

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re

Woodbridge Group of Companies, LLC, et al.,

Debtors.

Chapter 11

Case No. 17-12560 (KJC)

Hearing Date: December 21, 2017, 9:00 a.m.

Objections Due: December 20, 2017, 12:00 p.m.

**UNITED STATES TRUSTEE’S OBJECTION TO
ENTRY OF INTERIM ORDER (I) PURSUANT TO 11 U.S.C. §§ 105, 361, 362, 363, 364,
507, AND 552 AUTHORIZING DEBTORS TO (A) OBTAIN POSTPETITION SECURED
FINANCING, (B) USE CASH COLLATERAL, (C) GRANT ADEQUATE PROTECTION
TO PREPETITION SECURED PARTIES; (II) MODIFYING THE AUTOMATIC STAY;
(III) SCHEDULING A FINAL HEARING PURSUANT TO BANKRUPTCY RULES
4001(b) AND 4001(c); AND (IV) GRANTING RELATED RELIEF**

Andrew R. Vara, Acting United States Trustee for Region Three (“U.S. Trustee”), through his counsel, objects to Debtor’s Motion for Entry of Interim Order (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 507, and 552 Authorizing Debtors to (A) Obtain Postpetition Secured Financing, (B) Use Cash Collateral, (C) Grant Adequate Protection to Prepetition Secured Parties; (II) Modifying the Automatic Stay; (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (IV) Granting Related Relief (Dkt. No. 22) (the “Motion”)¹ as follows:

PRELIMINARY STATEMENT

The U.S. Trustee objects to the Debtors borrowing any monies or otherwise using estate assets, including any Cash Collateral, for the benefit of Debtors’ principal and prepetition

¹ Terms shall have the same meaning as ascribed to them in the Motion, unless stated otherwise.

manager, Robert Shapiro, as well as any affiliates of Mr. Shapiro (referred to collectively as “Mr. Shapiro”). The Debtors are currently seeking additional funds under the DIP Facility, as well as the use of Cash Collateral, for a period extending to January 10, 2017. Based on the Debtors’ Declaration of Lawrence R. Perkins In Support of the Debtors’ Chapter 11 Petitions and Requests for First Day Relief (Dkt. No. 12) (the “Perkins Declaration”), it appears that the Debtors intend to pay Mr. Shapiro a consulting fee of \$175,000 on or about January 1, 2018, pursuant to a Transition Services Agreement that was executed on the eve of bankruptcy. In addition, Mr. Shapiro is occupying two properties owned by the Debtors (one of which Mr. Shapiro leases at below current market rent) under a Forbearance Agreement and two subordination, non-disturbance, and attornment agreements (the “SNDAs”). The Debtors do not have a motion pending to assume the Transition Services Agreement, the Forbearance Agreement or the SNDAs. Also, the Debtors intend to consummate certain sale transactions on “Contracted Properties” which, while subject to the Contribution Agreement, might benefit his interests at the Estates’ expense. Unless approved on separate motion to the Court, the U.S. Trustee believes that any compensation or other benefits paid by the Debtors to Mr. Shapiro are inappropriate. Further, while additional interim DIP funding may be necessary to preserve certain assets of the Debtor until a final hearing, the Debtors should be required to demonstrate precisely what expenditures are required.

JURISDICTION

1. Pursuant to i) 28 U.S.C. § 1334; ii) applicable order(s) of the United States District Court for the District of Delaware issued pursuant to 28 U.S.C. § 157(a); and iii) 28 U.S.C. § 157(b)(2)(A), this Court has jurisdiction to hear and resolve this Objection.

