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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	**Case No. 11-35165-SGJ**
	§	
RETIREMENT VALUE, LLC,	§	**Involuntary Chapter 11**
	§	
DEBTOR.	§	

MOTION TO ABSTAIN OR DISMISS

Eduardo S. Espinosa, in his capacity as the State Court Receiver (the "Receiver") for Retirement Value, LLC (the "Alleged Debtor") appointed by the District Court of Travis County, Texas for the 126th Judicial District (the "State Court") in *Texas v. Retirement Value, LLC, Richard H. "Dick" Gray, and Bruce Collins, and Keisling, Porter & Free, P.,C., Relief Defendant*, Cause No. D-1-GV-10-000454 (the "Receivership Action") hereby moves the Court to abstain from hearing this involuntary Chapter 11 bankruptcy case (the "Involuntary") filed by Richard Stafford, Frank Marlow, Yvonne Staley, and Hugh Dunn (together, the "Petitioners") in favor of an ongoing state-court proceeding or to dismiss the Involuntary. In support of this request for relief (the "Motion"), the Receiver states as follows:

I. SUMMARY

1. This case, quite simply, does not belong in bankruptcy. It presents no unique issue of bankruptcy law or any other issue that the State Court is not equally equipped to resolve. It was filed not because of any perceived concern about the State Court's authority to act but simply to get a second "bite at the apple" in this Court. It is no coincidence that this case was filed just hours after the Petitioners were told that the investor-victims who had intervened in the case and who were also PLI140 investors (including the single largest investor-victim) supported the Receiver's plan for a pro rata distribution.

2. At base, this case presents a dispute among various groups of investor-victims over the proper distribution of the remaining assets of the Alleged Debtor. The Receiver contends that the assets should be distributed among the investor-victims on a pro rata basis based on the amount that each invested in the scam. Not only has this method been adopted by virtually every court to consider the issue; but it also provides the greatest return to greatest number of investor-victims.[1] The Petitioners disagree. They argue that they should be treated preferentially to the other investors because one of the policies in which they "participated" matured. In essence, the Petitioners wish to be able to trace their investment to a particular asset, the proceeds of the PLI140 policy, to the detriment of the other investors.

3. This dispute could have, should have and, but for the filing of this case, would have been resolved in the State Court. Yet, the Petitioners failed to raise the issue there. They did not even bother to file an objection to the Receiver's proposed plan of distribution. There is no excuse for their delay. Their fundamental objection – that the Receiver plans to pay all

[1] Ironically, three of the four Petitioners would recover more (ranging from a 3% to a 9% increase) in a liquidation under the pro rata distribution recommended by the Receiver than under a distribution under the false structure created by Alleged Debtor favored by them. Under the Receiver's plan to hold the policies to maturity, each of the Petitioners would roughly double his or her recovery.

investor-victims pro rata – has been an issue in the Receivership case since its earliest days. From the very beginning, the Receiver has made his belief that all investor-victims should share pro rata in the assets of the estate clear in communications to the investor-victims beginning in July 2010. That the Receiver planned to pay all investor-victims pro rata was repeated in a group teleconference, motions, postings on the receivership website and reports as well as in communications (both orally and in writing) with various individual investor-victims over the course of a year. Despite having ample notice of the Receiver's intention to distribute the assets of the estate pro rata, the Petitioners did nothing in the Receivership case for months on end. Having unreasonably delayed acting in state court and without even bothering to object to the Receiver's plan before the scheduled hearing, the Petitioners instead sought to avoid the consequences of their delay by filing this case and derailing a plan that would benefit all of the investors.

4. The Court should not allow that. Instead, the Court should abstain from hearing the Involuntary until the Receivership Action has been concluded or should dismiss the Involuntary entirely. It should do so using one or more of the following entirely proper justifications available to it as a matter of law (each explained, in detail, below). The Court should abstain from hearing or dismiss the involuntary because: (i) the Receivership Action is a pending, nearly complete liquidation action that promises a more efficient resolution of claims against the Alleged Debtor's assets, in a manner more consistent with a state-law regulatory regime; (ii) the Northern District is an improper venue for the Alleged Debtor's bankruptcy, if it is to have a bankruptcy at all; (iii) the Petitioners' claims are subject to bona fide disputes, leaving them without standing to file the Involuntary; (iv) the Alleged Debtor's facts present no

statutory basis for entry of an order of relief; and (v) the Petitioners filed the Involuntary in bad-faith.

