsecured claims in these Chapter 11 Cases," and that "[t]he Debtors intend to commence adversary proceedings seeking the avoidance of these security interests." *Declaration of Lawrence R. Perkins in Support of the Debtors' Chapter 11 Petitions and Requests for First Day Relief* [Docket No. 12], ¶ 19 n.9; *see also id.* ¶¶ 44–50 (discussing investigations by SEC and at least 25 states relating to violations of securities laws).[10]

35. Even assuming that the Berlingers did not know about the above-referenced pleadings, they would still be caught by the representations Contrarian had them make (notwithstanding that it doubtless had read and understood the implications of the Perkins Declaration and the pleadings relating to the appointment of a trustee) in the Transfer of Claim Agreement (Guffy Decl. Exhibit 4), as there are a plethora of landmines in it for the Berlingers. These include the Berlingers' warranting that [¶ 3f] "the Claim is not subject to any objection,

[10] In addition, there were the widely publicized hearings on the motion to appoint a trustee.

counterclaim, defense or claim or right of setoff, reduction, recoupment, impairment, avoidance. preference, clawback, disallowance…," and that [¶ 3n] "Seller is an 'Accredited Investor' as defined by Rule 501 of Regulation D under the Securities Act of 1933 (17 CFR § 230.501 et seq.), and has completed the Accredited Investor questionnaire provide by Buyer." The Berlingers also agree that [¶ 6] "If any motion, complaint, objection, application, plan of reorganization or other pleading is filed … to disallow, impair, reduce … all or any portion of the Claim for any reason whatsoever, or to assert that all or any portion of the Claim is or is deemed to have been or subject to a clawback, preferential payment or fraudulent conveyance … Seller shall repurchase such portion by paying immediately on demand of Buyer cash in an amount equal to the amount of the Transferred Rights subject to the Impairment multiplied by the Purchase Rate." And, finally, the Seller agrees that if there is any dispute, the parties will litigate in New York. *Id.* ¶ 9. The Berlingers live in Florida. Guffy Decl., Exhibits 1-3 (showing the Berlingers' address) and Exhibit 4 (showing Florida notarization).

36. Contrarian's response appears to be that the Debtors should not care. These issues are solely between it and the Berlingers. But that is not the case. As an estate fiduciary, and the successors to the prepetition entities that issued the Notes, the Debtors cannot be indifferent to a further abuse of Noteholders when they have the ability, through their power to withhold consent to transfer of the Notes, to prevent this from occurring. *Cf.* RESTATEMENT (SECOND) TORTS §§ 315 & 321 (person is absolved of duty to aid third persons only where there is no special relationship or its own prior conduct did not create risk of harm).

37. Although Contrarian cloaks itself as the defender of the rights of the Berlingers and others similarly situated to contract freely—and the Debtors as seeking "to benefit the Ponzi

scheme operator and not the Noteholders," Response, ¶ 22 & n.8—Contrarian's own documents, including the misleading solicitation it sent in January (Exhibit A), belie such a noble purpose.

38. By contrast, the Debtors are working to provide liquidity for Noteholders, not via distressed sales of unregistered securities with inadequate information and onerous terms, but, following full disclosure and regular reporting, in a market based environment that will permit Noteholders to obtain a fair price. As provided in the Plan Term Sheet:

> The Plan will include provisions reasonably intended to enhance the liquidity of the Liquidation Trust Interests, including, without limitation,
>
> A. Initial and quarterly public reporting by the Liquidation Trustee;
>
> B. Efforts to list the Liquidation Trust Interests on a trading index; and
>
> C. Division of the Liquidation Trust Interests in a fashion designed to produce a price that would support subsequent trading.

Notice of Submission of Summary Plan Term Sheet Entered Into by the Debtors, the Official Committee of Unsecured Creditors, the Ad Hoc Noteholder Group, and The Ad Hoc Unitholder Group [Docket No. 828], at p. 8.

39. Additionally, pending confirmation, as Contrarian concedes, *see* Response, ¶ 39, the Ad Hoc Noteholder Group is seeking to arrange for Noteholders who need to raise cash to borrow funds without accepting a below market purchase price and continuing liability for representations and warranties that could result in their being sued for all or a portion of the paltry sale price or facing possible securities law violations.

40. The preceding seven paragraphs may well be beside the point. However, if Contrarian is seeking to validate its actions by repeated reference to public policy or the protection of the Debtors' creditors, *see* Response, ¶¶ 2, 15, 20, 22 and 39, then the Court can rightly ask whether allowing Contrarian to do as it pleases actually advances, and is the best way to accomplish, those goals.

WHEREFORE, the Debtors respectfully request that the Court enter an order sustaining the Claim Objection and granting such other and further relief as is just and proper.

Dated: Wilmington, Delaware
May 31, 2018

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