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) **Hearing Date: October 24, 2018, at 10:00 a.m. (ET)** **Objection Deadline: October 17, 2018, at 4:00 p.m. (ET)** **Ref. Docket No. 2397**

DEBTORS' MOTION FOR APPROVAL OF CERTAIN COMPROMISES AND SETTLEMENTS, PARTIAL SUBSTANTIVE CONSOLIDATION, AND RELATED RELIEF WITH RESPECT TO THE PLAN

Woodbridge Group of Companies, LLC ("WGC") and its affiliated debtors and debtors in possession (collectively, the "Debtors") in the above-captioned cases (the "Chapter 11 Cases") hereby move the Court (this "Motion"), pursuant to sections 105(a) and 1123(b) of title 11 of the United States Code, 11 U.S.C. §§ 101–1532 (the "Bankruptcy Code") and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), (i) to approve certain of the global compromises and settlements (collectively, the "Plan Settlements") that are encompassed within the *First Amended Joint Chapter 11 Plan of Liquidation of Woodbridge Group of Companies, LLC and Its Affiliated Debtors* [Docket No. 2397] (as amended, supplemented, or modified from time to time pursuant to the terms thereof, the "Plan"[2]), as more fully detailed

[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, 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 this 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] All capitalized terms used but not otherwise defined herein have the meanings set forth in the Plan.

below, and (ii) to substantively consolidate all Debtors ***other than*** the seven Fund Debtors (as defined in the Plan and which were the entities issuing Notes and Units to investors) into WGC.[3]

Although the Debtors intend to seek approval of the Plan Settlements within the context of confirmation of the Plan, the Debtors, in an abundance of caution, are filing this Motion as a protective measure such that certain aspects of the Plan Settlements (the "Plan Settlement Elements") may be considered by the Court separately from the Plan to the extent necessary or appropriate. In particular, as set forth more fully below, substantive consolidation of the Other Debtors into WGC is warranted in its own right and independent of the other Plan Settlements.

In support of this Motion, the Debtors will rely on the declarations and other evidence submitted in support of confirmation of the Plan and further respectfully state as follows:

JURISDICTION

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334(b) and 157 and the *Amended Standing Order of Reference* from the United States District Court for the District of Delaware dated as of February 29, 2012. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and, pursuant to Rule 9013-1(f) of the Local Rules of Bankruptcy Practice and Procedure of the United States Bankruptcy Court for the District of Delaware (the "Local Rules"), the Debtors consent to the entry of a final order by the Court in connection with this Motion to the extent that it is later determined that the Court, absent consent of the parties, cannot enter final orders or judgments in connection herewith consistent with Article III of the United States Constitution. Venue is proper before the Court pursuant to 28 U.S.C. §§ 1408 and

[3] The Debtors have previously filed and served that certain *Findings of Fact, Conclusions of Law, and Order Confirming the First Amended Joint Chapter 11 Plan of Liquidation of Woodbridge Group of Companies, LLC and Its Affiliated Debtors* [Docket No. 2658] (as may be amended, supplemented, or modified, the "Proposed Confirmation Order"), which will, among other things, address the Plan Settlement Elements once entered. To the extent the Debtors ultimately seek to have the relief requested hereby approved outside of confirmation of the Plan, the Debtors shall file a separate proposed order.

1409. The primary statutory and legal predicates for the relief requested herein are Bankruptcy Code sections 105(a) and 1123(b) and Bankruptcy Rule 9019(a).

GENERAL BACKGROUND

2. On December 4, 2017, a total of 279 Debtors commenced voluntary cases under chapter 11 of the Bankruptcy Code. Thereafter, on February 9, 2018, March 9, 2018, March 23, 2018, and March 27, 2018, additional affiliated Debtors (27 in total) commenced voluntary cases under chapter 11 of the Bankruptcy Code. Pursuant to sections 1107(a) and 1108 of the Bankruptcy Code, the Debtors are continuing to manage their financial affairs as debtors in possession.

3. The Chapter 11 Cases are being jointly administered pursuant to Bankruptcy Rule 1015(b) and Local Rule 1015-1. No trustee has been appointed in the Chapter 11 Cases. An official committee of unsecured creditors (the "Unsecured Creditors' Committee") was appointed on December 14, 2017 [Docket No. 79]. On January 23, 2018, the Court approved a settlement providing for the formation of an official ad hoc noteholder group (the "Noteholder Committee") and an official ad hoc unitholder group (the "Unitholder Committee"), as well as a replacement board (the "New Board") and management for the Debtors [Docket No. 357].

BACKGROUND REGARDING THE PLAN PROCESS

4. Following the appointment of the New Board, the preferred path of the New Board, the Debtors, and their professionals was to build consensus with key constituencies and reach an agreement that would provide for a prompt and orderly path out of bankruptcy for the Debtors while also conserving the Estates' resources for the benefit of all Creditors.

5. To that end, the Debtors' counsel at Klee, Tuchin, Bogdanoff & Stern LLP ("KTBS") hosted several all-day negotiating sessions at its offices in Los Angeles. First, on March 8, 2018, KTBS hosted a full-day meeting attended by counsel for the Debtors, the

Unsecured Creditors' Committee, the Noteholder Committee, and the Unitholder Committee. Then, during the week of March 19, 2018, KTBS hosted three all-day meetings attended by the parties and their professionals. At these meetings, the parties engaged in extensive debate and discussion regarding, among other things, key legal issues in the Chapter 11 Cases. Certain of the parties circulated detailed "position papers" regarding such topics in advance of the meetings.

6. The negotiations were ultimately fruitful, as they culminated with the signing of a *Summary Plan Term Sheet*, dated as of March 22, 2018 [Docket No. 828] (the "Plan Term Sheet"). The Plan Term Sheet memorialized an agreement in principle by and among the Debtors, the Unsecured Creditors' Committee, the Noteholder Committee, and the Unitholder Committee regarding the fundamental terms of a chapter 11 plan, while providing a basis for further discussion regarding the specific details of the plan and related transactions, which details remained subject to further review, comment, and final approval by the parties.

7. Following execution of the Plan Term Sheet, the parties continued to extensively negotiate the details of the potential plan. After many weeks of further discussion and negotiations with the Committees, the Debtors finalized and filed the Plan, which substantially incorporates and expands upon the Plan Term Sheet.

8. On August 22, 2018, the Court entered its *Order (I) Approving Disclosure Statement, (II) Fixing Voting Record Date, (III) Scheduling Plan Confirmation Hearing and Approving Form and Manner of Related Notice and Objection Procedures, (IV) Approving Solicitation Packages and Procedures and Deadlines for Soliciting, Receiving, and Tabulating Votes on the Plan, and (V) Approving Forms of Ballots and Notice to Non-Voting Classes* [Docket No. 2396] (the "Disclosure Statement Order"). The Debtors subsequently began soliciting votes on the Plan in accordance with the procedures approved by the Disclosure

Statement Order. A hearing to consider confirmation of the Plan is scheduled for October 24, 2018, at 10:00 a.m. (ET).

SUMMARY OF THE PLAN SETTLEMENTS[4]

9. Section 3.11.1 of the Plan provides that:

> Pursuant to Bankruptcy Code sections 1123(a)(5), 1123(b)(3), and 1123(b)(6), as well as Bankruptcy Rule 9019, and in consideration for the Distributions and other benefits provided under the Plan, the provisions of the Plan will constitute a good faith compromise and settlement of all claims and controversies relating to the rights that a Holder of a Claim or an Equity Interest may have against any Debtor with respect to any Claim, Equity Interest, or any Distribution on account thereof, as well as of all potential Intercompany Claims, Intercompany Liens, and Causes of Action against any Debtor, including the Unsecured Creditors' Committee Action. The entry of the Confirmation Order will constitute the Bankruptcy Court's approval, as of the Effective Date, of the compromise or settlement of all such claims or controversies and the Bankruptcy Court's finding that all such compromises or settlements are (i) in the best interest of the Debtors, the Estates, and their respective property and stakeholders; and (ii) fair, equitable, and reasonable. This comprehensive compromise and settlement is a critical component of the Plan and is designed to provide a resolution of myriad disputed intercompany and intercreditor Claims, Liens, and Causes of Action that otherwise could take years to resolve, which would delay and undoubtedly reduce the Distributions that ultimately would be available for all Creditors.

