AMERICAN BANKRUPTCY INSTITUTE

2017 Southwest Bankruptcy Conference

Third Party Litigation Funding and Issues It Creates in Bankruptcy Cases: This Ain't Your Father's Contingency Fee Arrangement!

Thomas J. Salerno, Moderator
Stinson Leonard Street LLP; Phoenix

Justin G. Brass
Jefferies LLC; New York

Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

David Gallagher
Bentham IMF; Los Angeles

Jordan A. Kroop
Perkins Coie LLP; Phoenix

CONCURRENT SESSION

2017

Third Party Litigation Funding and Issues It Creates In Bankruptcy Cases—This Ain't Your Father's Contingency Fee Arrangement!

ABI SOUTHWEST BANKRUPTCY CONFERENCE
San Diego, California
Friday, September 8, 2017
9:45 a.m.

PANELISTS:

Justin Brass
Managing Director
JEFFRIES LLC SPECIAL SITUATIONS GROUP
New York, New York

David Gallagher
Manager and Legal Counsel
BENTHAM IMF
Los Angeles, California

Jordan A. Kroop, Esq.
Partner
PERKINS COIE LLP
Phoenix, Arizona

Thomas J. Salerno, Esq.
Partner
STINSON LEONARD STREET LLP
Phoenix, Arizona

Hon. Barbara J. Houser
Chief Judge
U.S. BANKRUPTCY COURT, ND TEXAS

"These materials are designed to provide general information prepared by professionals in regard to subject matter covered. It is provided with the understanding that the authors are not engaged in rendering legal, accounting or other professional services. Although prepared by professionals, these materials should not be utilized as a substitute for professional service in specific situations. If legal advice or other expert assistance is required, the service of a professional should be sought." From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers.

SPEAKERS

HON. BARBARA J. HOUSER is the Chief United States Bankruptcy Judge in the Northern District of Texas. She received her undergraduate degree from the University of Nebraska with high distinction in 1975 and her doctor of laws from Southern Methodist University School of Law in 1978. She then joined Locke, Purnell, Boren, Laney & Neely in Dallas and became a shareholder there in 1985. In 1988 she joined Sheinfeld, Maley & Kay, P.C. as the shareholder-in-charge of the Dallas office and remained there until she was sworn in as a United States Bankruptcy Judge in 2000. While at Sheinfeld she led the firm's representation of clients in a variety of significant, national chapter 11 cases.

Judge Houser, who lectures and publishes frequently, is a past chairman of the Dallas Bar Association's Committee on Bankruptcy and Corporate Reorganization, is a member of the Dallas, Texas and American Bar Associations, and is a fellow of the Texas and American Bar Foundations. She served as a contributing author to *Collier on Bankruptcy* for many years and taught Creditors' Rights as a Visiting Professor at the SMU Dedman School of Law.

She was elected a fellow of the American College of Bankruptcy in 1994. In 1996, she was elected a conferee of the National Bankruptcy Conference, an organization of nationally recognized experts in bankruptcy. In 1998, the National Law Journal named her as one of the fifty most influential women lawyers in America. After becoming a bankruptcy judge in January, 2000, she joined the National Conference of Bankruptcy Judges and served as its President in 2009-2010. She has received a number of prestigious awards including: (i) the Distinguished Alumni Award for Judicial Service from the SMU Dedman School of Law in February, 2011, (ii) the William L. Norton Jr., Judicial Excellence Award in October, 2014, and (iii) the Distinguished Service Award from the Alliance of Bankruptcy Inns of the American Inns of Court in October 2016. Judge Houser currently serves as a member of the Executive Board of the SMU Dedman School of Law and is an officer and member of the Executive Committee of the Board of Directors of the American Bankruptcy Institute. In March 2017, Chief Justice John Roberts appointed her to serve as a member of the Board of Directors of the Federal Judicial Center, the education and research arm of the Third Branch

JUSTIN BRASS is a Managing Director in the Jefferies LLC Special Situations Group where he specializes in litigation finance and distressed investing. Mr. Brass's professional background spans law and finance. He began his career at Greenberg Traurig in Miami before serving as a law clerk for Judge Robert D. Drain in the United States Bankruptcy Court for the Southern District of New York. After completing his clerkship, he joined the bankruptcy and corporate reorganization group at Paul, Weiss in New York. In 2008, Justin transitioned to finance and worked on the distressed desk at Jefferies. After five years at Jefferies, he moved to Stone Lion Capital Partners L.P., where he focused on investing in litigations and liquidations. In 2016, Justin led Burford Capital's efforts to expand their litigation finance business into insolvency related litigation. After a successful 2016 where Justin led the effort to create a secondary market for litigation risk and litigation funding for distressed corporations, he rejoined Jefferies to start a litigation finance business as part of the Special Situations Group.

Mr. Brass graduated from Stetson University College of Law, where he received the American Bankruptcy Institute Medal Award for Excellence in Bankruptcy Studies. He received an LL.M. in Bankruptcy from St. John's University School of Law.

DAVID GALLAGHER is a litigator turned litigation funding investment Manager and Legal Counsel for Bentham IMF. David helps companies and individuals obtain financing for commercial suits, to mitigate their litigation risks, and to achieve their growth strategies.In addition to serving as a point of contact for parties seeking non-recourse litigation funding, David conducts due diligence to advise Bentham about which cases present viable investment opportunities that will deliver fair and sustainable returns for the clients, the law firms trying the cases, and Bentham's shareholders.

While David does not direct the litigation decisions in the cases he recommends for funding, he does remain actively engaged as a strategic partner, providing consultation as needed to the lawyers involved. In addition to actively monitoring a multi-million dollar investment portfolio for Bentham, David gives CLE lectures and participates in panel discussions about commercial litigation finance.Prior to working at Bentham, David was senior litigation counsel at the Los Angeles office of Akin Gump Strauss Hauer & Feld LLP. His litigation experience includes business disputes with a concentration on intellectual property matters. He has represented and counseled clients in industries ranging from apparel to military contracting to hospitality, both at trial and on appeal in state and federal court, as well as in arbitration.

David holds a J.D. from Harvard Law School, an M.Phil. from Oxford University, and a B.A. from Sarah Lawrence College.

JORDAN KROOP is a partner in the Bankruptcy & Restructuring group of Perkins Coie LLP in Phoenix. Jordan represents debtors, official committees, acquirers, and significant creditors in Chapter 11 matters involving publicly-traded and privately-held companies throughout the nation. His representation of creditors includes secured lenders, committees, lessors, and institutional lenders. Among the prominent Chapter 11 matters Jordan has handled is representing the NHL's Phoenix Coyotes as debtor's counsel and leading the team to its eventual sale. He has also represented the Boston Celtics and Milwaukee Bucks in bankruptcy-related matters.

Jordan provides Chapter 11 representation to reorganizing clients in a vast array of industries, including telecommunications, manufacturing, real estate development, construction, hospitality, gaming, and technology. He has represented a large REIT, a consumer electronics manufacturer, makers of construction materials, and the iconic Manhattan restaurant, the Russian Tea Room, in its Chapter 11 filing. Jordan is a Fellow of the American College of Bankruptcy and serves as an adjunct professor of law at the Sandra Day O'Connor College of Law at Arizona State University. He also instructs at the American Bankruptcy Institute's litigation skills workshops and has taught at the University of the Pacific's McGeorge School of Law in Salzburg, Austria. Since 1998, Jordan has co-authored and regularly updated the two-volume treatise, *Bankruptcy Litigation and Practice: A Practitioner's Guide*, now in its fourth edition. He has also co-authored a chapter on Chapter 11 and sports franchises in the Collier Guide to Chapter 11 (LexisNexis 2011, rev'd 2012-2016) and co-authored *The Executive Guide To Corporate Bankruptcy* (Beard Books). Jordan has also authored dozens of articles in national

publications. He augments his writing with frequent panel and seminar presentations across the nation. Recognized by Southwest Super Lawyers (including as Phoenix's "Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law Lawyer of the Year" in 2017) and The Best Lawyers in America, Jordan was one of twelve lawyers named in 2000 among the "Outstanding Young Bankruptcy Lawyers" in the U.S. by Turnarounds & Workouts.

THOMAS J. SALERNO is a partner in the Bankruptcy and Creditors Rights group at Stinson Leonard Street, LLP. A graduate of Notre Dame Law School, Mr. Salerno has represented parties in insolvency proceedings in 30 states and five countries. He has been involved in restructurings in the United States, the United Kingdom, Germany, France, Switzerland and the Czech and Slovak Republics. In addition, Mr. Salerno taught Comparative International Insolvency at the University of Salzburg and Gray's Inn School of Law in London, and is an adjunct professor at the Sandra Day O'Connor School of Law at Arizona State University, teaching Bankruptcy Litigation and Advanced Chapter 11 Bankruptcy. In addition, he is a regular guest lecturer at the Eller MBA Program for the University of Arizona.

Mr. Salerno has extensive experience representing distressed companies, acquirers and creditors in financial restructurings and bankruptcy proceedings, pre- and post-bankruptcy workouts, and corporate recapitalizations. He has represented clients in diverse industries such as casinos, resort hotels, sports teams, real estate, high-tech manufacturing, electricity generation, agribusiness, construction, healthcare, airlines and franchised fast-food operations. Mr. Salerno has also served as an expert witness on U.S. insolvency law in litigation in Germany. Mr. Salerno represented Coyote Hockey LLC, owners of the Phoenix Coyotes of the National Hockey League (NHL), in historic bankruptcy proceedings that resulted in an unprecedented solution: the NHL purchasing one of its own teams for the first time in the league's 90-year history. . Mr Salerno is a former board and Executive Committee member of the American Bankruptcy Institute; past director of the American Bankruptcy Board of Certification, Inc.; a fellow of the American College of Bankruptcy Fellow; and a member of the Plan Issues Advisory Subcommittee for the ABI landmark Bankruptcy Review Commission.

Among his other publications are "Chapter 11 Cases Involving Professional Sports Franchises," *Collier Guide to Chapter 11: Key Topics and Selected Industries,* LexisNexis, 2011; *Executive Guide to Corporate Bankruptcy*, Second Edition, Beard Publications; and the two-volume *Bankruptcy Litigation and Practice; A Practitioners' Guide*, Fourth Edition, Aspen Law Publications.

Third Party Litigation Funding and Issues It Creates In Bankruptcy Cases—This Ain't Your Father's Contingency Fee Arrangement! ©

The myriad issues (including ethical issues) that have arisen, and will likely arise in the future, as the current trend of third party litigation funding begins to be a more common funding vehicle in bankruptcy cases.

Thomas J. Salerno, Esq.
STINSON LEONARD STREET, LLP

OVERVIEW OF MATERIALS

I. Speaker Introductions

II. Setting The Stage: Third Party Litigation Funding and Funders ("TPLF") In The Bankruptcy Context

a. Pre-Bankruptcy TPLF (the third party litigation funder as creditor)
b. Post-Bankruptcy TPLF (funding sources for trustees/DIPs; possible "buyer" of litigation claims)
c. "Business Is Booming!"

III. Historical Context

a. "What's Old Is New Again": Champerty/Maintenance
b. Evolution Of The Law

IV. Special Issues Presented

a. "Necessary Tool"?
b. TPLF As "Insider"?
c. Applicable Non-Bankruptcy Law Restrictions?
d. Standing Issues?
e. Fiduciary Duty Issues?
f. Ethical Issues For Counsel?
g. So What's The Beef?

PRESENTATION MATERIALS

I. SPEAKER INTRODUCTIONS

II. SETTING THE STAGE: Third Party Litigation Funding and Funders ("TPLF") In The Bankruptcy Context:

a. Pre-Bankruptcy TPLF (the third party litigation funder as creditor)

b. Post-Bankruptcy TPLF (funding sources for trustees/DIPs; possible "buyer" of litigation claims)

c. "Business Is Booming!"

i. The "new game" in town. Numerous players have entered into this marketplace[1]. For example, Burford Capital, LLC ("**Burford**"); Bentham IMF, Gerchen Keller Capital (acquired in December 2016 by Burford); Therium Group Holdings (announced a $300 million fund for commercial litigation TPLF in April 2016), Longford Capital Management LP; Lake Whillans Litigation Finance LLC; Harbour Litigation Funding; Vannin Capital; Pravati Capital, Juridica and TownCenter Partners are just a few examples.[2]

---

[1] *See, e.g.* Henry Meier, "Litigation Costs Go Third Party", *Los Angeles Business Journal*, July 4, 2016("[TPLF] industry growth has been rapid."); Matthew Fechik & Amy G. Pasacreta, "United States: Litigation Finance: A Brief History Of A Growing Industry", *Mondaq*, Apr. 4, 2016 ("[TPLF] firms now invest about $1 billion a year, and the industry seems to be growing.").

[2] *See* "Renewed Proposal To Amend Fed. R. Civ. P 26(a)(1)(A)" at pp. 2-7 (June 1, 2017), a letter from numerous groups to the Secretary of the Committee On Rules of Practice and Procedure of the United States Courts (hereinafter the "**Chambers Letter**"). The Chambers Letter was sent by the following groups: US. Chamber Institute for Legal Reform, the Advanced Medical Technology Association, the American Insurance Association, the American Tort Reform Association, the Association of Defense Trial Attorneys, DRI – *The Voice of the Defense Bar*, the Federation of Defense & Corporate Counsel, the Financial Services Roundtable, the Insurance Information Institute, the International Association of Defense Counsel, Lawyers for Civil Justice, the National Association of Mutual Insurance Companies, the National Association of Wholesaler-Distributors, the National Retail Federation, the Pharmaceutical Research and Manufacturers of America, the Product Liability Advisory Council, the Property Casualty Insurers Association of America, the Small Business & Entrepreneurship Council, the U.S. Chamber of Commerce, the Michigan Chamber of Commerce, the State Chamber of Oklahoma, the Pennsylvania Chamber of Business and Industry, the South Carolina Chamber of Commerce, the Virginia Chamber of Commerce, Wisconsin Manufacturers & Commerce, the Las Vegas

ii. How lucrative is this area? Burford reported $378 million new investments in TPLF in 2016 (up 83%), with total investments in TPLF totaling more than $2 billion. *See* Barrett, "The Business Of Litigation Financing Is Booming", *Bloomberg Businessweek* (May 30, 2017). Burford (publicly traded) announced a 75% increase in profits-after-tax for 2016 compared to 2015, and $216 million in cash from investment returns in 2016 (48% increase over 2015). *See* "Litigation Funder Burford Had 75% Profit Increase In 2016—And Thinks It Could Be Bigger", *ABA Journal* (March 15, 2017).

iv. It's here to stay—get used to it! Love it or hate it, its big business with the potential for huge upside. Whether it's the savior of underdog litigation for those without resources to protect and prosecute rights and claims, or contingency financing on steroids, it is here to stay as a practical matter, particularly in the bankruptcy arena. Moreover, the issues identified herein, by no means exclusive, represent real time issues and developments in the law, and are presented in no particular order of priority. As publicized by Burford: "The only limits are your imagination!" *See* "MagCorp Bankruptcy Trustee On Litigation Finance: "The Only Limits Are Your Imagination"", *Burford Capital Press Release* (May 1, 2017).

III. HISTORICAL CONTEXT

a. **What's Old Is New Again**? While TPLF is a relatively new concept in the U.S. (last 10 years or so), it is something that is not a new concept.

i. "Champerty", "Maintenance" and other feudal English legal common law theories: Suddenly relevant once more?

ii. "Maintenance": Generally assisting another in litigating a lawsuit.

iii. "Champerty": A form of maintenance, is maintaining a lawsuit in exchange for a financial interest in settlement or judgment of the suit.

