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. 713, 797, & 798**

DEBTORS' REPLY IN SUPPORT OF MOTION FOR ENTRY OF AN ORDER (I) AUTHORIZING THE SALE OF 11541 BLUCHER AVENUE, GRANADA HILLS, CALIFORNIA PROPERTY OWNED BY THE DEBTORS FREE AND CLEAR OF LIENS, CLAIMS, ENCUMBRANCES, AND OTHER INTERESTS; (II) APPROVING THE RELATED PURCHASE AGREEMENT, AND (III) GRANTING RELATED RELIEF

Woodbridge Group of Companies, LLC and its affiliated debtors and debtors in possession in the above-captioned chapter 11 cases (collectively, the "Debtors") hereby submit this reply (the "Reply") in support of the *Debtors' Motion for Entry of an Order (I) Authorizing the Sale of 11541 Blucher Avenue, Granada Hills, California Property Owned by the Debtors Free and Clear of Liens, Claims, Encumbrances, and Other Interests; (II) Approving the Related Purchase Agreement, and (III) Granting Related Relief* [Dkt. No. 713] (the "Motion"),[2] and in response to the objections ("Objections") of West Coast Pharmaceutical, Inc. Defined Benefit Plan and Trust ("West Coast Trust"), Jeffrey E. Wolk, Jeffrey Sun, Angeline and Sureshchandra Desai, and Jonathan Greenleaf [Dkt. Nos. 797 & 798] (the "Objecting Noteholders").

[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 defined herein shall have the meanings assigned to such terms in the Motion.

PRELIMINARY STATEMENT

1. The Objections are built on a fiction: that the documents the Objecting Noteholders received and the representations made to them were true and that the money they invested was actually channeled directly into the property in which they thought they were investing. The reality is vastly different. However, for purposes of responding to the Objections, the Debtors assume that the documents on which the Objecting Noteholders rely accurately reflect the transactions described and referred to therein.[3]

SUMMARY OF ARGUMENT

2. After extensive negotiations, the Debtors, the DIP Lender, the Committee, the Noteholder Group, and the Unitholder Group negotiated a comprehensive resolution concerning the disposition and use of sale proceeds by the Debtors that is set forth in Section 3.1.2.4 of the Final DIP Order. In simple terms, that section provides (subject to certain adjustments not relevant to this particular sale), that 10% of the net sale proceeds shall be reserved for Noteholders with interests or liens on the applicable sale property, 10% of the net sale proceeds shall be reserved for Noteholders holding adequate protection liens on the applicable sale property, and 80% shall be released to the Debtors.[4]

3. By not requiring the Debtors to reserve all net sale proceeds up to the amounts of all Noteholders' asserted claims, the Final DIP Order avoided the anticipated immediate need for

[3] To be clear, that the Debtors are engaging the Objecting Noteholders' arguments on the Objecting Noteholders' terms is not and should not be deemed or construed to be an admission as to the occurrence, nature, or character of these or any other transactions. Any description or characterization herein of loans or other transactions between Woodbridge Fund 4 and the Seller is solely for purposes of this Reply. The Debtors reserve all rights with respect to the loans purportedly made by the "Fund-level" Debtors to the "PropCo" and "MezzCo" Debtors, including, without limitation, the right to challenge or dispute that such loans were actually made or any liens related to those loans are valid.

[4] As noted in the *Limited Response and Reservation of Rights of the Ad Hoc Noteholder Group Formed Pursuant to January 23, 2018 Order [D.I. 357] with respect to the Proposed Sale of the 11541 Blucher Avenue Property* [Dkt. No. 811] (the "Limited Response"), the Debtors have agreed that the 80% going to them from the Blucher sale is being used to retire secured high interest debt on other real property.

litigation over the Noteholders' secured claims. Although the Debtors were confident of their legal position in part for the reasons set out below, they did not wish to battle the Noteholders or to waste precious resources that could better be utilized to maximize the value of the estates (and thus the return to Noteholders and others).

4. Among other benefits to the estates, the Section 3.1.2.4 resolution reduces the Debtors' reliance on borrowing under the DIP Financing Facility. Specifically, every dollar of sale proceeds that is escrowed rather than released to the Debtors is a dollar that the Debtors may otherwise have to borrow under the DIP Financing Facility – at 9.5% interest. The Section 3.1.2.4 resolution, which permits the Debtors to access 80% of sale proceeds, thus minimizes the Debtors' borrowing costs and improves the prospect of greater overall returns to creditors.