II. BACKGROUND

A. THE RECEIVERSHIP ACTION

5. Upon learning of the Alleged Debtor's fraudulent scheme, the Texas State Securities Board issued a cease and desist order on March 29, 2010. The Texas Department of Insurance followed shortly with a cease and desist order of its own. The State of Texas filed the Receivership Action against the Alleged Debtor and two of its principals on May 5, 2010, alleging that the defendants had perpetrated a massive fraud on the investing public through the sale of "participations" in policies of life insurance to be purchased by the Alleged Debtor.

6. At the request of the State, the State Court appointed the Receiver. The State Court directed the Receiver to: (a) collect and preserve the receivership assets; (b) notify the investor-victims of the Receivership Action; (c) attempt to effect fair restitution to the investor-victims based on a plan to be approved by the State Court; and (d) assist the State in its investigation of the Alleged Debtor, its principals, and those who dealt with them. On May 28, 2010, the State Court continued the Receiver's appointment indefinitely.

7. Eventually, the State Court set a May 9, 2011 deadline for parties to intervene in the Receivership Action. Three sets of interveners, including investors in the same policies as the Petitioners, took the State Court up on this invitation before that deadline passed. The Petitioners, who had the same notice the interveners did, declined, only seeking to intervene in the Receivership Action at the end of July 2011.

B. Results Achieved and Costs Incurred in the Receivership Action through Involuntary Filing

8. During the Receiver's 15 months on the job before the Petition Date (as defined below), he actively managed the affairs of the Alleged Debtor and discharged his State-Court imposed duties. All told, the Receiver has brought more than $14 million into the Alleged Debtor's estate over the course of the Receivership Action, at a cost of only $1.4 million. He has filed a plan of distributions that promises to repay investors between 80% and 120% ($62.5 million to $92.5 million) of their investment, including 10% or $7.7 million this year.

C. Stayed August 15th Hearing and Filing of the Involuntary

9. As described above, before the filing of this Involuntary by the Petitioners, the Receiver proposed a plan of distribution in the Receivership Action and provided notice of the procedures that plan would establish. The State Court was set to consider that plan (and the two objections filed to it, along with other matters) at an August 15, 2011 hearing.

10. One business day before that hearing, on the afternoon of August 12, 2011 (the "Petition Date"), the Petitioners filed the Involuntary. While the Petitioners had been served with the Receiver's motion to approve his plan and notice of the hearing, they did not file an objection to the Receiver's plan with the State Court. This inaction was consistent with their pattern in the Receivership Action. After all, the Petitioners had missed the deadline to intervene in the Receivership Action, despite more than a year of actual notice of the Receivership Action and the active involvement in the Receivership Action of other interveners. The Petitioners took no action in the Receivership Action to resolve their asserted but disputed status as holding claims preferred to those of other investors in the Alleged Debtors' fraudulent enterprise, even when other interveners litigated a parallel argument for preferential treatment.

11. But for the filing of the Involuntary, the active phase of the Receivership Action would now be all but over. The work of reorganizing the Alleged Debtor would be complete. A plan would be in place determining who would be paid what and when. The methodology by which the Receiver would generate the assets necessary to pay them would have been established. The Receiver's plan called for an abbreviated proof of claims process that would allow claims not listed on the Receiver's schedule of claims to be added and any disputes as to amount, classification, and status of claims to be resolved. The only other remaining steps would have been to resolve the Alleged Debtor's causes of action and to continue to manage the Alleged Debtor's insurance portfolio over time.