Metro Chamber of Commerce, the Florida Justice Reform Institute, the Louisiana Lawsuit Abuse Watch, the South Carolina Civil Justice Coalition, and the Texas Civil Justice League,

b. Evolution Of The Law. Historically, Maintenance/Champerty was prohibited because it encouraged potentially fraudulent/baseless litigation. While such prohibition had its roots in old English common/statutory law, in the US some states still prohibit or materially limit it (*e.g.* Alabama, Colorado, Kentucky, Mississippi, North Carolina, Minnesota, New York and Pennsylvania), while others allow it (perhaps with some restrictions) (*e.g.* Florida, Indiana, Ohio, New Jersey, Tennessee, and Texas). *See* Pribisich, "Maintenance, Champerty and Usury: Ethical Issues Of Alternative Litigation Financing", *ABA Presentation* (2015) (hereinafter "**Pribisich**"); Beisner, Schwartz, "How Litigation Funding Is Bringing Champerty Back to Life", *Law360* (January 20, 2017) (discussing two cases which invalidated TPLF agreements based on, *inter alia*, the concepts of champerty).[3] *See* McDonald, "The Best And Worst States For Litigation Finance (Part I and II)", *Above The Law* (June 28 and July 11, 2017); *See also* discussion in IV.c, below, regarding the issue in a bankruptcy context.

IV. SPECIAL ISSUES PRESENTED

a. "Necessary Tool"? Trustees and DIPs are starting to realize that TPLF may be the new tools necessary to prosecute/assert estate causes of action. *See, e.g.* Frankel, "Litigation Funding In Bankruptcy Should Be In Every Trustee's Toolkit", *Reuters* (March 14, 2017) (reporting on the *MagCorp* Chapter 11 litigation "auction", with trustee stating TPLF "is an absolutely perfect fit for bankruptcy", discussed below) (hereinafter "**Frankel**"). See also McDonald, "The Value Of Middle Market Litigation Finance", *Above The Law* (May 2, 2017) (defining middle market litigation as involving between $500,000 to a "few million" in damages).

i. Case Study: Magnesium Corp ("MagCorp") (Bankr. SDNY). In September 2016 MagCorp trustee (Lee Buchwald) auctioned off a $213 million judgment in favor of the estate (obtained after 13 years of hard fought litigation) against billionaire Ira Rennert (former majority shareholder in MagCorp)

---

[3] *Justinian Capital SPC. V WestLB AG*, 65 N.E.3rd 1253 (N.Y. 2016) (New York Court of Appeals invalidated a TPLF agreement on the basis that it violated champerty restrictions under Judiciary Law Section 489(1)); *WFIC LLC v. Labarre*, No. 1985 EDA 2015 (Pa. Super. Ct. September 13, 2016) (Pennsylvania Court of Appeals affirmed that "champerty remains a viable defense in Pennsylvania."). *See also Maslowski v. Prospect Funding Partners, LLC,* 2017 Minn. App. LEXIS 26 (Minn. Ct. App. February 13, 2017) (court refusing to enforce NY forum selection clause on litigation to enforce TPLF agreement based on public policy and Minnesota's prohibition on champerty).

and the Renco Group based on fraudulent transfers and other theories[4]. The judgment was on appeal to the 2nd Circuit at the time of the auction. The buyer at the auction was Gerchen Keller Capital (which paid $26.2 million, and has since been acquired by Burford[5]).

ii. Auction "sale": The auction/sale process was objected to by both Rennert (who offered to "buy" the judgment against himself for $45 million payable even if he lost the appeal, and $100 million should the Trustee prevail on appeal), as well as Jeffries LLC (the largest noteholder of MagCorp, based upon what it asserted were inadequate disclosures by the Trustee). Despite the Rennert offer being higher than the Gerchen bid, the Trustee asserted he had concerns about whether Rennert could fund the bid. The Bankruptcy Court (Judge Vyskocil) approved the sale to Gerchen in September 2016. The judgment was ultimately upheld on appeal in March 2017, making the recovery to Gerchen approximately $187 million over what it paid for the judgment (or about a 600% return on a7-month investment). [6]

iii. Clarion call for regulation? Hindsight is, of course, 20/20. TPLF has great rewards for the funder, and attendant great risks as well (it can be a very risky bet, after all). That said, the huge return, and short time period between the investment and return in MagCorp, has resulted in both gushing

---

[4] It was alleged Rennert siphoned money from MagCorp to build a 43,000 square foot mansion in the Hamptons valued at over $200 million. *See* "Billionaire Rennert's Loss Is A Quick Double For Litigation Finance Firm Burford", *Forbes* (March 8, 2017).

[5] *See* "Litigation Funder Burford Poised To Cash In From First Ever Bankruptcy Deal", *American Lawyer* (March 13, 2017) (Burford acquired Chicago based Gerchen for $160 million in December 2016); Julie Triedman, "Topping $1 Billion Mark, Big Litigation Funder Gets Bigger", *The Am Law Daily*, Jan. 6, 2016, http://www.americanlawyer.com/id=1202746351295/Topping-1-Billion-Mark-Big-Litigation-Funder-Gets-Bigger?slreturn=20160006110304; "Burford Acquires Gerchen Keller: What is Going on?", *Fulbrook Capital Management,* LLC,Dec. 20, 2016, http://www.fulbrookmanagement.com/burford-acquires-gerchen-keller-what-is-goingon

[6] *See* Frankel; "MagCorp Bankruptcy Trustee On Litigation Finance: "The Only Limits Are Your Imagination"', *Burford Capital Press Release* (May 1, 2017); "Billionaire Rennert's Loss Is A Quick Double For Litigation Finance Firm Burford", *Forbes* (March 8, 2017). In fairness to the MagCorp trustee, he had been involved in ugly litigation with Rennert for 5 years after the MagCorp bankruptcy filing in 2001. Getting cash to exit the bankruptcy (and pay administrative expenses) was undoubtedly a highly attractive option for him, his professionals, and the estate.

commentary praising TPLF in bankruptcy cases (such as the Frankel article), and also renewed calls to regulate the TPLF industry. *See, e.g*. Chambers Letter (seeking amendments to Fed. R. Civ. P. 26(a)(1)(A) to require, *inter alia*, full and complete disclosure of all TPLF details in federal court litigation similar to the required disclosure of liability insurance); "Third Party Litigation Funding In US Enters Mainstream, Leading To Calls For Reform", *Financier Worldwide* (November 2016). Not surprisingly, proponents of TPLF decry any such regulation, asserting such regulations are unnecessary and unduly burdensome. *See, e.g.* "Critics Pushing Back On 3rd-Party Funding Disclosure Rule", *Law360* (June 21, 2017); Chock, Harrison and Pai, "Big Business Lobby Tries To Hobble Litigation Finance, Again", *Law360* (June 6, 2017) ("The Chamber raises several supposed concerns about litigation finance to justify its overbroad proposed rule, which is rather obviously meant to reveal a plaintiff's ability to withstand protracted litigation.")[7].

iv. Is MagCorp a harbinger of the future? While proponents of TPLF hail the *MagCorp* decision/process as a blanket acceptance of TPLF in bankruptcy cases[8], in reality it really is not that broad. The TPLF in that case really "bought" the litigation claim. In essence, it was really a sale of an "asset" under Bankruptcy Code Section 363. Once the litigation was acquired, it controlled it (and counsel). This situation is starkly different than, for example, a true "financing" under section 364, or enforcement of a post-petition claim, all of which involve different considerations. *See* Sections IV.b-f, *infra.*

---

[7] TPLF is not for the faint of heart. The economic power TPLFs have, especially given that plaintiffs need such funding expeditiously, can and often does lead to decidedly hardball tactics. For an example of such dynamics, *see First Amended Complaint (Fraudulent Transfers; Equitable Subordination; Recharacterization; Objection to Claims)* filed November 28, 2016, In re Epicenter Partners, LLC, Case No. 2:16-bk-05493-MCW, Adv. P. No. 2:16-ap-00334-MCW, (Bankr. D. AZ.) (Docket No. 59) ("**Epicenter Adversary**"), involving the history of the TPLF initial funding by Burford, a copy of which is attached hereto for reference (the "**Epicenter Complaint**"). The Epicenter Adversary against the transferee of the claim of Burford was subsequently dismissed. *See* note 11, *infra*. The entire adversary proceeding was initially maintained under seal due to confidentiality provisions in the original TPLF documents. Judge Wanslee subsequently "unsealed" the file. *See Order Granting Motion To Unseal Adversary No. 2:16-AP-00334*, Docket No. 229 (November 21, 2016).

[8] *See, e.g.* "Litigation Funding In Bankruptcy Should Be In Every Trustee's Toolkit", *Reuters* (March 14, 2017) ("Travis Lenkner of Burford, who was on the Gerchen Keller team that made the MagCorp investment, told me Judge Vyskocil's 'blessing with a capital B' should open the way for other bankruptcy trustees to work with litigation financiers—a concept he's pushing with trustees and their lawyers.")

b. TPLF As "Insider"? In a situation where a TPLF is in place pre-filing, and given the extreme close connection between the TPLF source (access to confidential information, control over the financed litigation, communications with counsel, and similar dynamics), can the TPLF be considered a non-statutory insider as someone in control of material aspects of the plaintiff? This is certainly a possibility for parties looking to either challenge a lien or claim of a TPLF in bankruptcy cases[9]. It is understandable from the TPLF perspective why such control is needed (to manage the "investment")—that said, the ethical and legal overlay makes this particular "investment" not the usual cookie cutter deal to be managed.

i. Access to confidential information: Understandably, prudent TPLF will do substantial due diligence before deciding to fund a litigation. That will involve the exchange of material, presumably non-public (and possibly proprietary) information. See, e.g. Shang, "The Future Of Litigation Finance Is Analytics", *Law360* (July 17, 2017) (discussing "the moneyball effect in litigation finance."). While non-disclosure and similar agreements would be common in such a due diligence process, once the TPLF decides to fund, and in fact does, it is undeniable it has access to information and control that the non-insider would rarely be privy to.

ii. Attorney-client/work product privilege: At least one Court has held, for example, that a TPLF's communications with counsel for the plaintiff are protected by the attorney client privilege and work product doctrine. *See In Re International Oil Trading Company, LLC,* 548 B.R. 825 (Bankr. SD Fla. 2016) (litigation in which Burford was the TPLF); Innes, "Litigation Funding: Key Considerations", *Global Insolvency & Restructuring* (March 21, 2017) (hereinafter "**INSOL Article**").

---

[9] According to the Chambers Letter, "Bentham's own 2017 'best practices' guide contemplates robust control by funders. Specifically, it notes the importance of setting forth specific terms in litigation funding agreements that address the extent to which the TPLF entity is permitted to '[m]anage a litigant's litigation expenses', '[r]eceive notice of and provide input on any settlement demand and/or offer, and any response', and participate in settlement decisions." Chambers Letter at 16-17.

iii. Legal implications of insider status: If characterized as a non-statutory insider[10], there are legal implications such as potential subordination of claims, equitable disallowance, longer lookback periods for potential preferences, increased scrutiny of transactions, etc.

iv. Can such status, if present, be "cleansed" through a transfer of the claim? If the pre-petition TPLF is an insider, can the claim be transferred such that the transferee takes it free of such status? This is a distinct possibility. In the 9th circuit, for example, there is a decision that states (in an analogous situation) that a claim of an insider, transferred to a non-insider, sheds its characteristic of an insider claim for plan voting purposes. *See In re The Village At Lakeridge, LLC,* 814 F.3rd 993 (9th Cir, 2016) (currently on appeal to the Supreme Court); *Memorandum Decision Granting In Part And Denying In Part Defendant's Motion To Dismiss Adversary Complaint* dated June 2, 2017, Epicenter Adversary (hereinafter The "**Epicenter Memorandum Decision**"). [11] *Cf. In re Enron Corp.,* 379 B.R. 425 (SDNY 2007) (holding transferee of insider claim may still be subject to equitable subordination type claims that could have been brought against the insider/transferor); *In re KB Toys, Inc.,* 470 B.R. 331 (Bankr. D. Del. 2012), *aff'ed* 736 F.3rd 247 (3rd Cir, 2013) (transferees take subject to claims/defenses assertable against transferor). The calls for regulation (and disclosure) related to TPLF claims would be important information related to TPLF claims in this regard.

---

[10] The concept of non-statutory insider (as opposed to statutorily defined insiders) is accepted. *See, e.g. In re The Village of Lakeridge, LLC.* , 814 F.3rd 993 (9th Cir. 2016). *See also* "A *Sui Generis* Approach To 'Insider' Status In Bankruptcy", *Chapman Insights* (February 18, 2016).

[11] Judge Wanslee's Epicenter Memorandum Decision held that a claim secured by estate assets by Burford sold pre-filing to a subsequent transferee, was "cleansed" by transfer to the non-insider, relying on *Village of Lakeridge.* The decision is interesting in that the creditor (CPF Vaseo Associates. LLC—"**CPF**") purchased two claims (secured by first and second liens on the estate asset). The first was the Burford TPLF claim, in first position. The second was a claim of the prior litigation counsel (Simpson Thatcher Bartlett—"**STB**") for unpaid legal fees, secured by a second lien on the assets. The Epicenter Adversary was filed to characterize the claims as insider claims, equitably subordinate and disallow the two secured claims held by CPF. The Court dismissed the claim seeking to characterize (and subordinate) the CPF claim related to the prior Burford TPLF claim, but did not do so as to the STB secured claim that essentially arose from the same pre-filing litigation, and also acquired by CPF. Arizona has no law related to ultimate enforceability of TPLF claims as violative of champerty/maintenance laws. A copy of Judge Wanslee's decision in *Epicenter Partners* is attached to these materials for reference.

c. Applicable Non-Bankruptcy Law Restrictions? As set forth above, while these disputes that have arisen and will arise in bankruptcy cases will have a federal bankruptcy law component, there is also a material applicable non-bankruptcy law layer that cannot be avoided.

i. Legal Under State Law? Whether such TPLF claims are enforceable in bankruptcy will be determined with reference to non-bankruptcy law. *See, e.g. In re Designline Corp.,* 565 B.R. 341 (Bankr. WD NC 2017). Interestingly, *Designline* involved a post-confirmation TPLF situation. Bankruptcy Judge Whitley declined to approve a TPLF by a post-petition litigation trust (the existing lawyers did not wish to continue in the case on a contingency basis) on the basis, *inter alia*, that such arrangements were champertous and prohibited by North Carolina law. He also expressed concern about the control of the TPLF would have over the litigation process.

ii. Mortgage banking regulations? As TPLF is essentially a type of lending arrangement, could it implicate applicable state mortgage banking laws? For example, certain states require loans over a certain amount be made by lenders who register or otherwise are authorized by state regulators.

iii. Applicable law? When analyzing the legality of TPLF arrangements (at least pre-petition arrangements), what applicable non-bankruptcy law would control? For example, in the Epicenter Adversary, the TPLF arrangement provided that the law of the UK would apply. Would such provisions be enforceable in bankruptcy litigation?