5. Unfortunately, but unsurprisingly, nothing pleases all the people all the time. In this instance the Objecting Noteholders – representing approximately 3% of Noteholder claims directly against the Seller and thus, even if validly perfected (which they are not), would be entitled to just that same percentage of sale proceeds – would like more. They already have a baseline result, *i.e.*, the extensively negotiated Section 3.1.2.4 compromise, and are not entitled to anything extra.

6. In particular, the Objecting Noteholders are not entitled to adequate protection. Sections 363(e) and (p) of the Bankruptcy Code provide that for a creditor to have a right to adequate protection, the creditor bears the burden of proving that it has a valid interest in the property being sold. At least two of the Objecting Noteholders (West Coast Trust and Jeffrey Sun) were granted only security interests in the loan and security documents relating to the loan to the Seller's parent company and its membership interest in the Seller, not any interest in the Seller's Real Property, so they are not entitled to adequate protection resulting from the sale of

the Real Property.[5] The membership interest in the Seller is not being sold. The remaining Objecting Noteholders have failed to demonstrate that they are entitled to adequate protection because, under Article 9 of the Delaware Commercial Code (the applicable law), their asserted liens are unperfected.

7. As a result, the Motion should be granted, the Objections overruled, and the sale proceeds reserved and disbursed consistent with Section 3.1.2.4 of the Final DIP Order and the Limited Response.

BACKGROUND FACTS

8. None of the Objecting Noteholders are creditors of the Seller. Instead, they are (subject, as always, to the caveats in paragraph 1 and footnote 5) only lenders to the Seller's lender, debtor Woodbridge Mortgage Investment Fund 4, LLC ("Woodbridge Fund 4"). As creditors of a creditor, they are thus a level further removed. According to the Objecting Noteholders, Woodbridge Fund 4 made two loans – a roughly $13.65 million loan to the Seller, and a roughly $5.85 million loan to the Seller's parent company. Some Noteholders were granted security interests in the loan and security agreements with the Seller's parent company as well as the parent company's membership interests in the Seller. Other Noteholders were granted security interests in the loan and security agreements with the Seller itself, including the underlying note and deed of trust between it and Woodbridge Fund 4.

9. Of the Noteholders with claims secured by approximately $13.65 million in loans to the Seller (*i.e.*, alleged property-level Noteholders) and of the Noteholders with claims secured by approximately $5.85 million in loans to the Seller's parent company (*i.e.*, alleged mezzanine-

[5] Again, it is worth noting what we set out in paragraph 1. This discussion assumes, counter-factually, that the Objecting Noteholders' documents bear a close relationship to reality. They do not, but we address their arguments as if they do.

level Noteholders), only a very small fraction objected to the Motion or requested adequate protection beyond that set forth in the Final DIP Order. They are as follows:

Level	Objecting Noteholder	Amount	% of Total Noteholders at Respective Level
Property	Jeffrey E. Wolk[6]	$250,000	1.8%
Property	Angeline and Sureshchandra Desai	$100,000	0.7%
Property	Jonathan Greenleaf	$50,000	0.4%
Mezzanine	Jeffrey Sun	$200,000	3.4%
Mezzanine	West Coast Trust	$50,000	0.9%

REPLY

A. Section 363(e) Limits Parties Entitled to Adequate Protection

10. By its terms, section 363(e) of the Bankruptcy Code limits the right to adequate protection arising from the sale of property of the estate to "an entity that has an interest in property used, sold, or leased, or proposed to be used sold, or leased, by the trustee …." 11 U.S.C. § 363(e). If a creditor does not have an interest in the property in question, then "it is not entitled to adequate protection." *Callaway Cmty. Hosp. Ass'n v. First N. Bank & Trust (In re Chama, Inc.)*, 265 B.R. 662, 669 (Bankr. D. Del. 2000). This threshold requirement dooms at the outset the request for adequate protection by the two mezzanine-level Objecting Noteholders, West Coast Trust and Jeffrey Sun. By their own admission (and consistent with the loan documents they filed with their objection), these two Objecting Noteholders at best have claims tied to a loan to the Seller's ***parent company***, not to the Seller directly. *See* Dkt. No. 797, at

[6] The versions of the Promissory Note and Loan Agreement proffered by Mr. Wolk were not signed by Woodbridge Fund 4. *See* Dkt. No. 797, Exhs. B & C.