Plan § 3.11.1. The Plan then details seven (7) specific implementing settlement elements, including the treatment generally provided for the impaired voting Classes of Claims under the Plan. *See id.* § 3.11.2.

10. Among the many disputed issues that will be resolved through the Plan Settlements are the following complex matters, any one of which could be the subject of years of expensive, complicated, and uncertain litigation.[5]

---

[4] Nothing in this Motion shall be construed in any way to limit or alter any of the provisions of the Plan or of any related documents (collectively, the "Plan Documents") or to guide in the interpretation of the Plan Documents in any other proceeding. The summaries contained in this Motion are provided merely as a convenience to the Court and parties in interest in evaluating the settlements and compromises at issue. In the event of any inconsistency between the Motion and the Plan Documents, the Plan Documents shall control.

[5] For the sake of completeness and consistency with the approved Disclosure Statement, the following discussion summarizes the primary elements of the Plan Settlements. Nevertheless, as detailed below, this Motion

A. Nature of the Claims Asserted by the Noteholders

11. A significant dispute exists regarding whether the Noteholders hold, directly or indirectly, any valid and enforceable lien or other security interest on any Estate Assets, not subject to avoidance. This dispute involves complex legal issues; however, in brief, the issue involves the assertion by certain Noteholders that they hold valid and enforceable security interests, not subject to avoidance, in either or both of (i) the particular parcel of real property identified on their loan documentation provided to them by the Debtors or (ii) the promissory notes in favor of the applicable Fund Debtors issued by (a) the applicable special purpose vehicle entities that hold real properties (the "PropCos") with an alleged security interest on the owned real properties or (b) the related special purpose vehicle entities that own the PropCos (the "MezzCos") with an alleged pledge of the MezzCos' ownership interest interests in the PropCos (such assets generally, the "Purported Noteholder Collateral"). The Debtors believe there are fatal flaws with this assertion. *First*, the Debtors believe the steps legally necessary to "perfect" any such security interest in favor of a Noteholder have not been taken such that any such security interest would be avoidable. And *second*, as a more fundamental matter, the unfortunate reality that Robert Shapiro ("Shapiro"), who was formerly in control of all the Debtors, did ***not*** use investor funds as he promised – for example, Shapiro commingled all funds together, rather than using specific funds for specific properties, diverted extensive funds on lavish expenses for the benefit of himself and his family, created loan amounts that had no relationship to amounts actually advanced to specific PropCos, and even purported to structure loans and liens around

---

seeks approval of only some of those elements independent of the Plan itself, namely: (a) elimination of the Intercompany Claims and Intercompany Liens to the extent contemplated by Section 3.11.2(g) of the Plan, (b) provision of "claims" for the Unitholders at a discounted ratio of 72.5% relative to the Noteholders' claims; and (c) substantive consolidation of the Other Debtors into WGC independent of the Plan.

properties that were actually never owned by the Debtors – creates even greater problems for the Noteholders' claim to perfected secured status.

12. In contrast to Shapiro's representations, the Debtors believe that the Noteholders do not have valid, enforceable security interests in the Purported Noteholder Collateral that could withstand utilization of the "strong arm" avoidance powers. In particular, the Debtors believe the steps necessary to perfect any such security interests under Article 9 of the Delaware Commercial Code were not taken. Specifically, (i) the Debtors have determined that no Noteholder is in physical possession of any Purported Noteholder Collateral, *see* Del. Code Ann. tit. 6, § 9-313(a), and (ii) based on the Debtors' investigation, no UCC-1 financing statement was filed in Delaware on behalf of any Noteholder with respect to any of the Purported Noteholder Collateral, *see id.* § 9-312(a). The Debtors believe these facts would ultimately allow for a determination that any asserted security interests in the Purported Noteholder Collateral or on any other Estate Assets are subject to avoidance under Bankruptcy Code section 544(a), which provides that an estate representative may utilize "strong arm" powers to avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by certain creditors under applicable nonbankruptcy law. Among other things, these "strong arm" powers permit avoidance of asserted security interests that were not properly perfected in accordance with applicable nonbankruptcy law. Although the Debtors believe they would prevail in any such avoidance litigation, so utilizing the "strong arm" powers could necessitate commencement of a separate adversary proceeding against each Noteholder who asserts a security interest (approximately 7000 in total), which could be detrimental to all victims of Shapiro's fraudulent scheme by causing the additional hardships, costs, and delays attendant to litigation.

13. Apart from the general question whether any Noteholder has an enforceable

security interest is the more fundamental question whether any of the asserted intercompany loans and related liens and security interests purportedly granted to the Fund Debtors by the MezzCo and PropCo Debtors are enforceable in the Chapter 11 Cases. This fundamental question is raised directly by the adversary proceeding commenced by the Unsecured Creditors' Committee (Adv. Proc. No. 18-50878-KJC) and it implicates a variety of complex sub-issues that the Bankruptcy Court (and additional courts on appeal) could need to resolve, including:

- Are the promissory notes issued to the Fund Debtors enforceable obligations as a matter of applicable state law despite the facts that, in many cases, no loan proceeds whatsoever were provided directly from the Fund Debtors to the applicable MezzCo and PropCo Debtors and the amount of the obligations were not correlated with the actual funds received? If these obligations are unenforceable against the MezzCo and PropCo Debtors under applicable law for any reason other than because such claims are contingent or unmatured, then the Intercompany Claims held by the Fund Debtors would be subject to disallowance under Bankruptcy Code section 502(b)(1). The absence of allowed claims of the Fund Debtors would in turn mean that the associated Liens asserted by the Fund Debtors would be voided by Bankruptcy Code section 506(d).

- Are either the purported obligations of the applicable MezzCo and PropCo Debtors to the Fund Debtors or the associated Liens avoidable as "constructive" fraudulent transfers under Bankruptcy Code section 548(a)(1)(B) or as constructively voidable transactions under applicable nonbankruptcy law and Bankruptcy Code section 544(b)? Generally, an obligation and security interest may be avoided in bankruptcy if the debtor received less than a reasonably equivalent value in exchange for such obligation or transfer and was in one of several forms of financial distress at the relevant time. To the extent a particular MezzCo or PropCo Debtor did not receive reasonably equivalent value in exchange for liens and obligations that it created in favor of a Fund Debtor while it was insolvent, those liens and obligations could be avoided in the Chapter 11 Cases.

- Are either the purported obligations of the applicable MezzCo and PropCo Debtors to the Fund Debtors or the associated Liens avoidable as "actual" fraudulent transfers under Bankruptcy Code section 548(a)(1)(A) or as actually voidable transactions under applicable nonbankruptcy law and Bankruptcy Code section 544(b)? Generally, an obligation and security interest may be avoided in bankruptcy if the debtor made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted. Although courts often look to certain "badges of fraud" when

determining whether a given transfer or obligation was associated with the required debtor intent, the case law also recognizes a "Ponzi scheme presumption" that imputes such intent when a transfer or obligation was part of the perpetuation of a Ponzi scheme. *See, e.g.*, *Ritchie Capital Mgmt., LLC v. Stoebner*, 779 F.3d 857, 861-62 (8th Cir. 2015); *Bear, Stearns Sec. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 9-11 (S.D.N.Y. 2007); *In re DBSI, Inc*., 477 B.R. 504, 510 (Bankr. D. Del. 2012). As such, to the extent that the transactions between the MezzCo and PropCo Debtors and the Fund Debtors furthered a Ponzi scheme, those transactions could potentially be avoided as actual fraudulent transfers or voidable transactions.

- Are there other forms of interests between any given MezzCo and PropCo Debtor and any given Fund Debtor? For example, even though a particular Fund Debtor may contend that it is the only Person with an interest in a particular MezzCo or PropCo, other Fund Debtors could potentially try to assert equitable liens or other rights and remedies against that same MezzCo or PropCo on the theory that some portion of the other Fund Debtors' funds were part of the commingled pool that facilitated purchase of the underlying real property. These efforts would likely fail due to state law and bankruptcy considerations that weigh against recognition of any such interests in this context, but if such interests were recognized in favor of other Fund Debtors, then there could be further disputes about the extent to which those interests are senior to or on parity with any interests of the Fund Debtor that had a more formalized relationship with the same MezzCo or PropCo.