iv. Binding arbitration provisions? Many of the TPLF agreements provide for binding arbitration should there be any dispute. Are such provisions enforceable in bankruptcy contests? Likely not. *See, e.g. In re EPD Investment Co.,* 821 F.3rd 1146 (9th Cir. 2016); *In re Bethlehem Steel Corp.,* 390 B.R. 784 (Bankr. SDNY 2008). Even with respect to post-petition TPLF, a binding arbitration clause may not be enforceable. *See e.g. FBI Wind Down, Inc. Liquidating Trust v. Heritage Home Group, LLC*, Adv. Pro. No. 15-51899 (CSS) (Bankr. D. Del. September 15, 2016) (Sontchi, BJ) (dispute over court-approved sale transaction, with binding arbitration provision in asset purchase agreement determined to be unenforceable); "Bankruptcy Court Denies Motion To Compel Arbitration", *Fox Rothschild Update* (September 19, 2016).

d. Standing Issues? Who, precisely, has standing to seek approval of post-petition TPLF arrangements? If a DIP refuses to bring litigation claims (and

seek TPLF resources), can a Committee seek such TPLF and authority to obtain TPLF (at least in states where such arrangements are otherwise legal)? Not likely at least in the Ninth Circuit. *See, e.g. In re Debbie Reynolds, Inc.,* 238 B.R. 831 (BAP 9th Cir. 1999)**,** *rev'ed on other grounds*, 255 F.3rd 1061 (9th Cir. 2001).

i. In Re Blue Earth, Inc. (Bankr. ND CA 2016): In this case, the Committee sought to obtain TPLF from Bentham IMF to fund investigations and legal fees related to certain transactions over the objection of the debtor.[12] The Bankruptcy Judge Montali issued a tentative ruling on the Committee's motion on the basis, inter alia, that the TPLF was post-petition financing that only the DIP could legally seek. [13] After Judge Montali's tentative ruling, the Committee abandoned its efforts.

e. Fiduciary Duty Issues? TPLF is at its core an unconventional DIP financing—rather than being secured by tangible assets, it is "secured" by the proceeds of the litigation being financed. [14]Related to the all of these issues, and as underscored by Judge Montali in the Blue Earth situation discussed above, an issue with TPLF on a post-petition basis is who controls the litigation and directs counsel once the TPLF is in place? DIP/Trustees are of course fiduciaries. The terms of certain TPLF agreements give control and discretion to the TPLF (perhaps understandably given the risky nature of the investment in uncertain and costly litigation). Herein lies the issue in that estate fiduciaries can never abandon their fiduciary duties. *See, e.g. In re Mushroom Transp. Co., Inc.,* 247 B.R. 395 (Bankr. ED Pa 2000); Bankruptcy Code § 327. Because TPLF is a relatively new,

---

12 *See Official Motion Of Unsecured Creditors' Amendment To Motion: (1) Approve Retention Of Bartko, Zankel, Bunzell & Miller And Romero Park P.S. As Co-Special Investigation/Litigation Counsel On A Fixed Fee of $200,000 To Conduct Claims Analysis; (2) Pre-Approve Expenditure Of Up To $200,000 For Retention Of Experts And Other Related Costs; And (3) Approve Terms Of The Bentham IMF Investigation Funding, Certain Break-Up Fees And A Right To Fund Future Litigation* filed May 3, 2016, *In re Blue Earth, Inc*., Case No. 16-30296-DM (Docket No. 120). The debtors objected. *See* Docket No's 103, 136.

13 *See Tentative Ruling On Amended Motion To Approve Investigation Funding Agreement* dated May 19, 2016 (Montali, BJ).

14 Of course, there is nothing that says TPLF could not also be secured by traditional assets (real estate, etc. This is what essentially happened in the *Epicenter Partners* case above (TPLF modified after judgment from a percentage of the litigation proceeds to a lien against real estate and other assets) *See* note 11, *supra*. In any event, the issues discussed in these materials are further complicated by such an arrangement as the potential for huge returns are more questionable if the "risk" is mitigated because of the existence of other collateral.

unregulated form of post-petition financing in most cases with huge potential costs associated with it, the TPLF's control over the subsequent funded litigation could be viewed as a delegation of the estate's fiduciary duties.

i. "With power comes responsibility": On a related note, to the extent the funded litigation takes an ugly turn, and sanctions are assessed, who bears those? If the TPLF is controlling the litigation, should the TPLF source also bear sanctions? While never specifically addressed as of yet in bankruptcy cases, such a situation has arisen in the UK (where TPLF originated, and is very common). *See Excaliber Ventures LLC v Texas Keystone Inc. & Ors* (2014) (English court held the TPLF source was liable, jointly and severally with the litigants, for the costs of litigation on indemnity should the litigation not be successful and fees/costs were awarded). *See* INSOL Article.

f. Ethical Issues For Counsel? Finally, many commentators have noted that TPLF creates potential ethical issues for counsel proposing it to a client, as well as the counsel prosecuting the litigation that is being funded. Who is the "client", and to whom does the duty lie? *See, e.g.* Steinitz, "Whose Claim Is It Anyway? Third Party Litigation Financing", 95 *Minn. L. Rev*. 1268, 1291-1292 (2011); Decker, "A Litigation Finance Ethics Primer, *Above The Law* (March 9, 2017) (an article interestingly sponsored by a TPLF, Lake Whillans).

i. Sharing of fees with non-lawyer issues: Most states have ethical rules that prohibit the sharing of fees between lawyers and non-lawyers. See Chambers Letter at 13-15; *Model Rules Of Prof'l Conduct*, R.5.4(a) (hereinafter "**Model Rules**").

ii. Potential conflict of interests between plaintiff, attorney and TPLF source? The practical and economic pressure on counsel is real. Contentious litigation can be economically burdensome on counsel, and the prospect of TPLF that will result in cash flow to counsel is appealing to say the least. But once that happens, who is the attorney's master? Numerous Model Rules are implicated in the TPLF situation, including Rules 2.1 (requiring a lawyer to exercise independent judgment and render candid advice); 5.4(c) (prohibiting third party direction of lawyer); 1.7(a)(2) (prohibiting conflicts of interest); 1.8(a) (regulating the entry into business relationships between lawyers and clients); 1.8(e) (prohibiting financial assistance other than contingency fee arrangements); and 1.8(i) (prohibiting lawyers obtaining a proprietary interest in litigation, again other than contingency fee arrangements, which rule has its roots in the prohibition

against champerty and maintenance). *See, e.g.* Pribisich; Chambers Letter at 14-15. TPLF makes this dynamic a bit murky.[15]

iii. Epicenter Partners: For a real world example of the ethical issues attendant in TPLF for litigation counsel, see the Epicenter Memorandum Decision. As outlined in detail in the Epicenter Complaint, there were issues related to the acquisition of the TPLF proposed by counsel (Simpson Thatcher Bartlett—"**STB**"), and STB's interaction with the TPLF after such funding was in place. Judge Wanslee declined to grant a motion to dismiss with respect to claims against STB based upon, *inter alia,* serious ethical concerns in the way counsel interacted with the TPLF (which was alleged to be in detriment to the interests of the actual client)[16]. While Judge Wanslee determined that the creditor who acquires insider claims are not automatically themselves insiders (and thereby subject to the defenses and other implications of that), if the prior claim holder had been involved in "gross and egregious" such claims and defenses could arguably be asserted against the new claimholder. Of the two original claimants in Epicenter Partners, one was Burford, the other STB. Those original claimants held first and second liens against estate assets, respectively. A purchaser acquired both claims (CPF Vaseo Associates—"**CPF**"). *See* discussion in note 11, *supra*. The Bankruptcy Court dismissed the claims related to the Burford pre-petition conduct, but denied the motion to dismiss as to the pre-petition conduct of STB, finding it was a factual matter for trial whether STB breached its "ethical duties of loyalty, care and obedience, whose relationship with the client must be one of 'utmost trust'". Epicenter Memorandum Decision at 24-25. In other words, counsel's actions in guiding the negotiations with the TPLF (that counsel recommended), and

---

[15] The Chambers Letter further suggests that without strict disclosure of TPLF sources/entities, there exists the possibility that judicial conflicts of interest may arise as judges do not have sufficient information to determine if recusal is needed. *See* Chambers Letter at 15-16.

[16] "It is alleged that on numerous occasions, STB actively worked against the interests of its client, causing duress. For instance, STB told Mr. Gray, the principal of its client, that he was 'ion no position to negotiate' [regarding the TPLF]….STB threatened to resign as [client's] counsel unless [client] agreed to [Burford's] demand, thus further violating its general duty of loyalty to [its client]. Worst of all, STB negotiated a contract with a party holding adverse interests to its client [i.e. the TPLF] *without consulting* its client, or permitting its client to suggest changes [to the terms of the TPLF]….After the [litigation] settlement, [Burford] began demanding payment from [the client]. Rather than protect its clients' interests, STB refused to perform any work and instead demanded a settlement between [the client and Burford]." Epicenter Memorandum Decision at 24-25 (emphasis in original).

then interacting with the TPLF, created potential liability for counsel (under both ethical rules, and also the "gross and egregious" standards for equitable subordination under bankruptcy law).

g. So What's The Beef? The concept of contingency fee arrangements have been around for many years, and are both lawful and ethical under applicable law and rules of conduct. The same is true of class action plaintiff's representations. Why then is TPLF drawing such attention and concern from certain segments?

i. Protective self-interest? One reason is self-interest, of course. To be on the receiving end of a well-funded plaintiff is a decided tactical disadvantage. Hence, certain defense groups who participated in the chambers Letter are lobbying for their own self interests. A poor plaintiff is more easily defeated (*i.e.* outspent) than a well-funded one.

ii. Just a new type of contingency fee arrangement? Why isn't this just a version of contingency fee financing? Is it a question of degree? In reality, TPLF is materially different than contingency fee financing for a simple reason. Contingency fee financing is regulated and constrained by ethical rules binding the "financier" (*i.e.* the lawyer). There are real constraints on what a lawyer can and cannot do in a contingency fee arrangement. Those constraints are not present in TPLF. A comparison as to how Judge Wanslee viewed the actions of Burford and STB in the *Epicenter Partners* matter underscores this difference in a stark, real world example.

CONCLUSION

TPLF is in all respects "the wild west"—contingency fee financing without any regulation whatsoever. It is, in the end, contingency fee financing in an arena with no "drug testing policies"---bigger, more aggressive, the potential for huge returns, all with no ethical constraints. As it unfolds and evolves, the legal issues surrounding it will develop as well.

ATTACHMENTS

I. EPICENTER COMPLAINT

II. EPICENTER MEMORANDUM DECISION

Thomas J. Salerno (No. 007492)
Alisa C. Lacey (No. 010571)
Anthony P. Cali (No. 028261)
STINSON LEONARD STREET LLP
1850 N. Central Avenue, Suite 2100
Phoenix, Arizona 85004-4584
Tel: (602) 279-1600
Fax: (602) 240-6925
Thomas.salerno@stinson.com
Alisa.lacey@stinson.com
Anthony.cali@stinson.com
Attorneys for Debtors and Debtors-in-Possession

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re EPICENTER PARTNERS LLC, GRAY MEYER FANNIN LLC, Debtors.	Chapter 11 Case No. 2:16-bk-05493-MCW (Jointly Administered with Case No. 2:16-bk-05494-MCW)
EPICENTER PARTNERS LLC and GRAY MEYER FANNIN LLC, Plaintiffs, vs. CPF VASEO ASSOCIATES, LLC, Defendants.	Adversary No. 2:16-ap-00334-MCW **FIRST AMENDED COMPLAINT** **(Fraudulent Transfers; Equitable Subordination; Recharacterization; Objection to Claims)**

Plaintiffs, for their claims for relief, allege as follows:

PARTIES, JURISDICTION AND VENUE

1. Epicenter Partners LLC ("**Epicenter**"), and Gray Meyer Fannin LLC ("**GMF**"), are collectively referred to in this First Amended Complaint as "**Debtors**", and are each debtors and debtors in possession in Cases No. 2:16-bk-05493-MCW and 2:16-bk-05494-MCW ("Reorganization Cases") that were both commenced on May 16, 2016 ("**Petition Date**"). The

Debtors operate businesses in Maricopa County, Arizona. Under 11 U.S.C. § 1107, each of the Debtors, as a debtor in possession, has the rights of a bankruptcy trustee to bring causes of action arising under Chapter 5 of title 11. Both Debtors are Arizona limited liability companies.

2. Based on information and belief, CPF Vaseo Associates, LLC ("**CPF**"), is a Delaware limited liability company asserting two claims against the Debtors which were acquired from Ganymede Investments Limited, a closed-ended investment company organized under the laws of Guernsey ("**Ganymede**"). On information and belief, CPF has filed for authorization to do business in Arizona.

3. Each of the Debtor's Reorganization Cases is properly venued in the Phoenix Division of the United States Bankruptcy Court for the District of Arizona. As such, venue is proper for this Adversary.

4. CPF asserts claims against the Debtors in the Reorganization Cases. Debtors, in their capacity as Debtors-in-Possession, assert causes of action against CPF with respect to such claims under 11 U.S.C. § 1107. Each of the Counts of this Complaint arises under Chapter 5 of Title 11 of the United States Code, specifically 11 U.S.C. §§ 502, 510 (b & c), 544, and 550. Resolving these causes of action is a necessary step in the allowance or disallowance of CPF's claims, and formulating equitable distribution among all creditors. This action concerns adjudication of public rights and not *Stern* type claims. This Court therefore has original, exclusive, and constitutional jurisdiction to enter a final order pursuant to 28 U.S.C. §§ 1334(a), 157(a) and the general order of reference of the United States District Court for the District of Arizona.

GENERAL ALLEGATIONS

A. The NPP Litigation.

7. On July 7, 1993, Northeast Phoenix Partners ("**NPP**") entered into Commercial Lease No. 03-52415 with the State of Arizona through the State Land Commissioner regarding

approximately 5,700 acres of real property in Phoenix, Arizona located north of the Central Arizona Project Canal and south of Pinnacle Peak Road between 32nd Street and 64th Street.

8. NPP filed a special action appeal of a City of Phoenix Board of Adjustment decision in Maricopa County Superior Court of Arizona captioned *Desert Ridge Community Association, et. al v. City of Phoenix, et. al.*, Case No. LC2007-000011 (the "**Action**").

9. Debtors filed a Counterclaim, First Amended Counterclaim, and Second Amended Counterclaim in the Action against NPP, Desert Ridge Community Association, and CityNorth, LLC (hereafter referred to as the "**Litigation Claim**").

10. On December 9, 2008, Gray Development Group, LLC, the sole member of which is Gray/Western Development Company, which is the sole member of each of the Debtors, entered into an engagement letter agreement with Simpson Thacher & Bartlett, LLP ("**STB**") regarding representation of Debtors with respect to the Litigation Claim.[1]

11. In May 2010, less than six (6) months after the 2009 Agreement (defined below) with Ganymede, Debtors reached a settlement of a portion of the Litigation Claim with the defendant, Desert Ridge Community Association ("**DRCA**"), for approximately $6,000,000, of which $4,000,000 was paid to Ganymede.[2] The other $2 million, on information and belief, was paid to STB for invoices owed.

12. On October 19, 2010, Debtors obtained final judgement in the State Court on the Litigation Claim against NPP and CityNorth in the amount of $110,658,800 plus interest.[3]

B. <u>STB Requires Funding From Ganymede—the 2009 Agreement</u>.

13. In late 2009, after one year of being counsel with respect to the Litigation Claim, STB introduced the Debtors to Ganymede, an entity formed to fund litigation. From

[1] The Exhibits to the complaint are voluminous and are filed separately as Exhibits hereto. The December 9, 2008 letter is filed as Exhibit 1 hereto.

[2] The Settlement Agreement with Desert Ridge is filed as Exhibit 2 hereto.