III. MOTION TO ABSTAIN OR DISMISS

A. ABSTENTION

12. Pursuant to their discretion under 28 U.S.C. § 1334(c)(1), bankruptcy courts generally abstain from adjudicating cases when the following elements are met: (1) the petition was filed by a few recalcitrant creditors and most creditors oppose the bankruptcy; (2) there is a pending state insolvency proceeding; and (3) dismissal is in the best interest of the debtor and all creditors.[2] Moreover, abstention under Bankruptcy Code § 305 is appropriate where the matter is pending in another forum.[3] Some courts have additionally held that "economy and efficiency of the administration must be key considerations in the abstention decision."[4]

13. Lastly, and perhaps most importantly, abstention is particularly appropriate "where considerations of comity with state and federal administrative proceedings would dictate

[2] *GMAM Inv. Funds Trust I v. Globo Comunicacoes e Participacoes S.A. (In re Globo Comunicacoes e Participacoes S.A.)*, 317 B.R. 235, 254 (Bankr. S.D.N.Y. 2004); *In re Sherwood Enters., Inc.*, 112 B.R. 165, 168 (Bankr. S.D. Tex. 1989).

[3] *In re O'Neil Village Personal Care Corp.*, 88 B.R. 76, 80 (Bankr. W.D. Pa. 1988); *In re Michael S. Starbuck, Inc.*, 14 B.R. 134 (Bankr. S.D.N.Y. 1981).

[4] *In re O'Neil Village Personal Care Corp.*, 88 B.R. 76, 80 (Bankr. W.D. Pa. 1988) (citing cases).

that the Bankruptcy Court stay its hand in order to prevent undue interference or entanglement with state or federal administrative and regulatory schemes."[5]

i. <u>This Case is the Prototypical Case for Abstention</u>

14. The involuntary bankruptcy case of *Michael S. Starbuck, Inc.* closely resembles this Involuntary.[6] There, a receiver was appointed to administer the estate of two entities shut down by the SEC.[7] The receiver retained counsel and independent professionals to assist in the administration of the estate. Nearly 15 months after the appointment of the receiver, a group of estate creditors filed involuntary petitions against the estate.[8]

15. This required the bankruptcy court to decide whether it should abstain or dismiss the involuntary bankruptcy petitions. The *Starbuck* court noted that "there is no need to invoke the machinery of the bankruptcy process if there is an alternative means of achieving the equitable distribution of assets."[9] Ultimately, the court held that it was in the best interests of the creditors and the debtors to dismiss the proceedings; in so deciding, it stated that:

> Allowing this matter to continue as a debtor proceeding under the Bankruptcy Code would result in a terrible waste of time and resources. Many services, already rendered in the administration of the receivership estate, would have to be repeated at additional expense to the estate. No advantage would accrue to the creditors if this matter were to proceed in the bankruptcy court. Rather, their best

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[5] *In re First Fin. Enters., Inc.*, 99 B.R. 751, 754 (Bankr. W.D. Tex. 1989); *see also Barbee v. Colonial Healthcare Center, Inc.*, 2004 WL 609394, *1-*2 (N.D. Tex. 2004) (upholding bankruptcy court's permissive abstention out of deference to comity and to the existence of a closely related state law proceeding under way); *In re Michael S. Starbuck, Inc.*, 14 B.R. 134 (Bankr. S.D.N.Y. 1981) (abstaining from case that was administered in securities receivership); *In re O'Neil Village Personal Care Corp.*, 88 B.R. 76 (Bankr. W.D. Pa. 1988) (dismissing case involving receivership of personal care facility).

[6] *In re Michael S. Starbuck, Inc.* is perhaps the seminal case on abstention, and its reasoning has been applied in Texas bankruptcy courts. *See, e.g., In re Cent. Morg. & Trust, Inc.*, 50 B.R. 1010, 1021 (S.D. Tex. 1985); *In re First Fin. Enters., Inc.*, 99 B.R. 751, 754 (Bankr. W.D. Tex. 1989).

[7] *In re Michael S. Starbuck, Inc.*, 14 B.R. at 135.