14. These are all highly complex issues that could require the devotion of substantial professional and judicial resources to resolve with finality. The key point that bears emphasis is that any vulnerability in the Intercompany Claims or Intercompany Liens asserted by the Fund Debtors against the applicable MezzCos or the PropCos ultimately moots the secondary disputes about whether the associated Noteholders have perfected security interests; if the Purported Noteholder Collateral is invalid, void, or otherwise unenforceable, then it ultimately is irrelevant whether any Noteholder has a security interest regarding such an invalid, void, or unenforceable item.

15. The Plan Settlements resolve this subset of issues by providing that any Intercompany Claims that could be asserted by one Debtor against another Debtor will be extinguished immediately before the Effective Date with no separate recovery on account of any

such Claims and any Intercompany Liens that could be asserted by one Debtor regarding any Estate Assets owned by another Debtor will be deemed released and discharged on the Effective Date. *See* Plan § 3.11.2(g). As a result of this elimination of such Intercompany Claims and Intercompany Liens, there is no further need to litigate about whether any given Noteholder has a perfected security interest or not, nor about whether any given Noteholder has any specialized interest in any particular property (a very limited exception to this statement exits for the Noteholders with Non-Debtor Loan Note Claims, which through the Plan's treatment of Class 6 can each decide whether they wish to retain the ability to litigate whether they have enforceable security interests regarding the applicable non-debtor loans, *see* Plan § 3.7, although the Debtors do not believe any of these parties will ultimately prevail in such litigation).

16. By resolving the intercompany rights between the Fund Debtors and the Other Debtors in a fashion recognizing that the Fund Debtors ultimately should have some economic interest in the Other Debtors (whether through unsecured Claims for reimbursement asserted against WGC or directly through asserted Claims against the PropCos and MezzCos), the Plan avoids the substantial costs and uncertainty of litigation while providing what are anticipated to be substantial recoveries for all the economic stakeholders of the Fund Debtors (*i.e.*, the Noteholders and the Unitholders).

17. Solely with respect to any Secured Claim of a non-debtor as to which the associated Lien would be junior to any Intercompany Lien that could be asserted by one Debtor regarding any Estate Assets owned by another Debtor, so as to retain the relative priority and seniority of such Intercompany Claim and associated Intercompany Lien, the otherwise released Intercompany Claim and associated Intercompany Lien will be preserved for the benefit of, and may be asserted by (a) the Liquidation Trust as to any Collateral that is Cash and (b) otherwise,

the Wind-Down Entity. *See* Plan § 3.11.2(g) proviso. The Debtors are presently aware of only one significant non-debtor Lien (asserted by the IRS against the Debtors' property at 4030 Longridge Avenue, Sherman Oaks, California) as to which this issue is likely to be relevant.

B. Nature of the Claims Asserted by the Unitholders

18. Another significant dispute exists regarding whether the Unitholders hold "claims" or "equity securities" in the Chapter 11 Cases and the extent to which, if any, any "claims" of the Unitholders are subject to subordination under Bankruptcy Code section 510(b).

19. Under the Bankruptcy Code, there is a fundamental distinction between a "debt," which is the liability of a debtor on a "claim" (*i.e.*, a right to payment or right to an equitable remedy for breach of performance if such breach gives rise to a right to payment), on the one hand, and an "equity" interest or "equity security," on the other hand. *See* 11 U.S.C. §§ 101(5), (12) & (17); 1129(b)(2)(B) & (C). It is not always easy to determine whether a particular instrument creates debt or equity, and the case law has developed a complex, multi-factor test to guide the analysis. *See, e.g.*, *Cohen v. KB Mezzanine Fund II, LP (In re Submicron Sys. Corp.)*, 432 F.3d 448, 454-59 (3d Cir. 2006); *Walnut Creek Mining Co. v. Cascade Inv., LLC (In re Optim Energy, LLC)*, 527 B.R. 169, 174-75 (D. Del. 2015); *United States v. State St. Bank & Trust Co*., 520 B.R. 29, 72-79 (Bankr. D. Del. 2014); *Autobacs Strauss, Inc. v. Autobacs Seven Co. (In re Autobacs Strauss, Inc.)*, 473 B.R. 525, 572-23 (Bankr. D. Del. 2012).

20. Here, the Unitholders would maintain that they hold "claims" against, or "debt" of, the Fund Debtors based on a combination of reasons, including (i) an interpretation of the applicable governing documents whereby Units constitute convertible debt, which for the first five years gives rise to an unsecured claim and, if not repaid in full in five years, converts into equity; (ii) Unitholders received monthly interest checks, not dividends, and received from the Debtors 1099-INT tax forms characterizing these payments as interest income for each annual

period prepetition; (iii) the Units were recorded on the Debtors' books and records as a liability and treated as a liability in the Debtors' tax returns; and (iv) other relevant indicia of intent support characterization of the Units as debt rather than as equity. Moreover, the Unitholders could point to other cases involving Ponzi schemes where all investors have been treated as similarly-situated victims, albeit in contexts other than distributions under a chapter 11 plan. *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 628-29 (11th Cir. 2011); *Donell v. Kowell*, 533 F.3d 762, 771 (9th Cir. 2007); *SEC v. Infinity Grp*., 226 Fed. App'x 217, 219 (3d Cir. 2007); *SEC v. Credit Bancorp, Ltd.*, 290 F.3d 80, 88-89 (2d Cir. 2002); *SIPC v. Bernard L. Madoff Inv. Secs.*, 496 B.R. 744, 761 (Bankr. S.D.N.Y. 2013).

21. Other parties in interest would strenuously dispute these contentions and maintain that the Units are in fact only equity interests in the Fund Debtors. Among the assorted arguments that could be made in favor of the Units being equity interests are (i) the Units have some characteristics of preferred equity, including the prospect of incentive compensation and profit sharing from the Debtors' various real estate investments, which creates equity-like "upside" potential; (ii) the offering memoranda regarding the Units indicates that the Debtors would distribute, at least annually, returns of 6% to 10% per annum to Unitholders on account of any capital invested, but only to the extent of available funds *after* creditor claims are adequately provided for; (iii) other nomenclature used in the offering materials connotes that the Units were conceptualized as "equity" or "capital" investments; and (iv) nothing in the plain text of the Bankruptcy Code provides that the classification of a particular instrument as debt or equity varies based on whether a particular case involved a Ponzi scheme. The outcome of these complex, fact-intensive, and context-specific disputes is highly uncertain.

22. Moreover, even if the Unitholders do hold "claims" against the Fund Debtors,

parties in interest could assert that such claims are subject to statutory subordination under Bankruptcy Code section 510(b). Section 510(b) provides that, "[f]or the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security." 11 U.S.C. § 510(b). Thus, if Unitholders have claims for fraud or similar remedies against the Fund Debtors relating to their purchase of Units, those claims could potentially be subject to subordination. Unitholders, however, would argue that section 510(b) is inapplicable to them because their claims would be based on principles of "restitution" in a Ponzi scheme scenario, rather than claims for "rescission" or "damages." *See generally, e.g.*, *In re Tribune Co.*, 464 B.R. 126, 197 (Bankr. D. Del. 2011). The Unitholders could further contend that public policy dictates that Ponzi investments be treated as restitution claims from the beginning, bestowing creditor status on the investor at the outset and entitling the investor to recover the money illegally transferred to the Ponzi operator and nothing more, which removes all such claims from the policy purpose undergirding section 510(b). There is no case law resolving similar issues in this particular context, which again raises the prospect for significant and lengthy litigation, all with a highly uncertain result.

23. The Plan resolves the disputes about the nature of the Unitholders' rights by affording Unitholders 72.5% of the Class A Liquidation Trust Interests that Noteholders receive for their respective net investments (for Net Unit Claims versus Net Note Claims). *Compare* Plan § 3.4 (treatment of Standard Note Claims), *with id.* § 3.6 (treatment of Unit Claims); *see also id.* § 3.11.2(d) (specific settlement element). Put another way, a 27.5% discount is applied to Unitholders' Net Unit Claims in calculating their receipt of Class A Liquidation Trust Interests relative to the calculation of what Noteholders get for their Net Note Claims. This reduced

recovery for Unitholders effectuates a compromise of all the possible disputes that could be raised about the nature and priority of the Unitholders' rights (and certain of the Noteholders' rights) in the Chapter 11 Cases. Nevertheless, Unitholders also receive for their Net Unit Claims the Class B Liquidation Trust Interests, which are to be paid next in priority in the Liquidation Trust Interests Waterfall after Class A Liquidation Trust Interests until the full 27.5% discounted portion of Unitholders' Net Unit Claims are paid in full. *See* Plan §§ 1.84 & 3.6. Thus, the compromise preserves the prospect for Unitholders to eventually recapture the settlement discount if sufficient funds are generated through the overall liquidation of the Debtors' assets.