[3] The Judgment is filed as Exhibit 3 hereto.

April 30, 2009 through November 20, 2009, prior to any involvement of Ganymede, STB had been paid $1,162,885.76 in fees and costs. Nevertheless, STB refused to proceed further with the representation of Plaintiffs without funding from Ganymede. STB told Mr. Bruce Gray (the Plaintiffs' principal) that you are in no position to negotiate. STB told Plaintiffs to either accept the deal that Ganymede has offered or STB will withdraw tomorrow morning.

14. Ganymede would not entertain or make any revisions or changes to its agreement forms, despite Plaintiffs' attempts to negotiate terms. The terms were presented as "take it or leave it", resulting in unequal bargaining positions between Plaintiffs and Ganymede. As a result, the agreements with Ganymede were contracts of adhesion. The bargaining position between the Plaintiffs and Ganymede was unequal as the result of the constant and repeated pressure for payment, and threats to withdraw from representation, directed at the Plaintiffs by STB. Such duress caused the unequal bargaining positions throughout the Plaintiffs' relationship involving Ganymede.

15. The relationship between STB and Ganymede created an extraordinary economic motivation for STB to aid Ganymede in its inequitable conduct against Plaintiffs. STB was keenly aware that the source of payment of fees with respect to the Litigation Claim was Ganymede. Ganymede was keenly aware that STB's continued control of the Plaintiffs' Litigation Claim was in Ganymede's interest.

16. On December 22, 2009, Debtors entered into a Forward Purchase Agreement with Ganymede regarding the Litigation Claim ("**2009 Agreement**").[4] The 2009 Agreement was one of the series of contracts of adhesion which resulted from the unequal bargaining positions of Plaintiffs and Ganymede.

17. The 2009 Agreement, among other things:

a. Refers to Ganymede as "the Purchaser" (¶ (1));

b. Refers to Debtors as the "Counterparty" or "Forward Seller" (¶ 2);

[4] The 2009 Agreement is filed as Exhibit 4 hereto.

c. Declares that the Purchaser has a "common legal interest" with the Counterparty (¶ D);

d. Provides Ganymede with a continuing right to all of Debtors' (and its affiliates') attorney client privileged information with respect to the Litigation Claim (Preamble C, E);

e. Required the payment of $5,000,000 (the "Prepaid Amount") by Ganymede (Schedule 5, Schedule 1);

f. Designated STB as the "Nominated Lawyers" (Schedule 5), and directed that $4,000,000 of the funds paid by Ganymede be paid to STB (¶ 4.2);[5]

g. Required that the Debtors obligations under the agreement be "collateralized" by the entire Litigation Claim with all related assets (Schedule 4), or alternatively collateral with a minimum value of the Disposition Amount (Schedule 5) which was required to be a *minimum* of at least ten (10) times the Prepaid Amount which then escalated *monthly* by the Prepaid Amount starting in the seventh month (7th month 11x the Prepaid Amount, 8th month 12x the Prepaid Amount, etc.);

h. Terminated Ganymede's obligation to fund any further fees (¶ 9);

i. Required Debtors to retain and remunerate the Nominated Lawyers (Ganymede agreed to nominate STB) to prosecute the Litigation, bring about reasonable "monetisation" of the Litigation Claim, and required specific cooperation provisions with respect to the Nominated Lawyers and Ganymede (¶ 10.1);

j. Required Debtors to execute an irrevocable power of attorney to "secure" Debtors' performance of the 2009 Agreement;

[5] On information and belief, the entire $5 million listed in paragraph 12(c) was funded to STB. $1 million was funded to GDG Enterprises, LLC, but then was funded to STB in payment of back due invoices.

k. Declared that Ganymede would be entitled to the Resolution Amount (Schedule 2) which was a 40% share of the proceeds of the Litigation Claim--totaling the first $5,000,000 of proceeds plus, 40% of the Litigation Claim proceeds, plus a pro rata portion of any attorney's fees and costs awarded.[6]

l. Required Debtors to indemnify and hold harmless Ganymede and its representatives (¶ 17);

m. Required the Debtors to fund the payment of any tax amounts that may be required to be paid by Ganymede *without deducting same* from Ganymede's recovery (¶ 19.3);

n. Stated that the governing law was the law of England, and required arbitration of any dispute under the Arbitration Rules of the LICA to take place in London, England.

o. Stated that the parties agree that Ganymede was not subject to personal jurisdiction or venue in the United States.

18. No Uniform Commercial Code financing statement was recorded by Ganymede or Ganymede against Debtors in 2009.

19. As the result of the 2009 Agreement, Ganymede became a joint venture partner in the Litigation Claim.

20. On December 22, 2009, STB amended its December 9, 2008 engagement letter.[7] Such amendment was negotiated between Ganymede and STB without Plaintiffs' participation, and was thereafter presented to Plaintiffs as a negotiated agreement, in which Plaintiffs had no choice.

---

[6] Based on the amount of the eventual Judgment handed down in 2010, the 40% provision applied.

[7] The December 22, 2009 Letter is filed as Exhibit 5 hereto.

21. As a result of such amendment, STB and Ganymede changed the relationship with Plaintiffs such that STB went from counsel compensated on an hourly basis, to having a contingent fee interest in the outcome of the Litigation Claim. As a result of such relationship, STB became a joint venture partner with Plaintiffs in the Litigation Claim. *See, e.g., Waterman v. Rabinovitz*, 161 Ariz. 511, 779 P.2d 826 (App. 1989).

22. In summary, the December 22, 2009 letter provides:

a. All future invoices would reflect a 30% discount to the usual rates for fees;

b. STB would reimburse itself for all past due fees and disbursements, and would deduct future invoices, from the $4 million deposit from Ganymede;

c. In the event of a judgment on the Litigation Claim in an amount at least three times the amount of fees incurred in prosecuting the Litigation Claim that SBT would be entitled to a "premium" representing 130% of its "usual rates" on all hours previously billed at the thirty percent discount less the amount of the fees paid.

23. Despite such agreement, once STB starting receiving payment from Ganymede, STB's billings rose suddenly and dramatically in amount, to approximately in excess of three times (3x) prior amounts. When Plaintiffs complained about the invoice amounts, both Ganymede and STB would respond by indicating that approving invoices was no longer up to Plaintiffs, or their principal, Mr. Gray. Ganymede made no effort to control litigation costs with STB. Initial estimates of the cost of the Litigation Claim by STB were that total legal fees were estimated to cost $2 million to $3 million.

24. The $5 million paid to STB by Ganymede in December of 2009 was based on STB's "maximum projected billing" for the entire litigation, including a reasonable collection effort. But, in reality, the estimates and negotiated "maximum projected billing" of $5 million was far short of the amount Ganymede permitted STB to collect at the Plaintiffs' expense. The relationship between STB and Ganymede was mutually beneficial to them, and caused damage to Plaintiffs.

25. Less than six (6) months later, in May 2010, as the result of the DRCA settlement, *Ganymede was repaid $4,000,000* (of the $5,000,000 they had funded in December 2009 to STB)*, and STB was paid an* ***additional*** *$2,000,000 out of the DRCA settlement*. As a result, Ganymede's net cash investment at that time was $1,000,000, for which the 2009 Agreement granted Ganymede a 40% interest in the Litigation Claim. From just December 2009 to May 2010, STB was paid $7,000,000.

26. Ganymede never changed the "Nominated Lawyers" from STB throughout the multiple Ganymede agreements.

C. The 2010 Agreement.

27. On August 3, 2010, Debtors entered into a Restated and Amended Forward Purchase Agreement with Ganymede regarding the Litigation Claim ("**2010 Agreement**").[8] The 2010 Agreement was necessary as the result of the tremendous billing by STB, and Ganymede's refusal to curtail such conduct, despite objections by the Plaintiffs. STB threatened to resign as counsel unless Plaintiffs agreed to the 2010 Agreement. Like the 2009 Agreement, as the result of unequal bargaining positions of Plaintiffs and Ganymede, Ganymede rejected any comments or proposed modifications to the agreement, and the 2010 Agreement was a contract of adhesion.

28. Under the 2010 Agreement, the primary changes to the 2009 Agreement were:

a. Ganymede agreed to increase the Prepaid Amount from $5 million to $6.1 million, (Schedule 1, 3.6);

b. The Expiration Date was extended to December 31, 2011 (Schedule 1, 3.3);

c. Revised the Resolution Amount to be the first $7,662,500 (the "**Preferred Return**"), of which $4 million had already been paid to Ganymede, plus 40% of the Litigation Claim proceeds (Schedule 2).

[8] The 2010 Agreement is filed as Exhibit 6 hereto.

29. As the result of this 2010 Agreement, STB was paid an additional $1,100,000 in August 2010 by Ganymede. From December, 2009, STB had been paid *a total of $8,100,000*. Ganymede had paid $5,000,000 (of which $4,000,000 was repaid to Ganymede in May 2010 from DRCA), plus another $1,100,000.

30. No Uniform Commercial Code financing statement was recorded by Ganymede or STB against Debtors in 2010.

31. As a result of the 2010 Agreement, Ganymede continued in its capacity of a joint venture partner in the Litigation Claim.

D. <u>The 2011 Agreement</u>.

32. On January 3, 2011, Debtors entered into a Restated and Amended Forward Purchase Agreement with Ganymede regarding the Litigation Claim ("**2011 Agreement**").[9] The 2011 Agreement was again made necessary by the ever upward STB billing statements, that were not moderated by Ganymede, despite concerns expressed by Plaintiffs. Like the prior agreements in which the bargaining positions were unequal, and in which Plaintiff's faced economic pressure from STB to either agree to the terms demanded by Ganymede, or STB would cease representation, the 2011 Agreement is a contract of adhesion.

33. Under the 2011 Agreement, the primary changes to the 2010 Agreement were:

a. Ganymede agreed to increase the Prepaid Amount by $0.5 million, to $6.6 million (Schedule 1, 3.6);

b. The Expiration Date was extended to December 31, 2011 (Schedule 1, 3.3);

c. Revised the Resolution Amount to be the first $8,662,500 (the new "**Preferred Return**") (but acknowledging that Ganymede had already received $4 million), plus 40% of the Litigation Claim proceeds (Schedule 2). Total Net Recovery was revised to deduct the Fee Premium, and the amount of the Preferred Return was further increased by interest at the rate of 30% per month

[9] The 2011 Agreement is filed as Exhibit 7 hereto.

compounded monthly on any amount unpaid for 90 days of more following Litigation Resolution (full and final settlement of the Litigation Claim or entry of a final non-appealable judgment).

34. As the result of this Agreement, in January 2011, STB was paid an additional $500,000 by Ganymede. From December, 2009, through January, 2011, STB had been paid *a total of $8,600,000*.

35. In October 2011, Ganymede threatened to call Debtors in default of the 2011 Agreement if Gray does not *further* pay STB and Ganymede additionally threatens Debtors with negative consequences that "far exceed" the amount of the overdue STB invoice at issue. The threat to call a default by Ganymede was a threat to take control of the entire Litigation Claim, the Plaintiffs' sole asset. Such consequences would be catastrophic for Plaintiffs', and constituted a dire threat. Throughout the relationship of the parties, STB repeatedly assisted Ganymede in acquiring additional leverage against Plaintiffs by STB's demands for payment. Ganymede then "offers" to fund the STB invoice if Debtors would agree to add that to the amount owed on the Preferred Return. Plaintiffs' had no choice but to accede to the demands by Ganymede to appease the duress caused by STB.

36. No Uniform Commercial Code financing statement was recorded by Ganymede or STB against Debtors in 2011.

37. On December 16, 2011, the Expiration Date was extended to December 31, 2012.[10]

E. <u>The 2011 Supplemental Agreement</u>.

38. In response to the demands from STB, and the threats by Ganymede to call Plaintiffs in default as the result of the STB demands to Plaintiffs, Ganymede and Debtors executed the *Supplemental Agreement relating to Amended and Restated Forward Purchase*

[10] The December 16, 2011 letter is filed as Exhibit 8 hereto.

Agreement dated December 29, 2011 ("**2011 Supplemental Agreement**").[11] Under such 2011 Supplemental Agreement:

a. The Expiration Date was extended to December 31, 2012 (¶ 2);

b. The Prepaid Amount was increased to $6,775,000 (¶ 2)

c. The Resolution Amount was increased to $8,837,500, acknowledging that $4 million of such amount had already been paid, and the balance was subject to interest at 30% compounded monthly as set forth in the 2011 Agreement, plus 40% of the Proceeds.

d. The Fee Premium owed to the Nominated Lawyers [STB] was declared payable after the Purchaser received payment in full of the Preferred Return. (¶ 3);

39. Between December, 2009, to December, 2011, STB had been paid a *total amount of $8,775,000, almost three times the amount of the initial fee estimate that STB had provided to Plaintiff*. Of that amount, $6,775,000 had been paid by Ganymede, but Ganymede had been repaid $4,000,000 of that amount out of the settlement with DRCA in May of 2010.

F. Settlement of the Litigation Claim With NPP.

40. On May 31, 2012, Debtors negotiated a Settlement Agreement with respect to the Litigation Claim which provided that Debtors would receive, in summary, Assignment of the Lessee's Rights under the terms of the Arizona State Land Department Commercial Lease ("**ASLD**") No. 03-52415, the assignment of the Master Development Rights, the assignment of the Declarant's Rights and all intellectual property related thereto (collectively, such property interests shall hereafter be referred to as the "**Estates' Property**").[12] The Estates' Property comprises virtually all of the property of the Debtors' bankruptcy estates.

[11] The 2011 Supplemental Agreement is filed as Exhibit 9 hereto.

[12] The Settlement Agreement (without exhibits) is filed as Exhibit 10 hereto.

41. In the administrative bankruptcy case, Debtors have filed two August 8 appraisals, prepared by Mr. Thomas Raynak, MAI, CBRE, of the value of the real estate comprising the Estates' Property, which, combined, total $127 million.[13]

G. Outline of Terms—Ganymede Demands that the "Common Legal Interest" Be Converted to a "Liquidated Sum".

42. Shortly after the NPP settlement, Ganymede began demanding immediate cash payment from Plaintiffs. Ganymede took the (incorrect) position that the agreements required cash payment upon settlement. Importantly, the settlement transferred the leasee's rights under Commercial Lease No. 03-52415 to Plaintiffs. Such NPP settlement was not liquid cash, but a transfer of real property rights. Ganymede threatened to declare a default under the Agreements, and sue Plaintiffs in London if Plaintiffs did not agree to a resolution that Ganymede deemed satisfactory. STB indicated that it would withdraw from all representation of Plaintiffs immediately if an agreement was not reached.

43. Under the duress described, and on the terms dictated to Plaintiffs by Ganymede, Ganymede and Plaintiffs executed an "**Outline of Terms**" dated December 12, 2012.[14] In that Outline, Ganymede set forth terms under which Ganymede proposed to convert Ganymede's Preferred Return plus 40% "interest" in the Litigation Claim (referred to in the 2011 Supplemental Agreement as the Resolution Amount), into a "Liquidated Sum." Among other terms, the Outline of Terms states:

> a. "As of September 30, 2012, the total amount owing by Gray (Debtors) to Ganymede (Ganymede) is agreed to be $50,713,000 ("Liquidated Sum"). The Liquidated Sum shall be subject to a discount for early payment as set forth on the attached Exhibit "A" and shall be decreased by the amount of any Net Proceeds and Gray Cash Payments as defined below. The Discount for early

[13] See, Adm Dkt 106.