¶¶ 18 & 19 ("The note held by Affected Noteholder West Coast is … in the $5.8 million mezzanine loan [*i.e.*, the loan to the Seller's parent company] …. The Note held by Affected Noteholder Sun … is also in the mezzanine.").

11. Unlike the Objecting Noteholders with claims allegedly tied to loans to the Seller directly, Objecting Noteholders West Coast Trust and Jeffrey Sun were granted security interests only in the loan and security documents relating to the loan to the Seller's parent company and its membership interest in the Seller. *See id.* Exhs. D & E (Loan Agreement, § 2). They were never granted any interest in the real property owned by the Seller nor did they ever obtain any interest in a note or deed of trust on the Seller's Real Property. Accordingly, they have no interest in the Real Property or in the associated note and deed of trust within the meaning of section 363(e), and are therefore not entitled to adequate protection resulting from the sale of the Real Property. Creditors of a parent company are not entitled to adequate protection for the sale of a subsidiary's property. The equity in the Seller is not being sold. Thus, Objecting Noteholders West Coast Trust and Jeffrey Sun have no claim to adequate protection.

B. The Objecting Noteholders Fail to Meet Their Burden of Proof

12. Bankruptcy Code section 363(p)(2) provides that "the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest." 11 U.S.C. § 363(p)(2). As such, "[b]efore reaching the question of whether the Noteholders' interests [are] adequately protected, the Bankruptcy Court ha[s] to identify the nature of those interests … and the Noteholders ha[ve] the burden of proof of establishing the nature of their interests." *In re Grant Broadcasting of Philadelphia, Inc.*, 75 B.R. 819, 823 (E.D. Pa. 1987); *see also In re Exec. Assocs., Inc.*, 24 B.R. 171, 173 (Bankr. S.D. Tex. 1982) ("[The bank's] burden will be to establish a lien and initially demonstrate that the debtor is using cash

collateral that is subject to such a lien. Only in that event would the bank be entitled to adequate protection."). If a creditor claiming that the right to adequate protection does not show that it has "a perfected security interest in the [property]," then "it is not entitled to adequate protection." *Chama*, 265 B.R. at 669; *see also Emplexx Software Corp. v. AGI Software, Inc. (In re AGI Software, Inc.)*, 199 B.R. 850, 861 (Bankr. D.N.J. 1995) ("It is beyond dispute that the moving party must present sufficient evidence that it holds a valid perfected security interest in the subject property to be entitled to relief under § 362(d) on the basis of a lack of adequate protection."); *In re Cabrillo*, 101 B.R. 443, 450–51 (Bankr. E.D. Pa. 1989) (concluding a creditor failed to establish an entitlement to adequate protection where "on the basis of the present record, [the court] cannot conclude that [the creditor] has proven that it holds a valid security interest in the [property]"); *In re Microwave Prods. of Am., Inc.*, 94 B.R. 967, 970 (Bankr. W.D. Tenn. 1989) (concluding a creditor that "simply has an unperfected security interest … is not entitled to adequate protection"); *In re Coors of Cumberland, Inc.*, 19 B.R. 313, 320 (Bankr. M.D. Tenn. 1982) ("If the [asserted interests in property] are unperfected, then [the creditor] has no interest in the property of the estate which is entitled to adequate protection since [the creditor's] interest would be limited to that of a general unsecured creditor of the estate.").[7]

13. In order to establish their rights to adequate protection, the Objecting Noteholders must demonstrate ***both*** that their claims are secured by an interest in the Seller's Property (or at least in the $13.65 million Note given by the Seller to Woodbridge Fund 4) ***and*** that their rights are senior to the estate's rights under Bankruptcy Code section 544(a). Under section 544(a), "a trustee obtains a ***status*** as well as an avoiding power as a hypothetical judicial lien creditor,

[7] *See also* Feb. 13, 2018 Tr., at 40:16-21 (THE COURT: "[A] party who claims to be secured carries the burden of proving that they're secured and the filing of a proof of claim is not sufficient, it seems to me, for this or adequate protection purposes for the Court to have a basis upon which to find that they're secured.").