2. The U.S. Trustee is charged with overseeing the administration of Chapter 11 cases filed in this judicial district, pursuant to 28 U.S.C. § 586. This duty is part of the U.S. Trustee’s overarching responsibility to enforce the bankruptcy laws as written by Congress and interpreted by the courts to guard against abuse and over-reaching to assure fairness in the process and adherence to the provisions of the Bankruptcy Code. *See In re United Artists Theatre Co.*, 315 F.3d 217, 225 (3d Cir. 2003) (“U.S. Trustees are officers of the Department of Justice who protect the public interest by aiding bankruptcy judges in monitoring certain aspects of bankruptcy proceedings.”); *United States Trustee v. Columbia Gas Sys., Inc. (In re Columbia Gas Sys., Inc.)*, 33 F.3d 294, 298 (3d Cir. 1994) (“It is precisely because the statute gives the U.S. Trustee duties to protect the public interest...that the Trustee has standing to attempt to prevent circumvention of that responsibility.”); *Morgenstern v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990) (“As Congress has stated, the U.S. trustees are responsible for ‘protecting the public interest and ensuring that the bankruptcy cases are conducted according to [the] law’”).

3. The U.S. Trustee has standing to be heard on the Motion pursuant to 11 U.S.C. § 307.

STATEMENT OF FACTS

4. On December 4, 2017, the Debtors filed voluntary petitions under Chapter 11. The U.S. Trustee appointed an official committee of unsecured creditors in this case on December 14, 2017. The Debtors remain in possession of their assets and continue to manage their business as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

5. The Debtors filed the Motion on December 4, 2017. The Motion originally sought to fund these cases on an interim basis by borrowing \$25 million through January 10, 2018. Per agreement with the U.S. Trustee, the Debtors agreed to limit the initial borrowing to \$6 million, and to forestall additional interim borrowing pending a further interim hearing on December 21, 2017. The Debtors are currently seeking further interim Court approval of \$19 million in DIP financing to be supplied by Hankey Capital. Motion at ¶ 23.

6. The Perkins Declaration indicates that the Debtors have approximately \$6 million of unsecured trade debt, but additional debt of approximately \$750 million owed to approximately 9,000 Noteholders. Perkins Declaration at ¶¶ 18, 42-43. The Debtors also have secured debt on three properties that have seller financing. *Id.* at ¶ 42. As of the Petition Date the Debtors have approximately \$12.5 million in their bank accounts. *Id.* at Exhibit I & ¶ 40.

7. For much of the past year, the Debtors have been under investigation by the United States Securities and Exchange Commission (“SEC”), and approximately 25 state securities regulators. *Id.* at ¶¶ 46-48. Mr. Shapiro agreed to remove himself from control of the Woodbridge Group Enterprise’s assets because of concerns expressed by federal and state securities regulators. *Id.* at ¶ 25.

8. The purported objective of filing the chapter 11 case as set forth in the Perkins Declaration is to maximize value by completing the development of properties and restructuring the business as a going concern that relies on institutional capital sources, rather than raising funds through retail investors. *Id.* at ¶¶ 61-65.

9. The Debtors assert that Mr. Shapiro has unique experience and familiarity with the Debtors’ assets that will be important to the restructuring, and the Debtors have agreed to three “negotiated accommodations” that are the subject of this Objection. *See* Perkins Declaration at ¶

26. The negotiated accommodations are: Mr. Shapiro is (1) entitled to receive a consulting fee of \$175,000 per month pursuant to a Transition Services Agreement, entered on December 1, 2017; (2) entitled to the continued occupancy of two properties owned by the Debtors, one of which is at below current market rents under a Forbearance Agreement and two SNDAs; and (3) entitled to consummate sale transactions on “Contracted Properties.” *Id.* at ¶¶ 26-30. In addition, it is unclear if Mr. Shapiro will be able to benefit from the sale of any Debtor properties during the chapter 11 cases.

10. Upon information and belief, Mr. Shapiro has already received one monthly payment of the Consulting Fee, for the month of December. Pursuant to the Transition Services Agreement, that one-month Consulting Fee of \$175,000 would have been paid, for one month in advance, just before the bankruptcy cases were filed. Based on information and belief, many of the items that Mr. Shapiro’s experience and familiarity may assist with, can be supplied by other parties, including project management services for a number of the Debtors’ properties under construction.