[14] The Outline of Terms is filed as Exhibit 11 hereto.

payment shall apply only if the payment is made by the applicable date set forth on Exhibit A." (¶ II, A)

b. At the date of the Outline of Terms, Exhibit A would have required payment to Ganymede of $16,419,000 (Exhibit A to Outline of Terms).

c. By March 31, 2016, Exhibit A reflects a required payment to Ganymede of $40,517,000, an amount only slightly less than 250% higher than the amount required when the agreement was executed. The amounts due as set forth on Exhibit A are referred to as the "**Total Amount**" (Exhibit A to Outline of Terms).

d. The Outline of Terms required the Total Amount to be secured by a first position deed of trust on, and a lien upon, ***all of the Estates' Property***, not just 40%. (¶ II D).

e. The Outline required payment of $37,612,000 by December 31, 2015, or declared that the Total Amount would thereafter bear interest at ***35% compounded monthly*** (¶ II, H).

f. Reflected that Debtors had executed a *Negative Pledge Agreement*[15] which had been recorded against the real property portion of the Estates' Property[16] pending recording of the required deeds of trust to Ganymede and STB;

g. Required Mr. Gray, personally, to sign a *Guaranty* of the Negative Pledge Agreement (¶ IV, A(7));[17]

---

[15] The *Negative Pledge Agreement* is filed as Exhibit 12 hereto.

[16] The real property portion of the Estates' Property is defined as Lessee's Rights under the terms of the Arizona State Land Department Commercial Lease ("**ASLD**") No. 03-52415, minus approximately 2.39 acres referred to as the "Exception Parcels" for a total of approximately 97.2 acres.

[17] The Guaranty is filed as Exhibit 13 hereto. The Guaranty was also a contract of adhesion, stating, among other things, that the Guarantor "… hereby waives and fully discharges Ganymede from any and all obligations to communicate with Guarantor any information whatsoever regarding Gray or Gray's financial condition or business affairs." (¶ 3) The

h. Ganymede required Debtors to agree to pay to STB the sum of $2,956,703.66 with interest at 6% per annum from and after September 30, 2012, ***compounded monthly*** until payment in full. Ganymede required that Debtors execute a second position deed of trust in favor of STB on, and a lien upon, ***all of the Estates' Property***. Ganymede required Debtors to execute an Intercreditor Agreement satisfactory to Ganymede and STB, and grant both Ganymede and STB a security interest in order to permit them to record Uniform Commercial Code financing statements.

i. Ganymede required Debtors to purchase ALTA title policies for both Ganymede and STB.

44. Ganymede concocted the contrived "debt" structure and the fictitious $50,713,000 amount owed. In part, such structure was demanded by Ganymede for the purpose of minimizing United States taxes. If the conversion reflected the actual amount "lent" by Ganymede as only $2,775,000 (which it was), then Ganymede would be faced with having to report an enormous gain to the United States. Ganymede threatened Plaintiffs that the Agreements required that Plaintiffs be responsible for Ganymede's required tax payments (See, e.g. Exhibit 2, 2009 Agreement, ¶ 19.3). Ganymede manufactured what was effectively a loan in reverse. Plaintiffs strenuously objected to such structure. Ganymede, once again, presented the Outline of Terms as a "take it, or else" proposal, in which they threatened litigation against Plaintiffs in London. Ganymede told Plaintiffs that Plaintiffs needed to remain silent on this issue because if this does not hold up in court, Plaintiffs would be "equally" guilty of any wrongdoing.

45. No Uniform Commercial Code financing statement was recorded by Ganymede or STB against Debtors in 2012.

Guaranty also stated that Ganymede was permitted to, essentially unilaterally, modify the Negative Pledge Agreement (¶ 4), and that the Guaranty was governed by the laws of England and had an LICA arbitration provision to take place in London (¶ 11).

H. The New Notes and Securitization of the Notes, and the 2013 Agreement.

46. As a result of the Outline of Terms, and the leverage that Ganymede now held over Mr. Gray personally in the form of a Personal Guaranty (Exhibit 13 hereto), Plaintiffs were compelled under duress to execute notes and securitization documents set forth as follows.

47. Plaintiffs executed a Promissory Note dated April 22, 2013, to Ganymede Investments Limited in the amount of $50,713,000 ("**Ganymede Note**").[18] The governing law for such note is Arizona law (bottom of page 3).

48. Ganymede did not advance any additional funds to or on for the benefit of Debtors at the time of the executing of the Ganymede Note.

49. Debtors executed a Promissory Note dated April 22, 2013, to STB in the amount of $2,956,703.66 ("**STB Note**").[19] The governing law for such note is Arizona law (bottom of page 3).

50. STB did not advance any additional funds to or for the benefit of the Debtors at the time of the executing of the STB Note.

51. Debtors executed a Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing to Beneficiary Ganymede Investments Limited purporting to secure payment of the sum of $50,713,000 dated as of April 22, 2013 (Recorded in Maricopa County at 2013-0421833 on 5/08/2013) (hereafter the "**Ganymede DOT**").[20] The governing law for such document is Arizona law (¶ 9.11, p. 21).

52. Debtors executed a Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing to Beneficiary STB purporting to secure payment of the sum of $2,956,703.66 dated as of April 22, 2013 (Recorded in Maricopa County at 2013-0421835 on

[18] The Ganymede Note is filed as Exhibit 14 hereto.

[19] The STB Note is filed as Exhibit 15 hereto.

[20] The Ganymede DOT is filed as Exhibit 16 hereto.

5/08/2013) (hereafter the "**STB DOT**").[21] The governing law for such document is Arizona law (¶ 9.11**,** p. 21).

53. On April 22, 2013, Debtors, and Ganymede and STB, and entered into a *Subordination and Intercreditor Agreement* regarding Arizona State Land Department Commercial Lease No. 03-52415-99, dated July 7, 1993.[22]

54. On April 22, 2013, Ganymede and Plaintiffs entered into a Second Supplemental Agreement and Amendment Relating to Restated and Amended Forward Purchase Agreement ("**2013 Agreement**"). [23] Again, as previously detailed, the 2013 Agreement was a contract of adhesion. The primary purposes of the 2013 Agreement was to further document: Ganymede's demand for a liquidated amount; Ganymede's demand for, and its required terms of the requested securitization of Ganymede against all Estate Property; the creation of STB Note for no consideration, and force a second position lien on all Estate Property for STB.

55. On May 8, 2013, Ganymede filed a Uniform Commercial Code ("**UCC**") Financing Statement with the Arizona Secretary of State (2013-173-8764-3) against Debtors.[24]

56. On May 13, 2013, STB filed a UCC Financing Statement with the Arizona Secretary of State (2013-173-9095-6) against Debtors.[25]

57. Prior to May 8, 2013, neither Ganymede nor STB had any publicly recorded security interest in Debtors' property, claims, or otherwise with respect to the property that is described herein as the Estates' Property.

---

[21] The STB DOT is filed as Exhibit 17 hereto.

[22] The *Subordination and Intercreditor Agreement* is filed as Exhibit 18 hereto.

[23] The 2013 Agreement is filed as Exhibit 19 hereto.

[24] The Ganymede UCC is filed as Exhibit 20 hereto.

[25] The STB UCC is filed as Exhibit 21 hereto.

I. Net Investment of Ganymede.

58. At the time of the Ganymede Note for $50,713,000, the total net amount of funds previously invested by Ganymede in the Litigation Claim (that became the Estates' Property) was, on information and belief, approximately $2,775,000.

59. On September 26, 2013, Plaintiffs, STB and Ganymede entered into a *Letter Agreement* regarding the release of approximately 0.69 acres of real property.[26] According to such Letter Agreement, on information and belief, Ganymede received payment of $1,426,275 in exchange for release of property from the Deeds of Trust.

60. After such payment, the net capital invested by Ganymede in the pursuit of the Litigation Claim by Debtors, crediting the prior repayment of $4 million, and the payment for the property release discussed above of $1,426,275, was, on information and belief, approximately $1,348,725.

61. In summary, funds paid by Ganymede [to STB], and repaid to Ganymede, on information and belief are as follows:

	Paid to STB:	Repaid to Ganymede:
2009 Agreement	$5,000,000	
DRCA Settlement (5/2012)	$2,000,000	$4,000,000
2010 Agreement	$1,100,000	
2011 Agreement	$ 500,000	
2011 Suppl. Agmt.	$ 175,000	
Sept 26, 2013 Letter		$1,426,275

Net invested by Ganymede: **$1,348,725**

H. Ganymede Publicly Markets the Ganymede Debt, and Notices a Trustee's Sale.

62. On or around March 2015, Ganymede began an aggressive and highly public advertisement of the Ganymede Note for sale through an entity known as HFF.[27] Plaintiffs were not in default of any obligations to Ganymede or STB at that time.

[26] The *Letter Agreement* is filed as Exhibit 22 hereto.

[27] A copy of the HFF marketing circular is attached hereto as Exhibit 23.

63. The HFF materials were publicly circulated with one or more widely disseminated e-mail "blasts". The HFF materials stated that the asking price for such debt was ***$30.6 million*** (*see* Exhibit 23, p. 2), well below the $50,713,000 face amount of the Ganymede Note. Neither Ganymede nor HFF made any effort to protect the Plaintiffs' ability to attempt to sell the property or refinance the Notes.

64. As a result of Ganymede's public and aggressive marketing of its Note, the Plaintiffs' ability or opportunity to market the property for sale, or refinance of the Note, was destroyed. No buyer would pay a market price for the real property collateral (appraised at $127,000,000), or refinance the debt (with face amounts of $50,713,000 and $2,956,703.66 when the senior note was being advertised on the open market for $30.6 million.

65. Prior to such HFF conduct, the Arizona real estate market had begun to show signs of recovery in early 2015. The HFF marketing immediately caused the Estate Assets to be viewed as distressed. HFF provided the Ganymede debt documents (including the Ganymede Note, which has the maturity date in the document) to inquiring parties without regard to the consequences. As a result, the market became aware of the December 31, 2015 maturity date. The market was unaware of such information prior to the HFF marketing and its highly public "e-mail blasts". The Plaintiffs' ability to protect its interests was destroyed virtually overnight.

66. Ganymede violated its duties of good faith and fair dealing to Plaintiffs.

67. On January 14, 2016, a *Notice of Trustee's Sale and Notification of Disposition of Personal Property* was recorded with the Maricopa County Recorder (2016-0026295) regarding approximately 98 acres of vacant property located west of 56th Street and north of the Loop 101 in Phoenix, Arizona (Tax parcel no. 212-32-100G) and the balance of the Estates' Property.[28]

---

[28] The *Notice of Trustee's Sale and Notification of Disposition of Personal Property* is filed as Exhibit 24 hereto.

I. Ganymede Sells the Claims to CPF—*With Notice of All Claims Provided to CPF*.

68. CPF and Ganymede entered into a *Sale and Assignment Agreement*, dated March 23, 2016 (hereafter "**Sale Agreement**")[29]. Under that document, CPF contracted to purchase the claims of Ganymede and SBT for a very substantial discount from the amounts of the Ganymede Note and the SBT Note. (¶ 2.1 of the Sale Agreement, filed under seal, states the amount of the discounted Purchase Price).

69. On March 30, 2016, after signing the Sale Agreement, CPF was so pleased with the purchase terms that Mr. Robert Flaxman (on behalf of CPF) contacted a possible investor by e-mail stating that, "I have a juicy new deal. Deep distress and big upside. When can we connect?"[30]

70. The Sale Agreement contains a number of provisions relating to CPF's due diligence regarding the nature of the Ganymede and STB relationship with the Debtors. (¶ ¶ 2.4 through 2.10). CPF was afforded a 30 day Feasibility Period (¶ 2.5). CPF was solely responsible for investigation, even if documentation which could have an impact upon the value, merits and risk of the Debt was not provided to Buyer (CPF was the "Buyer") (¶ 2.6).

71. All risk of inaccuracy of the Review Materials was borne "exclusively" by Buyer (¶ 2.7). Seller (Ganymede) made no representations or warranties regarding Seller's records. (¶ 2.7)

72. In part, paragraph 2.8 of the Sale Agreement states:

> Limitation on Liability. **Except in the event of** any (i) breach of Seller's express warranties and covenants set forth in this Agreement (which breach is subject to the limitations and conditions in this Agreement), or (ii) **act of Seller found by a court of competent**

[29] The Sale Agreement is filed separately under seal (CPF claims such document confidential) as Exhibit 25 hereto.

[30] Copy of the e-mail (with potential investor's name redacted) is attached hereto as Exhibit 26.

> **jurisdiction to constitute fraud** by Seller or any Seller-Related Party, Buyer, for itself and any successors and assigns of Buyer, waives its right to recover from, forever releases and discharges, and covenants not to sue Seller, and any Seller-Related Party, with respect to any and all claims, demands, or legal proceedings, whether direct or indirect, known or unknown, foreseen or unforeseen, that may arise on account of or in any way be connected with this Agreement, the Collateral, the Debt, the Debt Documents, and the Review Materials, including, without limitation, Seller's right to assign and Seller's assignment of the Debt and Debt Documents to Buyer, …[Emphasis added.]

73. Paragraph 2.9 of the Sale Agreement even declared certain of the file material to be "Excluded Documents" to which CPF could only obtain partial access, even after closing the purchase of the claims.

74. Paragraph 2.10 of the Sale Agreement declared that the Master Development Assignment requires and is subject to the consent of the Arizona State Land Department ("**ASLD**"). CPF agreed that if CPF had not obtained the ASLD consent by "Closing", then at Closing, the escrow agent would retain the Master Developer Assignment in Escrow. Further, later in paragraph 2.10, the Agreement stated that if Buyer failed to obtain such consent, and thereafter proceeds to record the Master Developer Assignment, or otherwise assert or exercise any rights arising thereunder, Buyer shall indemnify, defend, and hold harmless Seller and Seller-Related Parties.

75. Paragraph 6.5 of the Sale Agreement states:

> Litigation and Bankruptcy. **Seller has disclosed to Buyer that Counterparty (Plaintiffs herein) has made repeated written and oral threats of litigation against Seller**, including threats contained in written communications from Counterparty to Seller, copies of which have been provided to Buyer in the Review Materials provided under Section 2.4, and also has threatened to file for bankruptcy but

> that no such proceedings have been initiated to the best of Seller's knowledge….The Parties expressly acknowledge that the existence of litigation or bankruptcy proceedings related to the Debt or the Counterparty shall not modify the parties obligations under this Agreement. [Emphasis Added.]

76. Paragraph 8.6 states that the Sale Agreement is governed by the laws of the state of **Arizona**. As a result, the law that governs whether CPF acquired the claims subject to all existing claims and defenses is Arizona law.

77. CPF was, therefore, on *actual notice* of the fact that the alleged debts were disputed by the Plaintiffs, and on notice of the claims, at the time it purchased the claims. To the extent CPF was not on actual notice, the information provided to CPF unquestionably required a duty of inquiry by CPF.

78. As a result, CPF is ***not*** a holder of such claims in due course under Arizona law, and is subject to all claims and defenses to the claims. *See*, *Cal X-Tra v. W.V.S.V. Holdings, L.L.C.*, 229 Ariz. 377, 397-398, 276 P.3d 11, 31-32 (2012) (an assignee stands in no better position that the assignor). *See also*, *Hunnicutt Constr., Inc. v. Stewart Title & Trust of Tucson Trust No. 3496*, 187 Ariz. 301, 304, 928 P.2d 725, 728 (App. 1996); *Van Waters & Rogers, Inc. v. Interchange Res., Inc.*, 14 Ariz. App. 414, 417, 484 P.2d 26, 29 (1971); *Dunn v. Progress Indus., Inc.,* 153 Ariz. 62, 65, 734 P.2d 604, 607 (App. 1986) *citing* Restatement (Second) of Contracts § 336, cmt. b (1981).