unsatisfied execution creditor, or bona fide purchaser as of the commencement of a bankruptcy case. *In re Alexander*, No. 11-74515-SCS, 2014 WL 3511499, at *9 (Bankr. E.D. Va. July 16, 2014) (emphasis in original; citation and internal quotation marks omitted), *aff'd*, 524 B.R. 82 (E.D. Va. 2014); *In re Don Williams Constr. Co.*, 143 B.R. 865, 868-69 (Bankr. E.D. Tenn. 1992) (where unperfected creditor's rights are not superior to a trustee's rights under section 544(a), "the trustee is entitled to the lot or the proceeds from its sale ahead of [the creditor's] claim").[8]

14. Here, the Objecting Noteholders have failed to meet their burden of proof. They have only outlined in passing (legally invalid, as shown below) arguments that they possess perfected secured claims, without detailing or providing evidence in support of those arguments. *See* Dkt. Nos. 797, ¶ 20 n.8; Dkt. No. 798, ¶¶ 2-3. There is no showing that any of the Objecting Noteholders have either possession of the Seller's note or have filed a UCC-1 financing statement to perfect their liens. (They did not.[9]) There are no documents showing that any of the Objecting Noteholders recorded anything at all in the real property records that they might argue

[8] To the extent the Objecting Noteholders assert that perfection must be challenged by way of an adversary proceeding, the case law is clear that non-perfection may be raised "defensively." *See, e.g., S. Bank & Tr. Co. v. Alexander (In re Alexander)*, 524 B.R. 82, 93 (E.D. Va. 2014) ("[T]he Trustee is entitled to raise her 'strong-arm powers' under § 544(a) as a defense to a superior claim to an asset of the estate, without regard to whether she has raised such powers in a lien avoidance adversary proceeding."); *In re Loewen Grp. Int'l, Inc.*, 292 B.R. 522, 528 (Bankr. D. Del. 2003) ("[T]he present action is essentially an attempt to recover on a claim asserted against the Mt. Nebo estate … [as] [t]he parties agreed by way of a … stipulated order that the dispute involved 'the entitlement to the net proceeds of the sale of the Mt. Nebo Property.' … Thus, Mt. Nebo is using § 544(a)(3) in opposition to a claim against the estate. In that context, Mt. Nebo is using § 544(a)(3) defensively and § 546(a) is not applicable."); *In re Ballard*, 100 B.R. 526, 527 (Bankr. D. Nev. 1989) (denying, notwithstanding there being no avoidance action, relief from stay where an error in the movant's UCC-1 did not make "its interest … valid as against a judicial lien creditor").

[9] Attached as Exhibit A to the Supplemental Declaration of Bradley D. Sharp (the "Supp. Sharp Declaration"), filed concurrently herewith, are the results of a March 21, 2018 UCC-1 lien search of Woodbridge Fund 4, the borrower of each of the Objecting Noteholders and the lender to the Seller. It reveals that there are no active UCC-1 financing statements whatsoever that are on file against it.

perfected their alleged secured claims. (They did not,[10] and, as set forth below, real property recordation does not work in any event.) And several of the Objecting Noteholders (Jonathan Greenleaf and Angeline and Sureshchandra Desai) have not filed with the Court any security agreements showing they were granted a security interest in anything. Mr. Greenleaf filed only a promissory note, *see* Dkt. No. 798, Exh. A; the Desais filed nothing at all. The Objecting Noteholders have simply not met their burden.

C. The Objecting Noteholders' Liens Are Unperfected

15. The Objecting Noteholders assert that they hold perfected liens in the Real Property. The only two arguments suggested in support of perfection are that: (i) the Objecting Noteholders were sold outright an interest in the note and deed of trust in the Real Property, as opposed to merely being granted a security interest in the note and the deed of trust, a position contrary to the clear terms of the loan and security agreements attached as exhibits to the Objecting Noteholders' objections, or, alternatively, (ii) the Objecting Noteholders' failure to perfect their liens via possession of the note or filing a UCC-1 financing statement as required by Article 9 of the Delaware Commercial Code is cured by inapplicable provisions of the California Business and Professions Code and a Ninth Circuit decision interpreting those provisions. *See* Dkt. Nos. 797, ¶ 20 n.8; Dkt. No. 798, ¶¶ 2-3. Neither argument has merit.