C. Substantive Consolidation Issues

24. Although the power to substantively consolidate bankruptcy estates is not explicitly authorized by any provision of the Bankruptcy Code,[6] it is well established that bankruptcy courts may use their equitable powers to consolidate cases involving related debtors. Substantive consolidation is a construct of federal common law, emanating from equity, which treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities, save for inter-entity liabilities, which are erased. *See, e.g.*, *In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005). In the Third Circuit, bankrupt entities can be substantively consolidated either on a consensual basis under a chapter 11 plan, or on a non-consensual basis if either (i) prepetition they disregarded entity separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and harms all creditors. *See id.* at 210.

25. The Plan Settlements would implement substantive consolidation based on stakeholder consent through their votes on the Plan and as a means of implementing the Plan as set forth more fully in the Plan.[7] The Plan's proposed substantive consolidation is the result of careful analysis and key stakeholder negotiation regarding ownership, operational entanglements, and creditor expectations based on creditors' prepetition dealings with two primary debtor groups

---

[6] Section 1123(a)(5)(C) of the Bankruptcy Code does, however, expressly contemplate plan provisions that provide for a merger or consolidation of the debtor with one or more persons as a means for the implementation of a chapter 11 plan. 11 U.S.C. § 1123(a)(5)(C); *see also, e.g.*, *In re Stone & Webster, Inc.*, 286 B.R. 532, 546 (Bankr. D. Del. 2002) ("[S]ection 1123(a)((5)(C)) clearly authorizes a bankruptcy court to confirm a Chapter 11 plan containing a provision which substantively consolidates the estates of the two or more debtors.").

[7] Pursuant to Section 5.8(d) of the Plan, the Debtors have reserved their rights, after consultation with each of the Committees, to seek to substantively consolidate all Debtors into WGC if all Impaired Classes entitled to vote on the Plan vote to accept the Plan. Thus, depending on the voting results, there may only be a single "Remaining Debtor" and single-tier of substantive consolidation. Such a single-tier approach is broader than the relief sought by this Motion insofar as it would also involve substantive consolidation of the Fund Debtors into WGC (this Motion does not seek approval of consolidation of any Fund Debtors with any other entities).

(*i.e.*, the Fund Debtors and the Other Debtors), which makes it an appropriate element of a comprehensive plan settlement. *See, e.g.*, *In re Abeinsa Holding, Inc.*, 562 B.R. 265, 279-81 (Bankr. D. Del. 2016). As discussed further below, however, this Motion seeks a subset of such relief independent of the Plan.

D. Ponzi Scheme Issues

26. Additional disputes and possible litigation could arise regarding whether the Debtors were operating a Ponzi scheme, when that scheme began, and the implications of such conduct.

27. The facts demonstrate that (i) beginning no later than July 2012 through December 1, 2017, Shapiro used his web of more than 275 limited liability companies, including the Debtors, to conduct a massive Ponzi scheme raising more than $1.22 billion from over 8,400 unsuspecting investors nationwide; (ii) the Ponzi scheme involved the payment of purported returns to existing investors from funds contributed by new investors; and (iii) the Ponzi scheme was discovered in December 2017. The crux of Shapiro's Ponzi scheme – like most such schemes – was to induce new investors to provide fresh capital based on false promises about the actual operations of the business, use that fresh capital to make payments to old investors (because the actual business operations did not generate sufficient cash flow to make those payments), siphon money off for himself and his family, and hope to keep the scheme afloat as long as possible. As an integral component of the Plan Settlements, the Debtors will seek corresponding findings in the Confirmation Order. *See* Plan § 3.11.2(f).

28. Following a judicial determination that the Debtors were operating a Ponzi scheme, any payments of "interest" or other consideration that was transferred from any Person to a Noteholder or a Unitholder on account of its Notes or Units, as applicable, during the period before the Petition Date, including in respect of holders of Notes that were converted to Units or

vice versa, but typically ***excluding*** payments representing the return of or repayment of principal owed on a Note or a Unit, could potentially be avoided and recovered as an "actual" fraudulent transfer. *See, e.g.*, *Perkins v. Haines*, 661 F.3d 623, 627 (11th Cir. 2011); *Donell v. Kowell*, 533 F.3d 762, 770-72 (9th Cir. 2008); *AFI Holding, Inc. v. Mackenzie*, 525 F.3d 700, 708-09 (9th Cir. 2008); *Geltzer v. Barish (In re Geltzer)*, 502 B.R. 760, 770 (Bankr. S.D.N.Y. 2013); *Fisher v. Sellis (In re Lake States Commodities, Inc.)*, 253 B.R. 866, 871-72 (Bankr. N.D. Ill. 2000). Because avoidance litigation would be a further hardship on the victims of Shapiro's fraudulent scheme, and to eliminate the significant litigation expense and inefficiency associated with seeking recovery from Noteholders and Unitholders of prepetition distributions on account of interest or the like (that would ultimately only reduce the aggregate amount available for distribution on account of allowable Claims), the Plan incorporates a netting mechanism that will account for any Prepetition Distribution received by a Noteholder or Unitholder when calculating the Net Note Claim and Net Unit Claim amounts that will in turn drive the specific Distributions that such Noteholder or Unitholder will receive under the Plan. *See* Plan §§ 1.89, 1.90, 1.124, 3.4, 3.6, 3.7, 3.11.2(a)-(b) & 7.3. The Schedule of Principal Amounts and Prepetition Distributions, attached to the Disclosure Statement as Schedule 3, sets forth the specific amounts that the Debtors intend to use for these purposes, subject to the possibility that a given Noteholder or Unitholder may choose to dispute those amounts and thereby become a Disputing Claimant under the Plan. *See* Plan §§ 1.47 & 7.3.

E. Plan Releases

29. The Plan proposes to provide general releases from the Debtors, the Estates, and other Releasing Parties[8] in favor of the Released Parties (which include the Debtors, the New

[8] The Releasing Parties other than the Debtors and their Estates include "any Person exercising or seeking to exercise any rights of the Estates (but solely in that capacity), including each of the Committees (but not their

Board, the Committees, and certain specified Related Parties). *See* Plan §§ 1.117 & 11.11(a)-(b). The Debtors are unaware of any viable Causes of Action against the Released Parties. Moreover, the Debtors believe that the Released Parties have provided many valuable contributions to the progress of the Chapter 11 Cases, including stewarding the Debtors through the bankruptcy process, negotiating and implementing settlements with various parties, pursuing Confirmation of the Plan, and otherwise preserving Estate Assets for the benefit of all stakeholders. In light of these different contributions, the Debtors believe the releases and exculpations included as part of the overall compromise and settlement embodied by the Plan are fair, equitable, reasonable, and well within the boundaries permitted by law. For the avoidance of doubt, the Excluded Parties – a non-exclusive list of which was included as Schedule 1 to the Disclosure Statement – are ***not*** receiving releases under the Plan.

* * *

30. In sum, the Plan is a vehicle for the near-term resolution of the myriad complex legal issues and disputes that have arisen in the Chapter 11 Cases, but several components of the Plan Settlements are warranted in their own right and independent of the Plan. The Plan Settlements will resolve several major issues that would otherwise have to be judicially determined through lengthy, expensive, and inherently uncertain litigation. There are colorable arguments on both sides of each of the foregoing issues, and the outcome of any litigation regarding such issues is necessarily uncertain. Moreover, if such issues were litigated to finality, it could be years before Holders of Notes, Units, and General Unsecured Claims received distributions, if any, from the Estates.

---

individual members), the Wind-Down CEO, the Liquidation Trustee, the Remaining Debtors Manager, and any other successor to the Debtors or any other estate representative that is or could be appointed or selected pursuant to Bankruptcy Code section 1123(b)(3) or otherwise." *See* Plan § 1.118. The Plan does not include so-called "third-party" or "non-debtor" releases that would release anyone from claims that could not be asserted on behalf of the Debtors or their Estates.