79. The holding and reasoning of *In re The Village at Lakeridge, LLC*, 814 F.3d 993 (9th Cir. 2016) is ***inapplicable*** to the present case. The bankruptcy question before the Ninth Circuit in that case was narrow; whether a trustee was permitted to designate the creditor's claim under 11 U.S.C. § 1129(a)(10), and disallow the creditor's vote to confirm the plan as a statutory insider under 11 U.S.C. § 101(31). The case did not consider whether a claim was assigned with notice, and is therefore subject to all claims and defenses under applicable non-

bankruptcy law. Whether CPF is a statutory insider is only one of the many considerations in a Section 510(c) action, but is not relevant to a recharacterization or a fraudulent transfer action.

80. Pursuant to an *Assignment of Beneficial interest In Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing (STB)* dated April 29, 2016 ("**STB to Ganymede Assignment**"), on information and belief, STB assigned its rights under the STB DOT to Ganymede. [31] The document references a March 23, 2016 *Sale and Assignment Agreement* between Assignor and Assignee.

81. Pursuant to an *Assignment of Beneficial Interest Under Deed of Trust (Ganymede)* dated May 5, 2016 ("**Ganymede Assignment**"), on information and belief, Ganymede assigned its rights under the Ganymede DOT to CPF.[32]

82. Pursuant to an *Assignment of Beneficial Interest Under Deed of Trust (STB-Ganymede)* dated May 5, 2016 ("**STB Assignment**"), Ganymede assigned its rights under the STB DOT to CPF.[33]

83. An *Assignment of Interest Under Assignment of Rights as Master Developer and Declarant* dated May 5, 2016, was recorded with the Maricopa County Recorder (2016-0306043) by Ganymede Investments Limited, recorded with the Maricopa County Recorder (2013-0421834), to CPF.[34] The document acknowledges that the original recording being assigned (Maricopa County Instrument no. 2013-0421834) was a Collateral Assignment of Master Developer Rights. The effect of such document, if any, is the subject of Adversary Proceeding No. 2:16-000395-MCW

---

[31] The STB to Ganymede Assignment is filed as Exhibit 27 hereto.

[32] The Ganymede Assignment is filed as Exhibit 28 hereto.

[33] The STB Assignment is filed as Exhibit 29 hereto.

[34] The *Assignment of Interest Under Assignment of Rights as Master Developer and Declarant* dated May 5, 2016, is filed as Exhibit 30 hereto.

84. On May 13, 2016, counsel for CPF sent correspondence to counsel for Debtors notifying Debtors that the claimed payoff amount as of May 16, 2016 for the Ganymede Note was a total of $54,853,149.17, plus interest accruing at $52,440.74 per day thereafter. The same correspondence notified Debtors that the claimed payoff amount for the STB Note as of May 16, 2016 was $3,674,319.86, plus interest accruing at $610.76 per day thereafter.

85. As the result of the STB to Ganymede assignments, STB may have been paid in excess of $13,400,000 if STB received payment in full on the STB Note. Such amount is in excess of four times the fee estimate of $2 to 3 million for the representation with respect to the Litigation Claim that STB provided to Plaintiffs.

COUNT I

Fraudulent Transfers (11 U.S.C. §§ 544(b), 550 and A.R.S. § 44-1001 et. seq.)

86. Plaintiffs hereby incorporate into this Claim for Relief each and every allegation set forth above as if fully set forth and repeated herein.

87. In the 4 years prior to the Petition Date, under the duress caused by the actions of Ganymede and STB, the Plaintiffs executed the Outline of Terms, executed and recorded the Negative Pledge, and executed the Ganymede Note and the STB Note. In addition, Debtors executed and permitted recording of the Ganymede DOT and the STB DOT, assigned a collateral interest in the Master Developer's and Declarant's rights, and permitted the recording of UCC financing statements upon the Debtors' property. Prepetition, Debtors permitted transfer and encumbrance of virtually all of the Estates' Property to Ganymede and STB. These transactions shall hereafter be collectively referred to as the "**Transfer**".

88. Prior to such Transfer, neither Ganymede nor STB possessed any publicly recorded security interest in the Estates' Property. As a result, no creditor or party in interest had any notice whatsoever of the Transfer.

89. The Transfer materially adversely changed the financial structure between Ganymede and STB, on the one hand, and Plaintiffs on the other hand. In the 2011

Agreement, Ganymede had a Resolution Amount of the first $8,662,500 (the new "Preferred Return" amount) (but acknowledging that Ganymede had already received $4 million), plus 40% of the Litigation Claim proceeds. Ganymede's interests were not secured, but were in the nature of an equity participation or partnership interest.

90. First, through the Transfer, Ganymede fraudulently converted a partnership or equity claim in the Plaintiff's Litigation Claim, into a secured claim collateralized by 100% of the Estate's assets.

91. As counsel agreeing to a contingency fee, STB also went from having a contingency interest in the Plaintiff's Litigation Claim (the "success fee" provision), a joint venture partnership interest under Arizona law, to also fraudulently converting to a secured claim collateralized by 100% of the Estates' assets, in second position to Ganymede.

92. Though not necessary to qualify as a fraudulent conveyance, Ganymede and STB held positions with Plaintiffs, as the result of the 2009, 2010, 2011 and 2013 Agreements, and the terms of the STB retention agreements, as either statutory insiders, persons in control, partners, non-statutory insiders, equity holders, or fiduciaries.

93. Indeed, Ganymede had contractual access to and a power of attorney with respect to all attorney client privilege information, and with respect to the Litigation Claim itself.

94. Further, Ganymede had the absolute power to nominate and require the payment of Plaintiff's counsel with respect to the Litigation Claim, which eventually became the Estates' Property. Ganymede controlled the payment of the Nominated Lawyers under the 2009-2011 Agreements. Such Nominated Lawyers were STB, and STB was intensely loyal to its source of payment. Ganymede permitted and paid, at Plaintiffs ultimate expense, billings by STB that far exceeded STB's projected fee estimates, over Plaintiffs' repeated complaints. STB threatened Plaintiffs a number of times to terminate representation unless Plaintiffs would agree to terms demanded by Ganymede in return for Ganymede making payment to STB.

95. Prior to the Transfer, Ganymede had no more than, on information and belief, $2,775,000 invested in the Litigation Claim. Pursuant to a series of contracts of adhesion, Ganymede obtained a 40% interest in the Litigation Claim net Proceeds, plus the Resolution Amount of $8,837,500 (of which $4 million of such amount had already been paid, and the balance was subject to interest at 30% compounded monthly as set forth in the 2011 Agreement).

96. When the Debtors were mired in the Agreements, and the Judgment had resulted in a settlement agreement to remit Lessee's Rights under the terms of the Arizona State Land Department Commercial Lease ("**ASLD**") No. 03-52415 (an interest in real property, not money), Ganymede pressed its demand for conversion of the "common interest" to a liquidated claim, and perfection of security in all of the Estates' Property. Ganymede then devised a reverse debt scheme in an effort to avoid substantial potential tax liability, and threatened Plaintiffs that it would name them as a co-conspirator if the scheme was not successful.

97. To further pressure the Debtors, Ganymede required the individual principal of the Debtors, Mr. Gray, to guarantee the Negative Pledge recorded against the entire real property asset. From there, Ganymede required the balance of the Transfer to place Ganymede, and STB, in a position to fully strip away the Estates' Property.

98. In essence, Ganymede inappropriately leveraged its $2,775,000 investment in the Litigation Claim into a $50,713,000 debt, *without providing the Plaintiffs any additional funding whatsoever*. In addition, Ganymede compelled the creation of the STB debt and lien, *without any funding from STB to Plaintiffs whatsoever*.

99. The Transfer caused Debtors to be insolvent. The Transfer subjected all of the Estate's Assets to alleged secured claims totaling in excess of $54,000,000 at the time of transfer. Debtors received no additional funding from either Ganymede or STB at the time of the Transfer. Debtors had no means with which to service the newly created and massive claims held by Ganymede and STB after the transfer.

100. Debtors received less than reasonably equivalent value for the Transfer.

101. When Ganymede orchestrated the Transfer, it intended to cause Debtors to incur, or reasonably should have known Debtors would incur, debts beyond Debtors' ability to pay as they became due. Debtors had no liquid assets, and no ability to service the debts created thereby. The notes matured by their terms on December 31, 2015, a mere two years and eight months after inception of the notes.

102. Ganymede and STB intentionally sought to gain advantage over other existing creditors pursuant to the Transfer to gain a perfected lien upon virtually all of the Estates' Property. The Transfer hindered, delayed and defrauded Debtors' other creditors, and Debtors.

103. Thereafter, Ganymede engaged in an aggressive and public marketing effort to sell the Ganymede and STB notes on the open market. Any ability that Debtors may once have had to refinance the alleged claims was destroyed by such conduct.

104. CPF knowingly purchased the Ganymede and STB claims with disclosure that Plaintiffs had asserted claims against such parties prior to the sale. CPF therefore accepts the claims subject to all claims and defenses thereto pursuant to Arizona law.

105. The Transfer therefor constitutes either actual or constructive fraudulent transfers pursuant to A.R.S. § 44-1001 et. seq. and should be avoided pursuant to 11 U.S.C. § 544(b).

106. The claims asserted by CPF are the result of the Transfer, and for the same reasons, should be avoided.

COUNT II

Equitable Subordination (11 U.S.C. § 510(c), or alternatively, (b))

107. Debtors hereby incorporate into this Claim for Relief each and every allegation set forth above as if fully set forth and repeated herein.

108. To the extent CPF's claims are allowed, and Debtors contend they should not be allowed as otherwise set forth herein, CPF's claims should be equitably subordinated as they are the successor to Ganymede and STB which are parties that are statutory insiders, persons in

control, general partners, non-statutory insiders, equity holders, or fiduciaries. Indeed, Ganymede had contractual access to, and a power of attorney with respect to, all attorney client privilege information, and the power to nominate counsel (and therefore the loyalty of STB to Ganymede) with respect to the Litigation Claim, which eventually became the Estates' Property.

109. The STB fealty to Ganymede was such that STB introduced Plaintiffs to Burford. Thereafter, STB frequently threatened Plaintiffs with withdrawal from representation in the Litigation Claim, and regularly copied Ganymede on the e-mails. Ganymede would then remind Plaintiffs of their obligations under the Agreements, threaten to call a default under the Agreements, and then negotiate further Agreements to extract further consideration. This pattern culminated in the Transfer, and pressuring Mr. Gray, Debtors' principal, to personally guarantee the Negative Pledge agreement. No personal guarantees had ever previously been required by Ganymede.

110. The Transfers resulted in injury to and an unfair advantage over Debtors' other creditors and constitute gross and egregious inequitable conduct which should result in the Court subordinating the CPF claims pursuant to 11 U.S.C. § 510(c) to the claims of all other creditors in the Reorganization Cases.

111. In the alternative, Ganymede held a 40% interest in the Litigation Claim and was essentially an equity holder in the Debtors. STB had accepted representation with a contingency interest in the outcome of the litigation. As a result, both Ganymede and STB were partners in the Litigation Claim, and should be considered to be an equity holder that conveyed an equity position in the Litigation Claim (which became all Estate Assets) for a secured claim, and such transfer should be equitably subordinated to the allowed claims of unsecured creditors under 11 U.S.C. § 510(b).

112. In addition, all liens purporting to secure the CPF claims should be transferred to the bankruptcy estates.

COUNT III

Recharacterization (11 U.S.C. § 502)

113. Debtors hereby incorporate into this Claim for Relief each and every allegation set forth above as if fully set forth and repeated herein.

114. The nature of the investments in the Plaintiffs was in the nature of equity, rather than debt. The CPF claims should be recharacterized from asserted debt to equity pursuant to 11 U.S.C. § 502(b) and *In re Fitness Holding*s Int'l, Inc., 714 F.3d 1141 (9th Cir. 2013).

115. However, insider status is irrelevant to whether or not a claim may be recharacterized. *See, In re Lothian Oil, Inc.*, 650 F.3d 539, 544 (5th Cir. 2011).

116. Ganymede and STB, hereafter the "**Predecessors**" were aware that the large Ganymede Note and STB Note could not likely be paid in the short maturity date set for December 31, 2015.

117. The Predecessors were aware that the Transfer hindered, delayed and defrauded the other creditors of the Debtors.

118. The cooperation and control provisions of the prior Agreements remained in effect in the 2013 Agreement (¶ 8.5) meaning that Ganymede retained its power of attorney and other control elements with respect to the Plaintiffs and STB.

119. The Predecessors were aware that the amount of the Ganymede Note for $50,713,000 was substantially in excess of the amount which Ganymede had actually invested in the amount of $2,775,000 (after repayment of $4,000,000) at the time of the Transfer.

120. In addition, the Predecessors knew that they did not possess any perfected security interests in any of the Estates' Property prior to the Transfer. As a result, despite the Agreements, no creditor was aware of any liens or claimed liens on the assets belonging to the Debtors.

121. In addition, Predecessors knew or should have known that Debtors were undercapitalized and had been unable to pay other creditors' claims when due.

Communications between Plaintiffs, STB and Ganymede consistently requested payment. STB and Ganymede were aware that Plaintiffs were not paying obligations as they came due.

122. In addition, Predecessors knew or should have known that the Transfer caused encumbrance of collateral that far exceeded the value of Predecessors' interest in the Litigation Claim which became the Estate's Property, to the hindrance, delay and detriment of Debtors' other creditors and the Debtors.

123. Predecessors knew that the design and structure of the Transfer was created to discourage Debtors from being able to obtain a loan from an outside financing source.

124. Finally, Predecessors engaged in aggressive and public tactics to market their own Notes and liens for sale publicly and on the open market in such a manner as to preclude Debtors from having any ability to obtain any market financing to replace the Notes and liens, or market the Estates' Property for a fair market value. No lender would refinance the total amount of the Notes, when they could simply purchase the debt and liens from Ganymede at a substantial discount. CPF acquired the Notes and Liens at an eight figure discount from the face amounts, and was aware from the Sale Agreement itself, of the fact that the Debtors actually asserted claims against Ganymede and STB. Alternatively, such information placed CPF under a duty to inquire further about potential claims against Ganymede and STB. In fact, the Sale Agreement provided a limited indemnity provision to CPF in the event that a court determined that Ganymede had committed an act of fraud. See, ¶ 2.8 of the Sale Agreement.

125. Predecessors designed the Transfer with the objective of obtaining either: an enormous rate of return on the relatively small amount of capital still invested, or the Estates' Property for themselves. The Transfer was designed to defraud not only the Plaintiffs' creditors, but deprive the Plaintiffs themselves of any equity from the Estates' Property.

126. Accordingly, the CPF claims should be recharacterized from debt to equity in accordance with the original nature of the interest of the Predecessors.

COUNT IV

Claim Objection (11 U.S.C. § 502)

127. Debtors hereby incorporate into this Claim for Relief each and every allegation set forth above as if fully set forth and repeated herein.