[8] *Id.*

[9] *Id.*

> interests will be served by the continued administration of the equity receivership.[10]

16. The State Court similarly appointed the Receiver as a result of the Texas State Securities Board and the Texas Attorney General exercising their regulatory authority. The Receiver has been successfully administering the estate for 15 months and has proposed a plan of distribution, projecting a recovery of up to 120 cents on the dollar for defrauded investors. All the typical indicia of a bad-faith filing and a case prime for abstention are present. The Involuntary was brought by a few disgruntled creditors attempting to better their position at the expense of the other creditors. This is precisely the situation Congress envisioned when it codified the abstention provision in Bankruptcy Code § 305.[11] The legislative history reveals that the law was designed to permit dismissal or suspension "where an arrangement is being worked out by creditors and the debtor out of court, there is no prejudice to the rights of creditors in that arrangement, and an involuntary case has been commenced by a few recalcitrant creditors to provide a basis for future threats to extract full payment."[12]

ii. Abstention Would Provide the Most Efficient Use of Estate Resources and Prevent an Unjustified Interference with the State's Regulatory Authority

17. The Alleged Debtor's liquidation will be more efficiently resolved in the State Court. The Receiver has already invested countless hours of time and effort into preparing for a plan of distribution. Pulling the case away from the State Court just hours before it adjudicated the merits to force this Court to re-invent the wheel is not an efficient use of time and estate resources.

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[10] *Id.*

[11] *See In re Nina Merchandise Corp.*, 5 B.R. 743, 747 (Bankr. S.D.N.Y. 1980) (stating that "it is evident that § 305 contemplates the instance where a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process.").

[12] *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 325 (1977).

18. The Involuntary, filed amidst a state-enforcement action in the State Court, involves fundamental issues of Texas law and the State's ability to administer and enforce securities and insurance rules and regulations. This Court should avoid any "undue interference or entanglement with state . . . regulatory schemes."[13]

19. It is also worth considering that the Bankruptcy Code does not stay the State's exercise of police and regulatory powers.[14] This raises the specter of the Receivership Action going forward in some aspects, even as this case, too, unfolds. As a precautionary measure if nothing else, this counsels toward abstention – the Court should not create a multiplicity of litigations if it can be avoided.

20. Accordingly, abstention would best prevent any undue interference with the State of Texas's regulatory authority while preserving efficient use of estate resources.

iii. The Receivership Action Will Provide Finality and Due Process to All Victims of the Alleged Debtor's Fraud

21. While the authorities interpreting § 305 militate strongly in favor of abstention and dismissal of this case, the Petitioners have suggested that the State Court lacks the jurisdiction and authority to resolve the issues presented by this case. They are wrong. The State Court has ample jurisdiction and authority to liquidate the Alleged Debtor in the manner recommended by the Receiver.

22. As an initial matter, there is no inherent conflict between the Bankruptcy Code and state laws providing for liquidation of insolvent entities. State courts in Texas and elsewhere have been liquidating corporations and other entities created under their laws for many years both prior to and after the adoption of the Bankruptcy Code. The authority of states to take

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[13] *See In re First Fin. Enters., Inc.*, 99 B.R. 751, 754 (Bankr. W.D. Tex. 1989).

[14] 11 U.S.C. § 362(b)(1).

charge of the management of wayward entities and to provide for their orderly liquidation arises out of the states' extensive powers over the life and death of corporations organized and existing under their laws. "The state court corporate receivership, one manifestation of such powers, is a creature of the equity courts' historical jurisdiction as modified or augmented by modern statute.[15]" Although a Texas receivership, like a bankruptcy, honors the interests of creditors whose claims encumber the entity's assets and provides for the equitable distribution of those assets among the creditors, the state receivership process supports rather than conflicts with the Code. As a bankruptcy court explained when holding that Rhode Island's receivership process, which is largely identical to Texas's process, was not pre-empted by the Code:

> As discussed above, the state procedures continue a long history of equity jurisdiction, a history that predates the Bankruptcy Code and its antecedents. Rhode Island receiverships, like state court receiverships generally, were within the contemplation of the Code's drafters, but the Code does not expressly preempt them. Indeed, there are instances in which the Code may encourage deference to such state proceedings.[16]

23. This is one such case. In the exercise of its authority to regulate the sale of securities and to protect the interests of consumers in Texas, the State requested and received the appointment of a receiver to take charge of and, ultimately, to liquidate the Alleged Debtor. Although it will take some time for the policies owned by the Alleged Debtor to mature and pay off, the Receiver's proposed plan of distribution provides for nothing more than liquidation. To the extent that it had an actual business – the commission of fraud is not normally considered to be a "business" – the Alleged Debtor will never be able to continue in business. It is the subject of two final injunctions by state agencies that effectively preclude any further operations.