ARGUMENT

11. It is often said that “the conduct of bankruptcy proceedings not only should be right but must seem right.” *In re Ira Haupt & Co.*, 361 F.2d 164, 168 (2d Cir. 1966). The negotiated compensation and other accommodations with Mr. Shapiro are not right, nor do they seem right given what has preceded this filing, particularly the extended SEC Investigation. Mr. Shapiro is the principle actor that precipitated the Debtors’ needs for these chapter 11 cases. Paying significant compensation to Mr. Shapiro through the Consulting Fee, allowing him continued use of two Debtor properties, and providing him with the opportunity to profit from sale transactions purposefully excluded from these chapter 11 proceedings, should not be allowed, where all of that

was the subject of eve of bankruptcy agreements. All compensation and other benefits to be received by Mr. Shapiro should be subject to close scrutiny by creditors and other parties in interest in these cases following due notice. See *In re Husting Land & Dev., Inc.*, 255 B.R. 772, 778-79 (Bankr. D. Utah 2000), *aff'd*, 274 B.R. 906 (D. Utah 2002) (citing *In re Media Central, Inc.*, 115 B.R. 119, 124 (Bankr. E.D. Tenn.1990)) (“Even if the debtor-in-possession believes its contemplated action would be beneficial to the estate, and even if it later turns out the transaction was beneficial to the estate, if [it] is not in the ordinary course of business, creditors still have the right to notice and hearing before the transaction is entered into.”). Payments to Mr. Shapiro should not be considered “ordinary course” transactions.

12. It is not appropriate under the facts and circumstances of this case for the insider that has been removed from his position in management to continue to receive compensation and benefits when the prepetition arrangements that governed the relationship have been terminated, and replacement arrangements were entered into without true arms-length negotiations and without an opportunity for review by the parties harmed by the Debtors’ prepetition actions. While Mr. Shapiro has been removed from managing the affairs of the Debtors because his conduct made the Debtors the target of numerous investigations, the Debtors may nonetheless have conceded to many of Mr. Shapiro’s demands simply to place as many of the Debtor entities as possible into chapter 11 protection. If current post-petition management is capable of preserving the assets remaining in the Estates, such management should also be charged with eliminating Mr. Shapiro’s continuing involvement in these bankruptcy cases going forward, and not pay Mr. Shapiro \$175,000 per month in Consulting Fees or provide additional benefits. It is not clear why Mr. Shapiro’s involvement in the bankruptcy cases is required, given that Debtors seek to maintain contractual relationships with vendors, including those that supply project management services.

Moreover, if Mr. Shapiro's cooperation is desired so as to obtain missing assets and/or records, surely alternative means exist to ensure cooperation.

13. As was the driving concern at the December 5 hearing, the actual necessity of any further DIP Financing draws should be of paramount importance. There should be no draw of funds without evidentiary support, listing the purposes for the funds requested in the interim, with detailed information as to what functions those funds are supporting, including budget items for construction by property.

WHEREFORE the U.S. Trustee requests that this Court issue an order denying the Motion and/or granting such other relief that this Court deems fair and just.

Dated: December 18, 2017
Wilmington, Delaware

Respectfully submitted,

ANDREW R. VARA
ACTING UNITED STATES TRUSTEE

By: /s/

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CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that on December 18, 2017, the United States Trustee's Objection to Debtor's Motion for Entry of Interim Order (I) Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 507, and 552 Authorizing Debtors to (A) Obtain Postpetition Secured Financing, (B) Use Cash Collateral, (C) Grant Adequate Protection to Prepetition Secured Parties; (II) Modifying the Automatic Stay; (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rules 4001(b) and 4001(c); and (IV) Granting Related Relief was served in the manner indicated to the following persons:

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