1. The Objecting Noteholders Did Not Purchase Promissory Notes

16. Certain of the Objecting Noteholders allude to "the differences in the manner of perfection of a security interest in, versus the sale of, a payment intangible or promissory note under Article 9 of the Uniform Commercial Code," Dkt. No. 797, ¶ 20 n.8, all but conceding that

[10] As revealed by the preliminary title report, a collateral assignment of the Woodbridge Fund 4 note and deed of trust was only recorded by a single Noteholder, Donna M. Tosi. Supp. Sharp Decl., ¶ 4 & Exh. B. Ms. Tosi is not one of the Objecting Noteholders.

their secured claims are unperfected under ordinary Article 9 rules absent a sale. The argument is ostensibly based on section 9-309 of the Delaware Commercial Code, which provides that the sale of a payment intangible or promissory note is perfected automatically upon attachment. *See* DEL. CODE ANN. tit. 6, § 9-309(3)-(4). By contrast, where there is no "sale," a lender's security interest in a payment intangible or promissory note can be perfected only by possession of the collateral or by filing a UCC-1 financing statement. *See id*., §§ 9-312(a) & 9-313(a).[11]

17. Here, the note issued by Seller to Woodbridge Fund 4 has not been sold or "negotiated" to any of the Objecting Noteholders or endorsed to and in favor of any Objecting Noteholder, as required by Article 3 of the Delaware Commercial Code to transfer and assign an "instrument." *See* DEL. CODE ANN. tit. 6, § 3-201(a) ("negotiation" is defined as "a transfer of possession … of an instrument by a person other than the issuer to a person who thereby

[11] Under the Uniform Commercial Code, as adopted in both California and Delaware, "[e]xcept as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral." Del. Code Ann. tit. 6, § 9-301(1) (emphasis added); *see also* CAL. COMM. CODE, § 9301(1) (same). Under Article 9, a limited liability company is "located" in the state in which it was organized. *See* DEL. CODE ANN. tit. 6, §§ 9-307(e) & 9-102(a)(71); *see also* CAL. COMM. CODE, §§ 9307(e) & 9-102(a)(71). Here, Woodbridge Fund 4 is a Delaware limited liability company, and thus the Delaware Commercial Code "governs perfection [and] the effect of perfection or nonperfection." DEL. CODE ANN. tit. 6, § 9-301(1); *see also* CAL. COMM. CODE § 9301(1) (same). Furthermore, all of the loan documents attached to the Objecting Noteholders' objections provide that Delaware law shall govern. *See* Dkt. No. 797, Exhs. B-E; Dkt. No. 798, Exh. A.

Del. Code Ann. tit. 6, § 9-301(2) does not alter this conclusion. Section 9-301(2) states: "While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral." DEL. CODE ANN. tit. 6, § 9-301(2). The words "perfection, the effect of perfection or nonperfection, and … priority" are all modified and relate solely to "a possessory security interest" in the collateral located in the jurisdiction, and not also other types of security interests in that jurisdiction. Because the Objecting Noteholders do not possess their alleged collateral, there are no possessory security interests at issue here and thus section 9-301(2) does not apply. The comments to the Delaware Commercial Code clarify that section 9-301(2) does not apply to a secured creditor who is not in possession of collateral. *See id*., § 9-301, cmt. 5(a) ("For example, were a secured party in possession of an instrument or tangible document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor."). Likewise, California law has long held that the Uniform Commercial Code, and not a recording in the real property records, governs perfection in collateral constituting a mortgage note. *See, e.g.*, *Huffman v. Wikle (In re Staff Mortg. & Inv. Corp.)*, 550 F.2d 1228, 1229 (9th Cir. 1977) (concluding creditors held unperfected security interests in promissory notes secured by deeds of trust, notwithstanding recording of the assignments in real property records, where the creditors never physical possessed the notes and never filed any financing statements).

becomes its holder"). Article 3 makes clear that "negotiation" (*i.e.*, transfer of an instrument) cannot occur until both possession of the instrument is transferred and the instrument is endorsed in favor of the transferee. *Id.*, § 3-203(c). The Objecting Noteholders do not even assert that they possess the underlying notes or that the notes were endorsed to them, much less introduce evidence in support of either proposition. On that basis alone, the "perfection via sale" argument hinted at in the Objections fails. Moreover, numerous terms in the Objecting Noteholders' loan and security agreements expressly refute the notion that the underlying note and deed of trust was "sold" to any of the Objecting Noteholders, as illustrated by Mr. Wolk's documentation:

- Mr. Wolk executed a "Promissory Note" and a "Loan Agreement." *See* Dkt. No. 797, Exhs. B & C. In both of the documents, Mr. Wolk is referred to as "Lender." *Id*. *See also* note 6 (observing that neither document was even signed by the obligor).