RELIEF REQUESTED

31. By this Motion, the Debtors respectfully request that the Court (i) if necessary or appropriate, approve the following aspects of the Plan Settlements, the Plan Settlement Elements, independent of the Plan: (a) elimination of the Intercompany Claims and Intercompany Liens to the extent contemplated by Section 3.11.2(g) of the Plan and (b) provision of "claims" for the Unitholders at a discounted ratio of 72.5% relative to the Noteholders' claims; (ii) if necessary or appropriate, substantively consolidate the Other Debtors into WGC independent of the Plan; and (iii) grant all such other relief as is necessary and proper.

BASIS FOR RELIEF

A. Bankruptcy Code Sections 105(a) and 1123(b) and Bankruptcy Rule 9019(a) Allow the Court to Approve the Plan Settlement Elements, Either as Part of or Independent of the Plan

32. Bankruptcy Rule 9019(a) states:

> On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.

Fed. R. Bankr. P. 9019(a). Similarly, Bankruptcy Code section 1123(b)(3) states that a plan may:

> provide for – (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or (B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest.

11 U.S.C. § 1123(b)(3). Bankruptcy Code section 105(a) provides in relevant part that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *Id.* § 105(a). Finally, Bankruptcy Code section 1123(b)(6) is a catch-all provision permitting a chapter 11 plan to "include any other appropriate provision not inconsistent with the applicable provisions of this title." *Id.* § 1123(b)(6).

33. "The federal courts have a well-established policy of encouraging settlement to promote judicial economy and limit the waste of judicial resources." *Russian Standard Vodka (USA), Inc. v. Allied Domecq Spirits & Wine USA, Inc.*, 523 F. Supp. 2d 376, 384 (S.D.N.Y. 2007); *see also, e.g., U.S. Bancorp Mortg. Co. v. Bonner Mall P'ship*, 513 U.S. 18, 27–28 (1994) (discussing the general utility of settlement vis-à-vis judicial economy). The force of this established federal policy is particularly acute in the bankruptcy context, where compromises and settlements are "a normal part of the process of reorganization." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968). Indeed, in order to "minimize litigation and expedite the administration of a bankruptcy estate, 'compromises are favored in bankruptcy.'" *Myers v. Martin (In re Martin)*, 91 F.3d 389, 393 (3d Cir. 1996) (quoting 9 COLLIER ON BANKRUPTCY ¶ 9019.03[1] (15th ed. rev. 1993)); *see also, e.g., In re Penn. Cent. Transp. Co.*, 596 F.2d 1102, 1113-14 (3d Cir. 1979); *In re World Health Alts., Inc.*, 344 B.R. 291, 296 (Bankr. D. Del. 2006); *In re Culmtech, Ltd.*, 118 B.R. 237, 238 (Bankr. M.D. Pa. 1990).

34. The decision whether to approve a proposed settlement is committed to the sound discretion of the bankruptcy court, "which must determine if the compromise is fair, reasonable, and in the interest of the estate." *In re Louise's, Inc.*, 211 B.R. 798, 801 (D. Del. 1997). In exercising that discretion, the United States Court of Appeals for the Third Circuit (the "Third Circuit Court of Appeals") has stated that courts should consider "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors." *In re Martin*, 91 F.3d at 393; *see also, e.g., Will v. Nw. Univ. (In re Nutraquest, Inc.)*, 434 F.3d 639, 644 (3d Cir. 2006); *In re Marvel Entm't Grp., Inc.*, 222 B.R. 243, 249 (D.

Del. 1998). The proponent of a settlement is not required to demonstrate "that the settlement is the best possible compromise. Rather, the court must conclude that the settlement is 'within the reasonable range of litigation possibilities.'" *In re World Health*, 344 B.R. at 296 (internal citations and quotation marks omitted); *see also, e.g.*, *Nellis v. Shugrue*, 165 B.R. 115, 123 (S.D.N.Y. 1994) (Sotomayor, J.) ("[I]n assessing the fairness of the settlement, a judge does not have to be convinced that the settlement is the best possible compromise or that the parties have maximized their recovery."); *In re Coram Healthcare Corp.*, 315 B.R. 321, 330 (Bankr. D. Del. 2004) ("[T]he court does not have to be convinced that the settlement is the best possible compromise."). When performing this analysis, the Court need only "canvass" the issues to determine whether the proposed settlement falls "below the lowest point in the zone of reasonableness." *Newman v. Stein*, 464 F.2d 689, 693 (2d Cir.), *cert. denied sub nom. Benson v. Newman*, 409 U.S. 1039 (1972); *see also, e.g.*, *Nellis*, 165 B.R. at 123 ("Although a judge must consider the fairness of the settlement to the estate and its creditors, the judge is not required to assess the minutia of each and every claim. The bankruptcy judge does not have to decide the numerous questions of law and fact raised by appellants. The court need only canvass the settlement to determine whether it is within the acceptable range of reasonableness." (citations and quotation marks omitted)).

35. Just as Bankruptcy Rule 9019 permits the approval of settlements during the course of a debtor's case, Bankruptcy Code section 1123(b)(3) permits a debtor to settle or adjust disputes as part of a plan. *See, e.g.*, *In re Hercules Offshore, Inc*., 565 B.R. 732, 755-56 (Bankr. D. Del. 2016); *In re Nutritional Sourcing Corp*., 398 B.R. 816, 832 (Bankr. D. Del. 2008); *In re Exide Techs.*, 303 B.R. 48, 66-67 (Bankr. D. Del. 2003). Courts have consistently recognized that plan settlements under section 1123(b)(3) should be evaluated under the same "fair and

equitable" standard generally applicable to Bankruptcy Rule 9019 settlements. *See, e.g.*, *Resolution Trust Corp. v. Best Prods. Co. (In re Best Prods. Co.)*, 177 B.R. 791, 794 n.4 (S.D.N.Y.) ("Irrespective of whether a claim is settled as part of a plan pursuant to section 1123(b)(3)(A) of the Bankruptcy Code or pursuant to a separate motion under Bankruptcy Rule 9019, the standards applied by the Bankruptcy Court for approval are the same."), *aff'd*, 68 F.3d 26 (2d Cir. 1995); *In re Nutritional Sourcing Corp*., 398 B.R. at 832 ("As noted by Debtors, the standards for approving settlements as part of a plan of reorganization are the same as the standards for approving settlements under Fed. R. Bankr. P. 9019."); *In re Int'l Wireless Commc'ns Holdings, Inc.*, 1999 Bankr. LEXIS 1853, at *13-14 (Bankr. D. Del. Mar. 26, 1999) (reciting legal principle of utilizing identical standards and evaluating proposed plan-based compromise using the standards applicable to one proposed under Bankruptcy Rule 9019).

36. In summary, although the Court should give weight to the reasonable views of all parties in interest during its evaluation process, "objections do not rule. It is well established that compromises are favored in bankruptcy." *In re Lee Way Holding Co.*, 120 B.R. 881, 891 (Bankr. S.D. Ohio 1990). In fact, courts generally accord great deference to the recommendations of an estate representative when considering negotiated agreements. *See, e.g.*, *Official Comm. of Unsecured Creditors v. James Talcott, Inc. (In re Int'l Distrib. Ctrs., Inc.)*, 103 B.R. 420, 423 (S.D.N.Y. 1989). In this case, for the reasons detailed below, the Plan Settlement Elements fall well within the range of reasonableness and meet the standards for approval.

B. The Plan Settlement Elements Should Be Approved

37. The Debtors have determined, in an exercise of the Debtors' sound business judgment, that the terms of the Plan Settlement Elements are fair and reasonable and that the best interests of the Debtors' Estates and Creditors will be served by their approval. The terms of the Plan Settlement Elements are the product of good faith, arm's length negotiations among the

Debtors and the three official Committees, and fall well within the reasonable range of litigation possibilities. The Debtors further discuss each of the *Martin* factors in turn below.

1. Probability of Success in Litigation

38. The Plan Settlement Elements appropriately reflect the probability of success in litigation. Some of the issues that are resolved by the Plan Settlement Elements – such as the nature and extent of the Claims held by Noteholders and Unitholders – are highly complex and involve little or no case law that is instructive, let alone that is directly on point. Because some of the issues – such as whether the Units represent debt or equity – could lead to binary outcomes, the resolution of those issues is highly consequential. There thus exist *bona fide* and highly-contested disputes between and among the different stakeholders. The Plan provides a negotiated resolution of these complex, uncertain, but distributionally-significant issues that strikes a fair balance between the potential ranges of litigated outcomes, any of which would occur only after very substantial investments of party and judicial resources, probably including one or more fact-intensive trials or evidentiary hearings and multiple rounds of appeals.