128. Debtors hereby object to the allowance of claims of CPF in the Reorganization Cases.

129. CPF is not entitled to an allowed claim for the following reasons:

a. The conduct of the Predecessors is cause for this Court to equitably disallow the CPF claims in their entirety;

b. CPF is liable for the return of the Transfer and its claims are disallowed by statute under 11 U.S.C. § 502(d);

c. Alternatively, CPF's claim(s) should be recharacterized as equity as set forth herein;

Wherefore, Plaintiff's pray for entry of a Judgment granting relief as follows:

A. Avoiding the Transfers, whether as a direct, mediate, or immediate transferee or beneficiary, such that the claims and liens now owned by CPF are avoided pursuant to Arizona law and 11 U.S.C. § 544(b), to the maximum extent permitted under Section 550;

B. Equitably disallowing the claims and liens of CPF;

C. Disallowing the claims of CPF pursuant to 11 U.S.C. § 502(d);

D. If any CPF claim is to be allowed, equitably subordinating the claims of CPF pursuant to 11 U.S.C. § 510(c), or alternatively 510(b), to the claims of all other creditors of the Debtors, and determining all liens to be transferred to the bankruptcy estates;

E. Recharacterizing the claim of CPF to that of an equity holder under 11 U.S.C § 502, or otherwise under 11 U.S.C. § 105;

F. For such other and further relief as the Court determines just under the circumstances, including, but not limited to, an award of attorneys' fees costs incurred in this action to the bankruptcy estates if determined appropriate.

DATED this 28th day of November, 2016.

STINSON LEONARD STREET LLP

/s/ Alisa C. Lacey

Thomas J. Salerno
Alisa C. Lacey
Anthony P. Cali
1850 N Central Ave., Ste. 2100
Phoenix, AZ 85004
Attorneys for Debtor and Debtor-in-Possession

SO ORDERED.

Dated: June 2, 2017

Madeleine C. Wanslee

Madeleine C. Wanslee, Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: EPICENTER PARTNERS L.L.C.; GRAY MEYER FANNIN L.L.C.; SONORAN DESERT LAND INVESTORS LLC; EAST OF EPICENTER LLC; GRAY PHOENIX DESERT RIDGE II, LLC, Debtors.	Chapter 11 Case No. 2:16-bk-05493-MCW Jointly Administered with: Case No. 2:16-bk-05494-MCW Case No. 2:16-bk-07659-MCW Case No. 2:16-bk-07660-MCW Case No. 2:16-bk-07661-MCW
EPICENTER PARTNERS L.L.C. and GRAY MEYER FANNIN L.L.C., Plaintiffs. vs. CPF VASEO ASSOCIATES, LLC, Defendant.	Adversary No. 2:16-ap-00334-MCW **MEMORANDUM DECISION GRANTING IN PART AND DENYING IN PART DEFENDANT'S MOTION TO DISMISS ADVERSARY COMPLAINT**

On February 2, 2017, the parties appeared for a hearing on the second Motion to Dismiss filed by CPF Vaseo Associates, L.L.C. in this adversary proceeding. The Court now issues this Memorandum Decision concluding that the Motion to Dismiss Plaintiff's First Amended Complaint should be granted in part and denied in part.

BACKGROUND

The following are the facts of this case taken in the light most favorable to the non-moving party. In 2008, Epicenter Partners, L.L.C. and Gray Meyer Fannin, L.L.C. ("May Debtors")[1] retained attorneys Simpson Thacher & Bartlett, LLP ("STB") to pursue and defend claims on behalf of May Debtors against Northeast Phoenix Partners ("NPP") and Desert Ridge Community Association ("DRCA") relating to real property located in Phoenix.[2] About six months into the litigation, STB informed May Debtors that it would no longer represent unless May Debtors unless they obtained litigation financing.[3] To that end, STB introduced May Debtors to Ganymede Investments Limited ("Ganymede") in late 2009 which agreed to finance May Debtors' litigation against NPP and DRCA.[4]

On December 22, 2009, May Debtors entered into a Forward Purchasing Agreement with Ganymede ("2009 Agreement"). Although May Debtors suggested changes and modifications to the 2009 Agreement, none of these suggestions were incorporated into the final document.[5] Additionally, STB refused to continue litigation unless May Debtors signed the 2009 Agreement and informed May Debtors' principal Bruce Gray ("Mr. Gray") that he was in no position to negotiate.[6] Pursuant to the 2009 Agreement, Ganymede paid STB $5,000,000 to continue the litigation against NPP and DRCA.[7] In exchange, Ganymede would be paid on a contingent fee

---

[1] Epicenter Partners, L.L.C. and Gray Meyer Fannin, L.L.C. are referred to as the "May Debtors" because that is the month in which they sought bankruptcy relief. Other Debtors in these jointly administered cases, specifically Sonoran Desert Land Investors LLC, East of Epicenter LLC, and Gray Phoenix Desert Ridge II LLC, were filed in July 2016 and have been referred to during the proceedings as the "July Debtors." These five cases are jointly administered, but have not been substantively consolidated.

[2] See STB Engagement Letter dated December 9, 2008. The Engagement Letter also states: "We [STB] are committed to performing services for the Company to the best of our ability and with the independent professional judgment that an attorney owes to a client in accordance with both the Lawyer's Code of Professional Responsibility of the State of New York and its analogue in the state of Arizona where this case is pending."

[3] See First Amended Complaint, Paragraph 13.

[4] See First Amended Complaint, Paragraph 13.

[5] See First Amended Complaint, Paragraph 14.

[6] See First Amended Complaint, Paragraph 13.

[7] See Forward Purchase Agreement dated December 22, 2009, Schedule 1, Section 3.

basis 40% of any proceeds collected from the litigation, plus the $5,000,000 advanced through the 2009 Agreement.[8] The 2009 Agreement defines proceeds as both cash and non-cash proceeds including real estate, contract rights, and annuities.[9] It also states that the parties have a "common legal interest" in pursuing the litigation claim.[10]

The 2009 Agreement contains several conditions that expressly limit the nature of the parties' relationship. For instance, it provides that the parties are not creating a joint venture or partnership.[11] The 2009 agreement also states that May Debtors are "sophisticated and experienced, represented by counsel and with full access to [their] own legal advice."[12] Schedule 4 provides a list of May Debtors' assets (including the litigation claim and nearly all of the May Debtors' personal property) and describes those assets as "collateral." Section 7 requires May Debtors to give notice prior to assignment or disposition, in which case Ganymede may exercise a payout option (equal to $20,000,000) to terminate the 2009 Agreement.[13] The 2009 Agreement expressly limits any obligation by Ganymede to continue to fund the litigation, or pay any associated expenses.[14] Section 10 creates a general duty to cooperate with the Nominated Lawyers (in this case, STB).[15]

After May Debtors obtained Ganymede's financing, STB increased its rates to almost three times its previous invoice amounts. STB also changed the nature of their fee arrangement with May Debtors by creating a "premium" under which STB would be paid 130% of its fees,

---

[8] See Forward Purchase Agreement, Schedule 2, Section 1(a).

[9] See Forward Purchase Agreement, Schedule 5, page 26.

[10] See Forward Purchase Agreement, Preamble, Paragraph D.

[11] See Forward Purchase Agreement, Section 16.1: "[May Debtors] and [Ganymede] are independent actors. [The Forward Purchase Agreement] does not create any joint venture, partnership or any other type of affiliation, nor create a joint ownership of the Litigation Claim, for any purposes, including for U.S. federal, state and local income tax purposes."

[12] See Forward Purchase Agreement, Preamble, Paragraph (B).

[13] See Forward Purchase Agreement, Sections 7.1-7.2.

[14] See Forward Purchase Agreement, Section 9.1.

[15] See Forward Purchase Agreement, Section 10(b): "[May Debtors] shall at its own expense and in a timely manner: cooperate with [STB] in all matters pertaining to the Litigation Claim and promptly pay all costs and expenses necessary or reasonably desirable in association with the Litigation Claim."

including those previously billed, in the event it could secure a judgment at least three times its litigation fees.[16] When May Debtors complained about the rising litigation costs, STB and Ganymede informed May Debtors that May Debtors were no longer controlling the litigation costs.[17] The $5,000,000 paid to STB was supposed to represent the maximum amount STB would be paid for the entire litigation pursuant to STB's initial fee estimates provided to May Debtors.

In May 2010, May Debtors settled their claim against DRCA for $6,000,000. Of the $6,000,000, $4,000,000 was paid to Ganymede and $2,000,000 to STB.[18] A few months later, STB and Ganymede presented May Debtors with an amendment to the 2009 Agreement ("2010 Agreement").[19] Again, none of May Debtors' suggestions or proposals were incorporated into the 2010 Agreement.[20] The 2010 Agreement increased the amount Ganymede paid to STB by $1,100,000 and revised the schedule of payments to Ganymede. The 2010 Agreement was negotiated solely between STB and Ganymede and presented to May Debtors for signature.[21]

About six months after the 2010 Agreement, STB and Ganymede presented May Debtors with another amendment to the 2009 Agreement ("2011 Agreement"). Under the 2011 Agreement, Ganymede paid STB an additional $500,000.[22] The parties' relationship continued to sour with Ganymede and STB threatening May Debtors with default and demands for payment.[23] May Debtors executed another agreement ("2011 Supplement"). Pursuant to the

---

[16] See Amendment to Engagement Letter dated December 22, 2009: "All invoices rendered to [May Debtors] … will reflect a thirty percent discount to our usual rates for our fees … In the event [STB] obtains a judgment in [May Debtors'] favor for at least three times the amount of its fees incurred in prosecuting the case … [STB] will be paid a premium representing the difference between one hundred and thirty percent of its usual rates on all hours previously billed at the thirty percent discount less the amount of the discounted fees that have been paid."

[17] See First Amended Complaint, Paragraph 23.

[18] See DRCA Settlement Agreement dated May 13, 2010.

[19] See 2010 Amended Forward Purchase Agreement dated August 3, 2010, Schedule 1, Section 3; and First Amended Complaint, Paragraph 27.

[20] See First Amended Complaint, Paragraph 27.

[21] See First Amended Complaint, Paragraph 20.

[22] See 2011 Amended Forward Purchase Agreement dated January 3, 2011, Schedule 1, Section 3.

[23] See First Amended Complaint, Paragraph 35.

2011 Supplement, Ganymede paid STB another $175,000.[24] Although STB had originally estimated their entire fees to range between $2 and $3 million, STB was paid $8,775,000 from December, 2009 through December, 2011 (both through financing from Ganymede and the DRCA settlement). The 2011 Agreement further provides that in the event May Debtors recovered real estate from the litigation, then any split of proceeds would not include maintenance and operation costs for the real estate.[25] The 2011 Supplement also imposed the interest rate of 30% per annum.[26]

On June 14, 2011, May Debtors obtained a unanimous jury verdict against NPP in the amount of $110,658,800.[27] On May 31, 2012, NPP assigned May Debtors 120 acres of Arizona trust land located at Desert Ridge in Northeast Phoenix and the Master Development rights to Desert Ridge to settle the verdict.[28] Upon reaching this settlement, Ganymede demanded immediate cash payment of 40% of the verdict amount,[29] and STB refused to continue representing May Debtors unless May Debtors and Ganymede settled their dispute.[30]

From September 2012 through April 2013, May Debtors, Ganymede, and STB executed a number of agreements and instruments relating to May Debtors' property interests at Desert Ridge. On October 29, 2012, Ganymede and May Debtors executed a Negative Pledge Agreement pending the recording of liens.[31] Ganymede also demanded Mr. Gray personally

---

[24] See Supplemental Agreement to Amended and Restated Forward Purchase Agreement dated December 29, 2011, Amendment 2, Section 2.2.

[25] See Supplemental Agreement dated December 29, 2011, Amendment 2, Section 2.3, Paragraph 5. This amendment further provides: "To the extent any land and other non-cash assets are received as part of an NPP settlement, there will be deducted from the amount of the Proceeds any and all reasonable direct out of pocket expenses incurred and/or paid by [May Debtors] in connection with … any unreimbursed entitlement or similar costs incurred in connection with any delegation and fulfillment of master developer duties appurtenant to the non-cash assets …"

[26] See Supplemental Agreement dated December 29, 2011, Amendment 2, Section 2.3, Paragraph 4.

[27] See Final Judgment.

[28] See Settlement Agreement dated May 31, 2012, Section II, Paragraph A.

[29] Which the Court calculates to be $44,263,520 ($110,658,800 x .40 = $44,263,520).

[30] See First Amended Complaint, Paragraph 42.

[31] See Negative Pledge Agreement dated October 29, 2012.

guarantee a Negative Pledge Agreement.[32] In December 2012, May Debtors and Ganymede signed an Outline of Terms ("Outline") providing a statement of amounts due to Ganymede ($50,713,000),[33] a proposed payment schedule to settle Ganymede's claim,[34] and a clause giving Ganymede a first priority lien on all of May Debtors' property, including 96 acres of the Arizona state trust land at Desert Ridge.[35] The Outline required May Debtors to pay STB an additional $2,956,703.66, and included similar provisions securing the payment of this amount.[36] Under the Outline terms, the sums due Ganymede and STB would bear interest compounded monthly at 35% and 6%, respectively.[37] The Outline, however, gave May Debtors incentive to pay the amounts due sooner rather than later. For instance, May Debtors could have paid Ganymede $18,439,000 on or before June 30, 2013 to settle Ganymede's claim in full.[38]

In April 2013, the parties executed promissory notes,[39] deeds of trust,[40] and a Subordination Agreement (from STB in favor of Ganymede).[41] Collectively, these documents memorialized the terms of the Outline and Negative Pledge Agreement ("2013 Agreements") and granted Ganymede and STB liens on a 96 acre parcel at Desert Ridge and all of May Debtors' personal property.[42] Ganymede and STB recorded UCC-1 financing statements after May Debtors signed the 2013 Agreements.[43] Neither Ganymede nor STB had filed UCC-1 financing

---

[32] See Guaranty dated October 29, 2012.
[33] See Outline of Terms dated December 12, 2012, Section II, Paragraph A.
[34] See Outline, Exhibit A.
[35] See Outline, Section II, Paragraph D, and Section IV.
[36] See Outline, Section III, Paragraph A, and Section IV, Paragraphs A and B.
[37] See Outline, Section II, Paragraph H, and Section III, Paragraph A.
[38] See Outline, Exhibit A.
[39] See Ganymede Promissory Note dated April 22, 2013, and STB Promissory Note dated April 22, 2013.
[40] See Ganymede Deed of Trust dated April 22, 2013, and STB Deed of Trust dated April 22, 2013.
[41] See Subordination and Intercreditor Agreement dated April 22, 2013.
[42] May Debtors, STB, and Ganymede also executed a document entitled Second Supplemental Agreement and Amendment Relating to Restated and Amended Forward Purchasing Agreement dated April 22, 2013. The Second Supplemental Agreement incorporated the terms of the Outline.
[43] See U.C.C. Financing Statements recording numbers 2013-173-8764-3 and 2013-173-9095-6.

statements from 2008 through 2013.[44] STB later assigned its interest in the 2013 Agreements to Ganymede.[45]

In March 2015, and while May Debtors were not in default under the 2013 Agreements, Ganymede marketed its interests in the 2013 Agreements for $30.6 million. Although then due under the 2013 Agreement was $50.7 million.[46] Ganymede's decision to aggressively market and sell its interest made it difficult for May Debtors to sell parcels at Desert Ridge, and obtain any sort of cash flow to operate its business.[47]