24. The State Court has ample authority to provide complete and final relief for all of the Alleged Debtor's victims. Generally speaking, parties with notice of a receivership's

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[15] *In re Newport Offshore Ltd.*, 219 B.R. 341, 346 (Bankr. D.R.I. 1998).

[16] *Id.* at 355 (discussing abstention under § 305 and excuse from turnover under § 543(d)).

existence, including constructive notice, are treated as "a claimant of ordinary prudence upon inquiry as to all measures requisite for him to pursue in order to share in the distribution" of the receivership estate.[17] Accordingly, receivership courts may make rulings concerning the distribution of receivership assets in its possession among claimants on the basis of the claims brought before it in a timely manner, without risk of subsequently arriving parties disturbing its rulings.[18]

25. There is no question that the Petitioners and all of the investor-victims have had ample notice of the Receivership Action. Each received a letter from the State Securities Board and from the Receiver advising them of the Receivership Action. In addition, the suit itself was reported widely in the press.

26. The Petitioners and all of the investor-victims were equally apprised of the progress of the case. The Receiver has sent letters to the investors, posted news and significant pleadings on his website,[19] held a teleconference and maintained a dedicated telephone number and e-mail address for the use of the investor-victims. The Petitioners and all of the other investor-victims will be bound by the plan of distribution entered by the State Court regardless of whether they are formally joined in the proceedings.

27. This is consistent with the law of other states.[20] For example, in Rhode Island, a "receivership court may … requir[e] creditors who wish to receive a distribution from the

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[17] *U.S. v. Whisenant*, 75 S.W.2d 958, 960-61 (Tex. Civ. App.—Dallas 1934, writ ref'd) (excusing IRS from receivership court's bar date following notice by publication that its agents never saw *only* because supremacy clause and federal statutory notice requirements for the IRS exempted it from the general rule).

[18] *Id.* at 960.

[19] The investor-victims were advised of the existence of the Receiver's website and encouraged to check it regularly for updates on the case in the Receiver's first letter to them. Moreover, searching "retirement value," "retirement value llc" or "retirement value lawsuit" on Google and Bing generates a list placing the Receiver's website as the first item in the search results.

[20] *In re Newport Offshore Ltd.*, 219 B.R. 341, 348 (Bankr. D.R.I. 1998).

receivership estate to file sworn proofs of claims and by fixing a claims bar date…. Creditors filing untimely, or not, claims may be barred from 'participating in the distribution of the assets of the corporation[.]'"[21] This is so despite the fact that unasserted claims remain claims against the entity in receivership that will not be satisfied from the assets controlled by the state court. "[A] creditor who fails to file a timely claim, or any claim, in state receivership proceedings may discover that post-receivership collection attempts prove an unrewarding experience,"[22] but he remains free to attempt them against any assets the subject company acquires post-receivership. The same is true in Texas.

28. In arguing that the State Court lacks authority to enter a plan of distribution because it has not asserted or could not assert personal jurisdiction over the investor-victims, the Petitioners fundamentally misperceive the nature of the Receivership Action. It is not, as they suggest, an action against the investor-victims. In fact, as to the receivership itself, the Receivership Action is not a suit *in personam* at all. Rather, it is a suit *in rem* to dispose of the assets derived from the swindle for the benefit of the investor-victims.

> A receivership, somewhat like a sequestration or attachment, draws to the custody of the court, as a proceeding *in rem* for the court's ultimate administration, adjustment and final disposition, all parties as well as their property. So to speak, the matters are *in custodia legis*, and no other court should interfere by taking jurisdiction of any portion of the assets to thus embarrass another court of like jurisdiction administering the same.[23]

It is well established that a court appointing a receiver has exclusive jurisdiction over the property subject to the receivership.[24] Its decisions as to the disposition of the property subject to its control are final and binding on all parties having claims to those assets.

[21] *Id.* at 348.

[22] *Id.* at 355.

[23] *Wright v. Kaler*, 293 S.W. 315, 317 (Tex. Civ. App. – San Antonio 1927, writ dismissed w.o.j.)