- The Promissory Note includes the typical hallmarks of a lending relationship, such as a defined interest rate (§ 1), a default interest rate (§ 2), a repayment schedule and maturity date (§ 3), events of default (§ 6), lender's remedies (§ 8), and a provision governing prepayment (§ 9).

- Similarly, the Loan Agreement features a defined interest rate (§ 1), a principal amount (§ 1), and a grant of a security interest in collateral (§ 2).

- The "Form of Assignment of Promissory Note and Mortgage" attached to the Loan Agreement as Exhibit B (the "Assignment of Note") expressly states that Woodbridge Fund 4 is assigning its interest in the Assigned Documents (as defined in the Assignment of Note) ***"as security for" the "term loan" extended by Mr. Wolk to Woodbridge Fund 4***. Further, the Assignment of Note provides that "[s]o long as no Event of Default shall have occurred, [Woodbridge Fund 4] shall be entitled to collect all payments of interest and all scheduled payments of principal … on the Assigned Documents." Assignment of Note, § 1.

- The "Form of Collateral Assignment" attached to the Loan Agreement as Exhibit C (the "Collateral Assignment") also makes clear that the Seller's loan and security agreements were assigned to Mr. Wolk "***[a]s security for the performance of all obligations of [Woodbridge Fund 4] to [Mr. Wolk] under the Note.***" Collateral Assignment, § 2 (emphasis added). The Collateral Assignment further provides that Woodbridge Fund 4 shall "continue to receive the benefits of, and exercise the rights under, the Underlying Documents unless an Event of Default ... exists …. *Id*., § 5.

18. Based on the plain terms of the documents that the Objecting Noteholders signed (putting aside that Mr. Wolk's Promissory Note and Loan Agreement are not signed by the obligor), they provided secured loans to Woodbridge Fund 4 and were to receive a security interest in Woodbridge Fund 4's note and deed of trust with the Seller to secure Woodbridge Fund 4's loan to them. Nothing indicates that the Seller's note and deed of trust from Woodbridge Fund 4 was "sold" to any of the Objecting Noteholders. (Indeed, the amount loaned by each Objecting Noteholder to Woodbridge Fund 4 was just a fraction of the stated amount of the loan between Woodbridge Fund 4 and the Seller.) The transaction documents unambiguously provide that the upside to each Objecting Noteholder was capped at the stated obligations owed to it by Woodbridge Fund 4; in no event would any Objecting Noteholder be entitled to collect the ***full stated amount*** owed by the Seller to Woodbridge Fund 4 under the underlying note and deed of trust. *See, e.g.*, Assignment of Note § 3. Further, the Objecting Noteholders do not cite (and the Debtors have not located) any authority suggesting that a pledge of an interest in an underlying note to secure the obligations on another note may be construed as a sale of the underlying note. Accordingly, Delaware Commercial Code sections 9-309(3) and (4), governing perfection of "sales" of payment intangibles and promissory notes, simply have no application here.

2. There Is No Exception to Article 9 Based on the California Statute

19. Again implicitly acknowledging that they failed to properly perfect their alleged liens under Article 9 of the Delaware Commercial Code, the Objecting Noteholders suggest that the failure can be cured by section 10233.2 of the California Business and Professions Code ("Cal. B&P Code") and a Ninth Circuit case interpreting that section, *Neilson v. Chang (In re First T.D. & Investment, Inc.)*, 253 F.3d 520 (9th Cir. 2001). As explained below, Cal. B&P

Code § 10233.2 has no bearing on whether the Objecting Noteholders are perfected as (i) the Objecting Noteholders' documents all explicitly contain Delaware choice of law provisions, and, (ii) under applicable law, Delaware law would apply even in the absence of such a choice of law provision. Additionally, if the California statute were applicable, its requirements were plainly not met here.[12]