39. Other issues that are resolved by the Plan Settlement Elements are less uncertain. For example, there is a high probability that the Intercompany Claims or Intercompany Liens asserted by the Fund Debtors against the applicable MezzCos or PropCos can be avoided or otherwise eliminated on any one of several grounds. As such, the Plan Settlement Elements appropriately include the consensual waiver of those Intercompany Claims and Intercompany Liens to the extent set forth in the Plan.

40. The different elements of the Plan Settlement Elements were holistically negotiated as part of a comprehensive settlement that resolves myriad complex and interrelated issues. When those issues are the subject of substantial case law and well-established legal principles, the likely result of a fully-litigated path was incorporated in the Plan Settlement

Elements. When those issues are more uncertain, however, negotiations occurred to reach consensus points across the range of possible fully-litigated outcomes. In either case, the Plan Settlement Elements were appropriately calibrated against the backdrop of what each set of stakeholders could plausibly achieve via litigation.

2. Likely Difficulties in Collection

41. This *Martin* factor is largely inapplicable to the aspects of the Plan Settlement Elements resolving the scope and nature of the Claims held by the Unitholders and Noteholders and substantive consolidation issues. All these aspects of the Plan Settlement Elements largely define the nature of third-party rights against a fixed *res* as to which collection risk would likely not be an issue.

3. Complexity of the Litigation Involved and the Expense, Inconvenience, and Delay Necessarily Attending It

42. The Plan Settlement Elements resolve many highly complex and uncertain issues that could take years and millions of dollars to litigate to finality. The time associated with such litigation would likely preclude ***any*** distributions from being made to Creditors during the interim period and the expenses of litigation would directly reduce the overall pool of value that is available for ultimate distribution to all Creditors.

43. Many of the issues raised, such as nature of the Unitholders' rights and the avoidability of various transactions (including Prepetition Distributions, Intercompany Claims, and Intercompany Liens), implicate open questions of bankruptcy law and state law, as well as an array of factual issues. Substantial effort would need to be directed to the numerous rounds of discovery likely required to fully complete the necessary records and the process of pursuing the litigations to finality, including prosecution of complaints, motion practice, and trials. The Debtors and their Creditors would incur meaningful costs associated with discovery, further

motion practice, and trials, requiring resources to be marshaled by the Debtors and one or more of the three Committees. And, in the case of the Debtors, litigation would distract the New Board and management from other important tasks that require attention, including maximizing the value of the real properties owned by the Debtors.

44. Moreover, regardless of the initial outcomes on the merits, it is possible that any of the parties involved would appeal, leading to lengthy briefing and further delays in several courts. The Plan Settlement Elements eliminate the need for those additional costs and uncertainty. Given the benefits of the proposed Plan Settlement Elements, a resolution of these matters on the terms and conditions set forth in the Plan is preferable to continued litigation and crucial to the success of the Plan.

45. During the time in which the litigation wars would be fought and additional professional fees would be incurred, the innocent victims of Shapiro's scheme would very likely have to sit and wait for a final resolution of the various issues through the judicial process. Given the binary nature of many of the disputes and the distributional implications of those disputes, there would not be a clear path whereby interim distributions could be made to any given Creditors. This could leave Creditors who are retired, elderly, or otherwise in need of timely liquidity sources without an accessible or economical way to recover something on their investment. As sometimes happens in larger chapter 11 cases, individual Creditors could be left in the lurch while their representatives engage in total war regarding what are largely winner-take-all issues, all at the expense of the Estates. Such an outcome would be highly unfortunate in these cases, and the Plan Settlement Elements are intended to obviate the need to engage in such complex, costly, and time-consuming litigation. Indeed, the Plan Settlement Elements disentangle the Debtors and their Estate from these many disputes in one fell swoop, thereby

removing the need for the Estates to incur any additional costs, while eliminating the risk that each of the different stakeholders could face if any particular issue were to be resolved adversely to their group's position.

4. Paramount Interest of the Creditors

46. Apart from the delay, uncertainty, and likely substantial cost associated with any litigation, there are other pragmatic factors that further support the consensual compromises and settlements provided by the Plan Settlement Elements. The Plan Settlement Elements consensually resolve numerous issues that have been central to the Chapter 11 Cases and are the cornerstone of the Plan. The comprehensive, full, and final resolution of these issues under the Plan provides for a fair, reasonable, and equitable result and greater distributions to Creditors than any alternative. Indeed, any attempt to resolve these issues in or out of the plan context without the Plan Settlement Elements could result in significant objections from one or more of the Committees and highly contested hearings, significant delay in obtaining confirmation of the Plan, erosion of distributions to Creditors (of a potentially material amount), and uncertainty as to the Debtors' and the Estates' future economic condition. The detrimental effects to the Debtors and all Creditors of further delay in confirmation and consummation of the Plan could be significant.

47. Moreover, the Plan Settlement Elements allow the Debtors to advance the progress of these Chapter 11 Cases to their next critical stage – determining critical issues in a way that provides certainty and furthers the administration of these cases, which is an interest of utmost federal concern. Advancing the Chapter 11 Cases and the prospect of meaningful distributions to Creditors not only is highly favorable for the Debtors' Estates and Creditors, but also advances the longstanding federal policy that bankruptcy cases should be promptly

administered for the benefit of innocent creditors who will get only partial recoveries on their claims.[9]

48. Finally, the Plan and the Plan Settlement Elements contained therein are the product of arms' length negotiations among many sophisticated parties and their counsel, and there can be no allegation of collusion or other unfair dealings regarding this process. Each term of the Plan and the related documents was reached through lengthy negotiations in which all sides were fully incentivized to protect their rights and maximize the benefits received in any agreement. The three official Committees and their experienced professionals have each independently studied the issues and determined that approval and implementation of the Plan Settlement Elements best advance their respective constituencies' interests.

* * *

49. In sum, all of the *Martin* factors support approval of the proposed Plan Settlement Elements. The Plan Settlement Elements fall well within the "range of reasonableness" required for approval of settlements in the context of a bankruptcy case, whether proposed as part of or separate from a chapter 11 plan. The Plan Settlement Elements fully and fairly resolve multiple complex litigations and, thereby, avoid the need for additional time-consuming, costly, and contentious litigation regarding numerous unprecedented legal issues. The Plan Settlement Elements were negotiated at length among, jointly crafted by, and endorsed by all estate

[9] *See, e.g.*, *Bullard v. Blue Hills Bank*, 135 S. Ct. 1686, 1694 (2015) ("[E]xpedition is always an important consideration in bankruptcy."); *Katchen v. Landy*, 382 U.S. 323, 328-29 (1966) (describing longstanding recognition "that a chief purpose of the bankruptcy laws is 'to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period'" (quoting *Ex parte Christy*, 44 U.S. (3 How.) 292, 312 (1845))); *Wiswall v. Campbell*, 93 U.S. (3 Otto) 347, 350-51 (1876) (emphasizing how "[p]rompt action is everywhere required by law," and that this principle requires quick resolutions of claims against a bankruptcy estate, as "[w]ithout it there can be no dividend"); *Bailey v. Glover*, 88 U.S. (21 Wall.) 342, 346-47 (1875) (discussing how "[i]t is obviously one of the purposes of the Bankrupt law, that there should be a speedy disposition of the bankrupt's assets," which is a goal "only second in importance to securing equality of distribution"); *Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1145 (1st Cir. 1992) (noting "the important policy favoring efficient bankruptcy administration"); *Century Glove, Inc. v. First Am. Bank*, 860 F.2d 94, 98 (3d Cir. 1988) (highlighting how "issues central to the progress of the bankruptcy petition, those likely to affect the distribution of the debtor's assets, or the relationship among the creditors, should be resolved quickly" (citation and quotation marks omitted)).

fiduciaries in these cases. Under the circumstances, the anticipated benefits of pressing forward on any of the myriad potential litigation paths are highly uncertain, come at a steep cost, and ensure many more years of delay in administrating the Chapter 11 Cases. In contrast, the Plan Settlement Elements provide certainty, the prospect of meaningful distributions to Creditors in the near term, an immediate resolution of significant disputes, and other tangible benefits to the Estates. For all these reasons, the Debtors respectfully submit that the Plan Settlement Elements are fair, reasonable, and in the best interests of the Estates.