[24] *Chimp Haven, Inc. v. Primarily Primates, Inc.*, 281 S.W.3d 629, 633 (Tex. App. – San Antonio, no pet.)(declaring judgment rendered by court other than the receivership court void for lack of subject matter jurisdiction).

29. A decision of a receivership court as to how, when and to whom it will distribute property cannot be collaterally attacked by another court – either state or federal – under the full faith and credit clause.[25] As the Supreme Court held in *Lion Bonding & Surety Company. v. Karatz,*[26]

> But, if the legality of the state court's action was to be questioned, it could be done only by laying the proper foundation through appropriate proceedings in that court. If such action had been taken and relief had been denied there, resort could then have been had to appellate proceedings. But the judgment of the state court, which had possession of the res, could not be set aside by a collateral attack in the federal courts. Nor could it be ignored. Lower federal courts are not superior to state courts.[27]

The Fifth Circuit has specifically reaffirmed this principal when affirming the dismissal of a suit attacking the actions of a state court receiver on full faith and credit grounds in *Clark v. Fitzgibbons*.[28]

30. In *Clark*, the Fifth Circuit also held that state court receivership liquidations are consistent with notions of due process and the personal jurisdiction limitations of state courts.[29] In that case, Texas creditors holding claims against an insurance company in receivership in Arizona attempted to challenge decisions made by the receiver through a suit filed in federal court in Texas. As a basis for their suit, the Texas creditors argued that they lacked contacts with Arizona such that the receivership court had no authority over them or their claims. Like the Petitioners have argued on behalf of out-of-state creditors of the Alleged Debtor, the creditors in *Clark* contended that they could not be forced to litigate their claims in a foreign receivership court and were not bound by its rulings.

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[25] *Moody v. State*, 520 S.W.2d 452, 457 (Tex. Civ. App – Austin 1975, writ ref'd n.r.e.)(refusing to allow a collateral attack on receivership proceeding pending in Alabama).

[26] 262 U.S. 77 (1923).

[27] *Id.* at 90.

[28] *Clark v. Fitzgibbons*, 105 F.3d 1049, 1053 (5th Cir. 1997).

[29] *Id*.

31. The Fifth Circuit agreed that Arizona appeared to have no personal jurisdiction over the creditors, but it nonetheless rejected this "creative" argument as "without merit" and affirmed the dismissal of the federal court litigation. The Court of Appeals noted that "[t]he minimum contacts standard protects defendants, not plaintiffs. If a plaintiff is unwilling to submit to the jurisdiction of the [receivership] Court, he need not bring a claim there."[30] However, as the Arizona court had custody over all of the debtor's assets, the Texas creditors would have no other source of repayment.

32. Simply put, the Receivership Action may go forward with or without a claimant's participation. If a resident of this or another state chooses not to participate in the Receivership Action, that choice is the right of the claimant. As a result, however, the claimant will simply be unable to obtain a recovery from the assets in the control of the State Court except as provided by that Court. Nothing in American due process jurisprudence affords him the right to litigate his claims elsewhere, including in a federal forum. On the authority of the Fifth Circuit, the Court's concerns on this matter may be safely laid to rest.

iv. To Address Due Process Concerns of Petitioners and the Court, Receiver Will Propose Additional Safeguards in the Receivership Action

33. Above and beyond this well-founded base for the Court to determine that all parties' due process rights would be fully respected in the Receivership Action if this Involuntary were dismissed, though, the Receiver stands willing and able to work with the Court to assure that any additional safeguards the Court believes would be appropriate will be put in place.

[30] *Id.*

34. In an effort to resolve the Petitioners' and the Court's expressed concerns, the Receiver commits to ask the State Court to alter the process through which it will approve a plan of distribution. The Receiver will ask the Court to:

- Allow any creditor may file an objection to the Receiver's plan without first having to intervene in the Receivership Action.
- Set a date by which objections to the plan must be filed.
- Require the Receiver to provide additional written notice of the plan as well as the date by which objections are due.
- Hold a hearing on the Receiver's proposed plan. Any creditor who timely filed an objection to the plan will be allowed to participate in the hearing.

Based upon consultation with the State, the Receiver believes that the State Court will enter an order incorporating these procedural protections.