20. Cal. B&P Code § 10233.2 provides that as a matter of ***California*** law, if the criteria set forth in the statute are satisfied, then a lender may be deemed to hold a perfected security interest in promissory notes or collateral instruments and documents notwithstanding such lender's lack of possession of the collateral. The statute provides:

> For the purposes of Division 3 (commencing with Section 3101) and Division 9 (commencing with Section 9101) of the [California] Commercial Code, when a broker, acting within the meaning of subdivision (d) or (e) of Section 10131 or Section 10131.1, has arranged a loan or sold a promissory note or any interest therein, and thereafter undertakes to service the promissory note on behalf of the lender or purchaser in accordance with Section 10233, delivery, transfer, and perfection shall be deemed complete even if the broker retains possession of the note or collateral instruments and documents, provided that the deed of trust or an assignment of the deed of trust or collateral documents in favor of the lender or purchaser is recorded in the office of the county recorder in the county in which the security property is located, and the note is made payable to the lender or is endorsed or assigned to the purchaser.

Cal. B&P Code § 10233.2. *In re First T.D. & Investment* is the only published case that has cited Cal. B&P Code § 10233.2. On the facts present in that case, the elements of the statute were satisfied and the Ninth Circuit held that the lenders were perfected even in the absence of possession. 253 F.3d at 531.

[12] The Debtors engage in this lengthy discussion of California law not because it is remotely applicable here, but because there is a possibility that other Noteholders may claim to have instruments controlled by that state's law and it is, therefore, important to put this matter to rest early on.

21. Here, neither Cal. B&P Code § 10233.2 nor *In re First T.D. & Investment* has any application. By its express terms, Cal. B&P Code § 10233.2 modifies the perfection rules of only the ***California*** Commercial Code. *See* Cal. B&P Code § 10233.2 ("***For the purposes of*** Division 3 (commencing with Section 3101) and Division 9 (commencing with Section 9101) of ***the Commercial Code***….") (emphasis added). The California Commercial Code, however, is inapplicable for purposes of determining whether the Objecting Noteholders have perfected security interests. Not only do all the Objecting Noteholders' documents choose Delaware law,[13] this state's law would have to apply any way.[14] Because Woodbridge Fund 4 is located in Delaware, the Delaware Commercial Code "governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral." DEL. CODE ANN. tit. 6, § 9-301(1); *see also* CAL. COMM. CODE, § 9301(1) (same). Because the Delaware Commercial Code is the applicable law and is unaltered by Cal. B&P Code § 10233.2, the standard Uniform Commercial Code rules requiring perfection by possession or by the filing of a UCC-1 financing statement are fully applicable to the Objecting Noteholders. *See* DEL. CODE ANN. tit. 6, §§ 9-312(a) & 9-313(a). As noted, the Objecting Noteholders have not perfected by either of these means.

22. Even beyond the statute's dispositive inapplicability, the Objecting Noteholders fail to satisfy multiple elements of the statute. In *In re First T.D. & Investment*, the Ninth Circuit divided Cal. B&P Code § 10233.2 into a five-element test:

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[13] ***All*** of the loan documents attached to the Objecting Noteholders' objections state the parties' intent and agreement that Delaware law shall govern. *See* Dkt. No. 797, Exhs. B-E; Dkt. No. 798, Exh. A.

[14] This point is worth emphasizing, as there may be future noteholders (clearly not the Objecting Noteholders) with claims that their notes choose California law. It would not matter, as Delaware law would still apply by virtue of section 9-301(1).

> (1) a "broker, acting within the meaning of" California Business and Professions Code §§ 10131 or 10131.1 possesses the security instrument; (2) the broker has "arranged a loan" or "sold a promissory note or any interest therein"; (3) the broker "undertakes to service the promissory note"; (4) the trust deed or collateral documents in favor of the lender are "recorded in the office of the county recorder in the county in which the security property is located"; and (5) "the note is made payable to the lender or is endorsed or assigned to the purchaser."

253 F.3d at 526 (quoting Cal. B&P Code § 10233.2).

23. Cal. B&P Code § 10233.2 plainly is intended to apply either where (1) a broker has arranged a loan for a third party where the third party is the lender and the broker's role is as the loan servicer, or (2) the broker has sold a loan to a loan purchaser and the broker's role is as the loan servicer. As neither of these fact patterns describes the Objecting Noteholders' investment – here, the Objecting Noteholders assert that Woodbridge Fund 4 made the loan to the Seller itself and, as noted, did not sell that loan to the Objecting Noteholders – it is unsurprising that many of the elements of Cal. B&P Code § 10233.2 are not met. Below are some more obvious examples.