C. The Court Should Substantively Consolidate the Other Debtors Into WGC

50. Unlike the substantive consolidation tests in other circuits, the Third Circuit Court of Appeals has developed no set list of factors to determine if substantive consolidation is appropriate; rather, "what must be proven (absent consent) concerning the entities for whom substantive consolidation is sought is that (i) prepetition they disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, ***or*** (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors." *In re Owens Corning*, 419 F.3d 195, 210-11 (3d Cir. 2005) (emphasis added). The appellate court opted for "an intentionally open-ended, equitable inquiry" rather than a factor-based analysis because a factor-based approach "often results in rote following of a form containing factors where courts tally up and spit out a score without an eye on the principles that give the rationale for substantive consolidation." *Id.* at 211.

51. Here, the second rationale for non-consensual substantive consolidation (*i.e.*, hopeless commingling of assets and liabilities) is readily satisfied with respect to WGC and the Other Debtors. As the Third Circuit explained in *Owens Corning*, this rationale is implicated in situations when "[w]ithout substantive consolidation all creditors will be worse off (as Humpty Dumpty cannot be reassembled or, even if so, the effort will threaten to reprise *Jarndyce and*

Jarndyce, the fictional suit in Dickens' *Bleak House* where only the professionals profited)." *Id.* at 211 n.20; *see also, e.g.*, *Windels Marx Lane & Mittendorf, LLP v. Source Enters. (In re Source Enters.)*, 392 B.R. 541, 554 (S.D.N.Y. 2008) (concluding that bankruptcy court appropriately ordered substantive consolidation when there was "pervasive" commingling that indicated "the debtors' books could not be untangled"); *In re Petters Co*., 506 B.R. 784, 816 (Bankr. D. Minn. 2013) ("This issue is especially salient where a high degree of commingling and intercompany transfers was among the abuses of the corporate form. Where tracing through such a history would involve large complications, substantive consolidation could greatly streamline the arithmetic (and the geometry) entailed in estate administration. That would be even more so in a case involving an incomplete, confusing, or facially unreliable documentary record from which the tracing would be made.").

52. The affairs of the Other Debtors were hopelessly commingled as part of the overall scheme Shapiro implemented. Once individual investor funds had been obtained by the Fund Debtors, those funds were transferred and commingled into one central bank account at WGC. Thus, even though the underlying loan documents facially referenced a loan by a specific prepetition Fund Debtor to the applicable PropCo, in reality, the funds for property purchases typically originated from a commingled account and generally cannot be traced to any particular prepetition Debtor. In almost every single case, WGC – rather than any prepetition Fund Debtor or PropCo – was the only source of funds used to purchase or develop a property. Moreover, in many instances the price to purchase or develop a property had little or no relationship to the amount of money that was nominally received by the particular PropCo or to the amount of money that same PropCo promised to repay. Indeed, in a number of circumstances, investors

hold documents evidencing a loan from a Fund Debtor to a PropCo that never acquired the underlying property at all.

53. The commingled account at WGC was also used for various other purposes, often without detailed records or accounting. For example, Shapiro used the commingled funds to pay for improvements, maintenance, operating expenses, or other expenses for individual properties, without always keeping clear records of what was spent on what specific items, let alone what was expended on an allocated, property-by-property basis. Shapiro further used these funds to pay for (i) general corporate overhead, (ii) broker commissions, (iii) payment of purported returns to old investors (as part of perpetuation of a Ponzi scheme), and (iv) at least $21.2 million for Shapiro's personal benefit (including, for example, purchasing luxury items, travel, wine, and the like). In many instances, the transfers made by WGC to or for the benefit of one or more of the Other Debtors were funneled through attorney trust accounts or directly to escrow companies without any clear indication why the transfers were being made or complete records of where all of the initially transferred money ultimately went.

54. The Debtors' professionals at Development Specialists, Inc. have examined what are literally tens of thousands of transactions made between or among WGC and the Other Debtors, or by WGC or another Other Debtor on behalf of a different Other Debtor – including based on QuickBooks entries, bank records, and discussions with Woodridge employees – and determined that it would be exceptionally difficult, if not literally impossible, to trace, reconcile, and reconstruct a reliable and complete allocation of assets and liabilities across WGC and the Other Debtors. This conclusion comports with that reached by a separate forensic accounting investigation conducted on behalf of the SEC by Soneet R. Kapila of KapilaMukamal, LLP, as set forth in a declaration dated December 18, 2017, and filed in the SEC's enforcement action,

Case No. 1:17-cv-24624-MGC, ECF No. 36-2 (S.D. Fla. Dec. 26, 2017) (the "Kapila Declaration"). Mr. Kapila identified "transfers totaling approximately $1.66 billion, exceeding 10,700 transactions, between the Woodbridge Entities resulting in extensive commingling of investor funds," which funds were used for various purposes that had little relationship to what correct accounting records would reflect. *See* Kapila Declaration ¶¶ 18(g), 89 & 74-79. The simple fact of the matter is that WGC and the Other Debtors were often not treated as legitimate separate entities with assets and liabilities properly and completely accounted for as among them. Instead, Shapiro effectively used WGC as an aggregated and wide-open "piggy bank" and spent money from a commingled account as and when he saw fit. The result is a tangled web of commingled and intermingled affairs, which would require consuming massive resources simply trying to put Humpty Dumpty together again (without any guarantee that result could even be achieved at all).

55. The disregard of accounting formalities is not the end of matters. There also is little documentation regarding transactions among and between WGC and the Other Debtors. For example, funds advanced by WGC for the benefit of the Other Debtors were not regularly documented (or even documented at all) as intercompany loan transactions, equity infusions, or some other specified relationship. Rather, consistent with Shapiro's treatment of the commingled account and Other Debtors as an undifferentiated mass freely available to him, many funds flowed on an undocumented basis, which means the Debtors' books and records simply do not contain materials that could in theory allow for a robust reconstruction of how assets and liabilities should be allocated based on formal agreements. Even if such a hypothetical allocation could somehow be constructed, it would inevitably have to rest on certain assumptions and allocation percentages regarding how to apportion operational costs and relative

historic liabilities for various expenses and expenditures, as well as potential litigation claims against third parties and other intangible assets, among and between hundreds of different entities. Some assumptions and allocations would likely have the effect of benefiting certain creditors at the expense of other creditors, and any effort to analyze and fix each separate entity's "fair share" would be a difficult, fact-intensive process that would likely be subject to challenge and ultimately result in costs that would decrease creditor recoveries across the board. Under these particular circumstances, at a minimum, the substantive consolidation of the Other Debtors into WGC is warranted.

56. In fact, courts have consistently deployed the remedy of substantive consolidation in similar circumstances where various entities have been created and used to perpetuate a Ponzi scheme rather than for legitimate business activity. *See, e.g.*, *In re Petters*, 506 B.R. 784, 788-90 (granting motion to substantively consolidate estates of operating and special-purpose-entity debtors when "the ostensible business and its transactional structure were virtually all a façade" and instead the enterprise structure was an aspect of a huge Ponzi scheme run by Thomas J. Petters); *In re Bonham*, 226 B.R. 56, 96-97 (Bankr. D. Alaska 1998) (substantively consolidating entities that were used as corporate shells as part of operating a Ponzi scheme and were hopelessly entangled, including due to the principal's use of commingled funds obtained from investors "to support a fashionable lifestyle for herself, her husband, and her children, providing for their home, vehicles, boats, education, and recreation," which precluded tracing which specific money paid which entity's expenses), *aff'd*, 229 F.3d 750 (9th Cir. 2000); *In re Baker & Getty Fin. Servs., Inc.*, 78 B.R. 139, 141-42 (Bankr. N.D. Ohio 1987) (determining that substantive consolidation was appropriate in case where Philip Cordek used entities that he controlled to implement a "classic Ponzi scheme" while in the process using commingled funds

without adequate substantiation of transfers and without adhering to corporate formalities). All these courts recognize that when the formalities associated with different entities were not fully respected as part of an individual's perpetration of a Ponzi scheme on innocent investors, substantive consolidation often is the best tool to avoid causing further reductions and delays in the limited recoveries that those same investors will ultimately receive through the bankruptcy process. Such an approach has a rich lineage and relates directly back to the original Supreme Court opinion explaining how relief similar to substantive consolidation is an appropriate way to rectify prepetition fraud on creditors. *See Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 218-20 (1941).