On January 14, 2016, Ganymede filed a notice of trustee's sale pursuant to the 2013 Agreements.[48] On March 23, 2016 and May 5, 2016, Ganymede sold and assigned its interest in the 2013 Agreements to CPF Vaseo Associates, L.L.C. ("CPF").[49] In an email, CPF's principal, Robert Flaxman, described the acquisition as "a juicy new deal."[50] The sale agreement between Ganymede and CPF contains limitations of Ganymede's liability arising out of fraud (if any), and disclosure to CPF of May Debtors' litigation threats against Ganymede.[51] The sale agreements did not provide CPF with complete disclosure of Ganymede's dealings with May Debtors and STB.[52]

THE ADVERSARY COMPLAINT

May Debtors filed for relief under Chapter 11 of the United States Bankruptcy Code on May 16, 2016. On July 19, 2016, May Debtors filed an Adversary Complaint ("the Complaint")

---

[44] In fact, the Amendment to STB's Engagement Letter provides: "[STB] represents that it currently has no perfected statutory or regulatory liens in the litigation matters in which it is representing [May Debtors]."
[45] See Assignment of Beneficial Interest in Deed of Trust, Assignment of Rents, and Security Agreement and Fixture Filing (STB) dated April 29, 2016.
[46] See HHF Listing (undated).
[47] See First Amended Complaint, Paragraph 64.
[48] See Notice of Trustee's Sale and Notification of Disposition of Personal Property dated January 12, 2016.
[49] See Assignment of Beneficial Interest Under Deed of Trust dated May 5, 2016, and Assignment of Beneficial Interest Under Deed of Trust (STB-Ganymede) dated May 5, 2016.
[50] See Email dated March 30, 2016 from Robert Flaxman.
[51] See Assignment of Interest Under Assignment of Rights as Master Developer and Declarant dated May 5, 2016, and Sale and Assignment Agreement dated March 23, 2016 (filed under seal).
[52] See First Amended Complaint, Paragraph 73.

against CPF seeking to avoid CPF's lien on the Desert Ridge property alleging fraudulent conveyance, equitable subordination, and recharacterization. CPF filed a motion to dismiss the Complaint, which the Court granted after oral argument on October 5, 2016. Specifically, the Court found that May Debtors failed to allege specific facts to characterize Ganymede's financing as an equity interest. The Court further held that Ganymede's security interest in the 2013 Agreements constituted an exchange for a prior debt and therefore did not constitute a fraudulent transfer. The Complaint also failed to allege specific facts to indicate how May Debtors were insolvent at the time of the transfer, or how the debt made it impossible to pay bills as they came due. The Court did not find significant facts indicating undue control by Ganymede or STB over May Debtors, or that any controls were not normal for a typical, arm's-length lending agreement. Lastly, the Court held that May Debtors' claim against CPF as an insider may be foreclosed by Ganymede's assignment pursuant to the Ninth Circuit's decision in *In re the Village at Lakeridge, L.L.C.*, 814 F.3d 993 (9th Cir. 2016). The Court, however, gave May Debtors leave to amend the Adversary Complaint.

May Debtors filed their First Amended Complaint on November 28, 2016 ("First Amended Complaint"). CPF filed a Motion to Dismiss the First Amended Complaint on December 15, 2016 ("the Motion"), alleging that the First Amended Complaint is virtually identical to the original Complaint. Additionally, CPF alleges that the First Amended Complaint contains numerous irrelevancies, including allegations that Ganymede and STB coerced May Debtors, and that the 2009 Agreement expressly contradicts May Debtors' allegations. CPF also alleges that May Debtors were solvent during the 2013 Agreements, as they owned property allegedly worth over $100,000,000. Lastly, CPF argues that neither Ganymede nor STB were insiders because neither exercised the requisite degree of control over May Debtors.

May Debtors filed their Response to the Motion on January 6, 2017 ("Response"). May Debtors argue that the Forward Purchasing Agreement created an equity interest for Ganymede in the litigation proceeds because both parties had a shared interest in the acquired property rights.

The 2013 Agreement, May Debtors argue, converted this equity interest into a secured obligation. May Debtors allege this would constitute a fraudulent transfer as they received no value from the transfer, and because the debt rendered May Debtors insolvent. The issue of solvency, May Debtors argue, is a factual one that cannot be adduced at the complaint stage. May Debtors further allege that Ganymede and STB were non-statutory insiders whose conduct should be rigorously scrutinized. Furthermore, to support their equitable subordination claim, May Debtors argue that Ganymede and STB knew that May Debtors were undercapitalized at the time of the 2009 Agreements. Lastly, May Debtors allege that intent to create equity or debt has a subjective prong, and therefore should not be decided by a motion to dismiss.

CPF filed its Reply in Support of the Motion on January 20, 2017 ("Reply"). CPF alleges that the documents contradict May Debtors' legal conclusions, and that the latter should not be accepted as true. CPF also alleges May Debtors were balance sheet solvent on the date of the transfers, which supports dismissal of the fraudulent transfer claim. CPF further claims Ganymede and STB only exercised control over the litigation (at most), and not over May Debtors directly. Lastly, CPF argues May Debtors failed to respond to the multi-factor test for recharacterization argued in its motion.

At oral argument on the Motion held February 2, 2017, the parties cited to case law and the documents in support of their separate positions. The Court took the matter under advisement. The Court now rules that the Motion should be granted in part, and denied in part.

LEGAL ANALYSIS

A. MOTION TO DISMISS STANDARD

Federal courts apply a two-step process when analyzing a complaint under Rule 12(b)(6) of the Federal Rules of Civil Procedure, made applicable here by Rule 7012, Federal Rules of

Bankruptcy Procedure.[53] First, the court must isolate factual statements, which the court must accept as true, from conclusory remarks, which the court does not consider. Second, the court considers whether those factual statements, standing alone, could plausibly state a claim for relief. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). At the motion to dismiss stage, the court should interpret all material facts in the light most favorable to the non-moving party. *Warfel v. City of Saratoga (In re Warfel)*, 268 B.R. 205, 209 (9th Cir. BAP 2001). In the Ninth Circuit, the courts generally grant leave to amend a dismissed complaint unless amendment would not save the complaint. *Polich v. Burlington N., Inc.*, 942 F.2d 1467, 1472 (9th Cir. 1991).

B. THE DOCTRINE OF JUDICIAL ESTOPPEL DOES NOT APPLY TO MAY DEBTORS' SOLVENCY ALLEGATIONS

CPF has alleged May Debtors should be judicially estopped from simultaneously claiming a property value of $127,000,000 and that the transfer left May Debtors insolvent.

Judicial estoppel prevents a claimant from adopting two contradictory or inconsistent positions in order to gain an unfair advantage. *Rissetto v. Plumbers and Steamfitters Local 343*, 94 F.3d 597, 600 (9th Cir. 1996). In *Rissetto*, the Ninth Circuit affirmed the District Court's application of judicial estoppel to the recipient of worker's compensation who subsequently filed suit alleging age discrimination. The court held that the plaintiff was judicially estopped from making the inconsistent claims of (1) being unable to work and (2) performing her job adequately. *Id.* at 605-06.

This reasoning is inapplicable to the present case as the merits of May Debtors' case have not been judged by this Court, or any other court. At the complaint stage, courts "allow pleadings in the alternative – even if the alternatives are mutually exclusive." *PAE Gov't Servs., Inc. v. MPRI, Inc.*, 514 F.3d 856, 859 (9th Cir. 2007). Additionally, the complaint stage is an inappropriate time for any court to rule with certainty on the alternative allegations contained in

[53] Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all "Rule" references are to the Federal Rules of Bankruptcy Procedure.

the complaint as discovery has not yet commenced. This allows claimants to "shape their allegations to conform to these newly discovered realities." *Id*. Thus, May Debtors are not precluded from asserting the alleged value of the property and that they were insolvent, especially at this early stage of the litigation.

C. NEITHER GANYMEDE NOR STB COULD HAVE PLAUSIBLY BEEN JOINT VENTURERS OF MAY DEBTORS

Counts I (Fraudulent Transfer) and III (Recharacterization) of the First Amended Complaint rely upon characterizing CPF's claim as an equity investment or as a non-arm's-length loan from a disinterested creditor. If the 2013 Agreements secured an antecedent debt, then the transaction would not qualify as a fraudulent conveyance as alleged in Count I. *See Geron v. Palladin Overseas Fund, Ltd. (In re AppliedTheory Corp.)*, 323 B.R. 838, 841-42 (Bankr. S.D.N.Y. 2005). Secondly, if the transaction cannot be recharacterized as an equity interest as a matter of law, then Count III would necessarily fail.

May Debtors cite *In re Fitness Holdings* as stating the legal standard for recharacterization in the Ninth Circuit. In that case, the Ninth Circuit agreed with the Fifth Circuit in holding that recharacterizing a "debt" or "claim" under the Bankruptcy Code requires engaging in a *Butner* analysis by applying state law. *Official Comm. Of Unsecured Creditors v. Hancock Park Capital, II, L.P. (In re Fitness Holdings Int'l, Inc.)*, 714 F.3d 1141, 1149 (9th Cir. 2013) ("Such an equitable approach is consistent with Supreme Court precedent requiring us to determine whether a party has a 'right to payment,' i.e., a 'claim,' § 101(5), by reference to state law.").

May Debtors then direct the Court to a California decision authored before *In re Fitness Holdings* in which the court stated "the Ninth Circuit has never addressed whether bankruptcy courts have the authority to recharacterize debt into equity." *Daewoo Motor Am., Inc. v. Daewoo Motor Co. (In re Daewoo Motor Am., Inc.)*, 471 B.R. 721, 730 (C.D. Cal 2012). In *Daewoo*, the court applied federal tax law precedent in its recharacterization analysis by examining the

objective and subjective intent of the parties. *Id.* The Ninth Circuit later affirmed *Daewoo* post-*In re Fitness Holdings* as the parties stipulated that California state and federal law applied an identical multi-factor test to characterizing a transaction as a loan or equity investment. *In re Daewoo of Am., Inc.,* 554 Fed. Appx. 636, 639 (9th Cir. 2014). May Debtors applied the factors stated in *Daewoo* without providing any legal basis as to whether these same factors would apply under Arizona law. CPF, on the other hand, offered a nine-factor test for the Court's consideration, but failed to identify any legal basis for the test.[54] Instead, CPF argues the Court should be bound by CPF's nine-factor test because of May Debtors' failure to respond. Following *In re Fitness Holdings*, the Court will apply Arizona law to May Debtors' recharacterization claim in the First Amended Complaint.

May Debtors alleged numerous times throughout the First Amended Complaint that the equity interests of Ganymede and STB were in the nature of joint ventures. As such, the Court will apply Arizona law of joint ventures to the First Amended Complaint, but will first analyze CPF's contention relating to inconsistent allegations between the exhibits and the First Amended Complaint.

1. The Court will accept as true factual allegations contained in the First Amended Complaint that contradict the attached exhibits.

As an initial matter, the Court notes that some of May Debtors' allegations in the First Amended Complaint directly contradict the 2009, 2010, and 2011 Agreements. Although federal courts must accept all allegations in a complaint as true, courts are not "required to accept as true conclusory allegations which are contradicted by the documents referred to in the complaint." *Warren v. Fox Family Worldwide, Inc.*, 328 F.3d 1136, 1139 (9th Cir. 2003) (quoting *Steckman v. Hart Brewing, Inc.,* 143 F.3d 1293, 1295-96 (9th Cir. 1998)). Where a matter proceeds past the complaint stage, courts have held that the parol evidence rule does not apply to fraudulent transfer actions in bankruptcy cases for two reasons. First, the policy of fraudulent transfer

[54] Outside the Ninth Circuit, courts commonly use an eleven factor test articulated by the Sixth Circuit in *Bayer Corp. v. Mascotech, Inc. (In re AutoStyle Plastics, Inc.)*, 269 F.3d 726, 745 (6th Cir. 2001).

actions is to uncover the "true nature" of the transaction, and the parol evidence rule would necessarily act as a "false prophet" by preventing this role. Second, under Bankruptcy Code Section 544(a)(1) and (b), the debtor-in-possession steps into the shoes of a lien creditor without notice, and the parol evidence rule does not apply to third-parties. *Alberts v. HCA, Inc. (In re Greater Se. Comty. Hosp. Corp. I)*, 365 B.R. 315, 318 (Bankr. D.C. 2007) (quoting *In re Zedda*, 103 F.3d 1195, 1206 (5th Cir. 1997)).

The Court shares CPF's concerns relating to the inconsistent allegations contained in the First Amended Complaint and the attached exhibits, but holds that the policy of allowing extrinsic evidence for fraudulent transfers outweighs any special significance to the exhibits attached to the First Amended Complaint. In its Motion and Reply, CPF failed to identify with specificity how the exhibits contradict the allegations in the First Amended Complaint, and as such the Court has conducted its own analysis. After reviewing the exhibits, the Court finds few allegations that directly contradict the exhibits, and most of these are legal conclusions which the Court is not obligated to accept as true. For instance, the First Amended Complaint alleges a joint venture with Ganymede, an allegation which the Court is not obligated to accept as true. The First Amended Complaint also alleges the documents were contracts of adhesion, which the Court does not accept as true, but the Court does accept as true the conditions under which the documents were signed. This would include the allegations that STB refused to continue workinf, and refused to allow May Debtors to provide suggestions and changes to the numerous agreements executed by the parties. If the Court did not accept these allegations as true, then the fraudulent nature of the transaction, if it exists, might never be brought to light. To put it another way, it would simply be illogical to not assume a factual allegation relating to reasonably equivalent value as true where the contract expressly provides otherwise. The same logic would apply to the nature of the transaction as a joint venture, or as an arm's-length loan transaction if the purpose of the allegation is to characterize the transaction as a fraudulent transfer.

The Court therefore assumes May Debtors' factual allegations relating to the existence of a joint venture, even those that contradict the attached exhibits, are true.

2. The First Amended Complaint fails to plausibly provide a claim of joint venture between May Debtors and Ganymede.

In Arizona, a joint venture is created where two or more persons enter into a particular enterprise in the hope of sharing a profit. *Arizona Pub. Serv. Co. v. Lamb*, 84 Ariz. 314, 317 (1958). Joint ventures differ from partnerships in that the former are typically limited to a single transaction. *Rubi v. Transamerica Title Ins. Co.*, 131 Ariz. 403, 406 (1981). The five elements of a joint venture are: (1) an agreement; (2) a common purpose; (3) a community of interest; (4) an equal right of control; and (5) participation in profits and losses. *Estate of Hernandez v. Flavio*, 187 Ariz. 506 (1997).

Elements 2 and 3 are satisfied with regard to Ganymede's interest. The 2009 Agreement creates a common purpose between Ganymede and May Debtors to successfully litigate claims against NPP. It also creates a community of interest in express terms (that the parties have a "common legal interest" in pursuing the litigation claim). Additionally, although Ganymede was under no obligation to continue funding the litigation, it issued new funds on three separate occasions, and increased the amount funded from $6,000,000 initially to over $8,700,000 by the end of the litigation. Such behavior coupled with the nature of the investment goes beyond a simple lending transaction between a debtor and creditor and rises to the level of two independent actors participating in a common, mutually beneficial enterprise.

The allegations in the First Amended Complaint, however, fail to plausibly satisfy elements 1, 4, and 5. The 2009, 2010, and 2011 Agreements expressly disclaim the existence of a joint venture, and the First Amended Complaint does not provide any extrinsic factual allegations indicating that the parties agreed to create a joint venture. That Ganymede took a security interest in all of May Debtors' property would tend to cut against an agreement to form a joint venture. Although May Debtors stress throughout the First Amended Complaint that they