24. ***First***, the statute applies only where "***a broker***, acting within the meaning of subdivision (d) or (e) of Section 10131 or Section 10131.1, … retains possession of the note or collateral instruments and documents." Cal. B&P Code § 10233.2 (emphasis added).[15] Section 10012 of the Cal. B&P Code, which appears within the "Real Estate" division of the Cal. B&P Code, provides that "[b]roker, when used without modification, means a person ***licensed as a broker*** under any of the provisions of this part." Cal. B&P Code § 10012 (emphasis added).[16]

[15] Another issue for the Objecting Noteholders is that it is not clear that Woodbridge Fund 4 is in possession of the Seller's promissory note, as required by Cal. B&P Code § 10233.2. Although the Debtors are in possession of many promissory notes, this one has not been identified as one in their current possession. Supp. Sharp Decl., ¶ 5.

[16] Moreover, Cal. B&P Code § 10233.2 requires that the broker "undertakes to service the promissory note … in accordance with Section 10233." Section 10233, in turn, applies only to "[a] real estate ***licensee*** who undertakes to service a promissory note." Cal. B&P Code § 10233 (emphasis added).

Cal. B&P Code § 10233.2 applies to California licensed real estate brokers, not to "brokers" in any generic or colloquial sense. *See Neilson v. Dwyer (In re Cedar Funding, Inc.),* 2011 Bankr. LEXIS 3487, at *28 (Bankr. N.D. Cal. Sept. 12, 2011) ("The court disagrees with the Chapter 11 Trustee's [Cal. B&P Code] analysis for the simple reason that no evidence has been offered demonstrating that CFI was a licensed broker. Section 10233.2 only applies to 'brokers,' which [Cal. B&P Code] §10012 defines as a 'licensed' broker."). The Objecting Noteholders do not provide any evidence that Woodbridge Fund 4 was a licensed real estate broker within the meaning of the statute, and, in fact, it was not.[17]

25. ***Second***, a mandatory element of Cal. B&P Code § 10233.2 is that the broker must "undertake[] to service the promissory note on behalf of the lender or purchaser in accordance with Section 10233." Section 10233, in turn, requires, *inter alia*, a "written authorization from the borrower, the lender, or the owner of the note or contract, that is ***included within the terms of a written servicing agreement*** that satisfies [certain requirements set forth in Cal. B&P Code § 10238]." Cal. B&P Code § 10233(a) (emphasis added). In *In re First T.D. & Investment*, this element was undisputed; the broker-debtor had entered into a "Servicing Agreement" with each investor that authorized the broker-debtor, acting as "servicing agent," to collect all loan payments from borrowers and to take other actions necessary or convenient to servicing of the note. 253 F.3d at 524. Here, the Objecting Noteholders provide no evidence of any written servicing agreements, and no such agreements exist. *See* Supp. Sharp Decl., ¶ 7.

26. ***Third***, Cal. B&P Code § 10233.2 requires that "the deed of trust or an assignment of the deed of trust or collateral documents in favor of the lender or purchaser is recorded in the office of the county recorder in the county in which the security property is located." Cal. B&P

[17] *See* Supp. Sharp Decl., ¶ 6 & Exh. C (showing that Woodbridge Fund 4 does not appear as a licensed broker on the website of the California Bureau of Real Estate).

Code § 10233.2. Assuming arguendo that recordation of the collateral assignment of the Seller's note and deed of trust would even meet the requirement of Cal. B&P Code § 10233.2, as noted above, no Objecting Noteholder recorded anything and so cannot invoke that section.

* * *

27. For all of the foregoing reasons, the Objecting Noteholders do not hold perfected liens in the Seller's note and deed of trust, and therefore hold no interest in the Seller's Real Property that is being sold, and so are not entitled to adequate protection.

CONCLUSION

28. For the foregoing reasons, the Debtors respectfully request that the Court overrule the Objecting Noteholders' objections and grant the relief requested in the Motion.

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Dated: Wilmington, Delaware
March 26, 2018

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