57. Moreover and importantly, in these cases the three Committees – each with the benefit of their own retained professionals – have concluded that substantive consolidation of the Other Debtors into WGC is appropriate, including in light of the significant difficulties and costs associated with trying to untangle their affairs. *See, e.g.*, *In re Republic Airways Holdings, Inc*., 565 B.R. 710, 721 (Bankr. S.D.N.Y. 2017) ("The Court also finds it persuasive that the Committee . . . supports the Debtors' request for substantive consolidation. The Committee agrees that the cost of untangling the assets would outweigh any benefits that creditors could obtain. The Committee also agrees that determining the actual value of the assets and liabilities of individual Debtors . . . would delay distributions and drain estate resources." (citations omitted)), *aff'd*, 582 B.R. 278 (S.D.N.Y. 2018). The representatives of the major creditor groups thus all agree that trying to allocate each Other Debtor's assets and liabilities would be prohibitive and so costly and time-consuming that it would harm all creditors. Indeed, the proposed consolidation will substantially reduce expenses by decreasing the administrative difficulties and costs related to the administration of the Estates of the Other Debtors separately,

as well as eliminating the need to determine professional fees on a case-by-case basis and streamlining the administration of a plan and the Chapter 11 Cases more generally.

58. Finally, the relief sought by the Debtors is not intended to be used "offensively" to destroy the rights of the few creditors that may have valid, perfected security interests in specific real property owned by the Other Debtors as a result of directed interactions involving only such specific property, including, for example, mechanics' lien holders, and tax lien holders.[10] As the Plan makes clear, the proposed substantive consolidation of the Other Debtors into WGC will not affect those secured creditors' claims and recoveries, Plan § 3.11.2(c), and thus will give effect to any reasonable expectations of any secured creditors who had created a specific and enforceable relationship with a specific property and is otherwise fair under the circumstances.

* * *

59. In summary, substantive consolidation of the Other Debtors into WGC is fair and consistent with the equitable moorings of the doctrine. Substantive consolidation also is warranted based on the unique facts of this case under the Third Circuit Court of Appeal's second rationale in *Owens Corning* – the massive and hopeless entanglement across myriad entities that was caused by Shapiro's actions. Because third-party creditors with legitimate security interests regarding specific real properties will not be impacted by the proposed substantive consolidation, such relief is not prejudicial or being done in an "offensive" fashion. Rather, such relief will produce significant benefits for the Debtors' general creditor body by eliminating what could be millions of dollars of incremental expenses and years of delay attempting (and probably, even then, without success) to do a complete reconciliation and

[10] *See Owens Corning*, 419 F.3d at 215 (stating that "substantive consolidation should be used defensively to remedy identifiable harms, not offensively to achieve advantage over one group in the plan negotiation process").

allocation model as among all the Other Debtors. For all these reasons, the Court should order that the Other Debtors be substantively consolidated into WGC.

NOTICE

60. The Debtors have provided notice of this Motion to: (i) the Office of the United States Trustee for the District of Delaware; (ii) counsel for the DIP lender; (iii) counsel for the Unsecured Creditors' Committee; (iv) counsel for the Noteholder Committee; (v) counsel for the Unitholder Committee; (vi) the Securities and Exchange Commission; and (vii) all parties who have requested notice in the Chapter 11 Cases pursuant to Bankruptcy Rule 2002. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is necessary.

CONCLUSION

WHEREFORE, the Debtors respectfully request that the Court (i) if necessary or appropriate, approve the Plan Settlement Elements independent of the Plan, namely: (a) elimination of the Intercompany Claims and Intercompany Liens to the extent contemplated by Section 3.11.2(g) of the Plan and (b) provision of "claims" for the Unitholders at a discounted ratio of 72.5% relative to the Noteholders' claims; (ii) if necessary or appropriate, substantively consolidate the Other Debtors into WGC independent of the Plan; and (iii) grant all such other relief as is necessary and proper.

Dated: October 3, 2018
Wilmington, Delaware

/s/ Ian J. Bambrick

YOUNG CONAWAY STARGATT & TAYLOR, LLP
Sean M. Beach (No. 4070)
Edmon L. Morton (No. 3856)
Ian J. Bambrick (No. 5455)
Betsy L. Feldman (No. 6410)
Rodney Square, 1000 North King Street
Wilmington, Delaware 19801
Tel: (302) 571-6600
Fax: (302) 571-1253

-and-

KLEE, TUCHIN, BOGDANOFF & STERN LLP
Kenneth N. Klee (*pro hac vice*)
Michael L. Tuchin (*pro hac vice*)
David A. Fidler (*pro hac vice*)
Whitman L. Holt (*pro hac vice*)
Jonathan M. Weiss (*pro hac vice*)
1999 Avenue of the Stars, 39th Floor
Los Angeles, California 90067

Counsel to the Debtors and Debtors in Possession

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) **Hearing Date:** **October 24, 2018, at 10:00 a.m. (ET)** **Objection Deadline:** **October 17, 2018, at 4:00 p.m. (ET)**

NOTICE OF MOTION

TO: (I) THE OFFICE OF THE UNITED STATES TRUSTEE FOR THE DISTRICT OF DELAWARE; (II) COUNSEL FOR THE DIP LENDER; (III) COUNSEL FOR THE UNSECURED CREDITORS' COMMITTEE; (IV) COUNSEL FOR THE NOTEHOLDER COMMITTEE; (V) COUNSEL FOR THE UNITHOLDER COMMITTEE; (VI) THE SECURITIES AND EXCHANGE COMMISSION; AND (VII) ALL PARTIES WHO HAVE REQUESTED NOTICE IN THE CHAPTER 11 CASES PURSUANT TO BANKRUPTCY RULE 2002

PLEASE TAKE NOTICE that Woodbridge Group of Companies, LLC and its affiliated debtors and debtors in possession in the above-captioned cases (collectively, the "Debtors") have filed the attached ***Debtors' Motion for Approval of Certain Compromises and Settlements, Partial Substantive Consolidation, and Related Relief with Respect to the Plan*** (the "Motion").

PLEASE TAKE FURTHER NOTICE that responses or objections to the Motion must be filed on or before **October 17, 2018, at 4:00 p.m. (ET)** (the "Objection Deadline") with the United States Bankruptcy Court for the District of Delaware, 3rd Floor, 824 North Market Street, Wilmington, Delaware 19801. At the same time, you must serve a copy of any response or objection upon the undersigned counsel to the Debtors so as to be received on or before the Objection Deadline.

PLEASE TAKE FURTHER NOTICE THAT A HEARING ON THE MOTION WILL BE HELD ON **OCTOBER 24, 2018, AT 10:00 A.M. (ET)** BEFORE THE HONORABLE KEVIN J. CAREY IN THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT

[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 this 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.

OF DELAWARE, 824 NORTH MARKET STREET, 5TH FLOOR, COURTROOM NO. 5, WILMINGTON, DELAWARE 19801.

PLEASE TAKE FURTHER NOTICE THAT, IF NO OBJECTIONS TO THE MOTION ARE TIMELY FILED, SERVED, AND RECEIVED IN ACCORDANCE WITH THIS NOTICE, THEN THE COURT MAY GRANT THE RELIEF REQUESTED IN THE MOTION WITHOUT FURTHER NOTICE OR A HEARING.

Dated: October 3, 2018
Wilmington, Delaware

/s/ Ian J. Bambrick

YOUNG CONAWAY STARGATT & TAYLOR, LLP
Sean M. Beach (No. 4070)
Edmon L. Morton (No. 3856)
Ian J. Bambrick (No. 5455)
Betsy L. Feldman (No. 6410)
Rodney Square, 1000 North King Street
Wilmington, Delaware 19801
Tel: (302) 571-6600
Fax: (302) 571-1253

-and-

KLEE, TUCHIN, BOGDANOFF & STERN LLP
Kenneth N. Klee (*pro hac vice*)
Michael L. Tuchin (*pro hac vice*)
David A. Fidler (*pro hac vice*)
Jonathan M. Weiss (*pro hac vice*)
1999 Avenue of the Stars, 39th Floor
Los Angeles, California 90067

Counsel to the Debtors and Debtors in Possession