35. The Court could suspend the bankruptcy to allow the Receiver and the State Court to put these additional protections in place. The Receiver would also be pleased to discuss with the Court (and the various creditors) what other provisions or assurances concerning proceedings in the Receivership Action could be included in such an order to give the Court comfort that the Receivership Action will proceed with all process that is due to investor-victims of the Alleged Debtor.

B. DISMISSAL

36. Should the Court decline to abstain from hearing the Involuntary, it must dismiss it. The Involuntary must be dismissed because the Petitioners are not qualified by the Bankruptcy Code to have brought the Involuntary before the Court in the first place. In addition, there is no statutory basis available for the Court to keep the Involuntary in this venue or to grant an order for relief against the Alleged Debtor. Furthermore, paralleling the abstention arguments above, the Involuntary should be dismissed because dismissal is in the clear-cut, best interests of

the Alleged Debtor and its creditors and because the Petitioners filed the Involuntary in transparent bad-faith.

i. <u>Venue is Not Proper in the Northern District</u>

37. Pursuant to the applicable venue statute, a bankruptcy case for the Alleged Debtor may be filed

> …in the district—(1) in which the … principal place of business in the United States, or principal assets in the United States, of the … entity that is the subject of such case have been located for the one hundred and eighty-days immediately preceding such commencement[.][31]

These are the only venues in which a case for an entity may be filed. When a case is improperly filed elsewhere, it must be dismissed or transferred.[32]

38. Because the Petitioners filed the Involuntary in an improper venue lacking the ability to hear this case, the Receiver asks the Court to dismiss.

(A) Alleged Debtor's Principal Place of Business Lies in Western District of Texas

39. An entity's principal place of business is the "place where general operations are supervised."[33] The "critical focus of § 1408" in this "'nerve center' analysis" is "the location at which supervisory/management decisions on behalf of the debtor are actually made."[34]

40. It is uncontested that, before the receivership, the Alleged Debtor's "nerve center" lay in its New Braunfels offices. New Braunfels is located in the Austin Division of the Western District of Texas.

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[31] 28 U.S.C. § 1408.

[32] *See* 28 U.S.C. § 1406; *Bass v. Hutchins*, 417 F.2d 692, 695 (5th Cir. 1969) (stating rule that dismissal or transfer is required of cases filed in wrong district or division).

[33] *In re Peachtree Lane Assoc., Ltd.*, 150 F.3d 788, 795 (7th Cir. 1998) (following *In re Commonwealth Oil Ref. Co.*, 596 F.2d 1239, 1246-47 (5th Cir. 1979)).

[34] *In re West Coast Interventional Pain Med., Inc.*, 435 B.R. 569, 575 (Bankr. N.D. Ind. 2010) (citing *Hertz Corp. v. Friend*, 130 S.Ct. 1181 (U.S. 2010) (holding liquidating companies that operated solely in California, whose principal and records moved to Indiana at the appointment of partial receiver for companies' accounts receivable to have principal place of business in Indiana, since principal retained management authority, not partial receiver)

41. An entity in receivership retains its former principal place of business. In *Royal Indemnity Company v. American Bond & Mortgage Company*, the Supreme Court held that a company's principal place of business does not change when it is placed in receivership.[35] *Royal Indemnity* involved a Maine corporation that conducted its business in Chicago, Illinois. A receivership action was filed against it in Chicago, the same week an involuntary was filed against it in Maine. The corporation contested the bankruptcy, but consented to the imposition of an equity receiver to liquidate it. Eventually, the receiver filed a voluntary bankruptcy petition in Illinois. The filers of the Maine bankruptcy contested the venue for that preceding, maintaining that the imposition of a liquidating receiver altered the analysis of the debtor's principal place of business for venue purposes.

42. The Supreme Court disagreed, holding that "the place where [the corporation's] business was conducted … still remained the 'principal place of business,' in the common acceptation of the phrase" during the equity receivership.[36]

43. Moreover, the Receiver is an officer of the State Court. He acts pursuant to that court's authority and subject to its supervision and control. Thus, to the extent that the receivership has changed the Alleged Debtor's "nerve center," it has moved from New Braunfels to Austin.

44. Since the appointment of the Receiver 15 months ago should not have altered the Alleged Debtor's principal place of business and since, to the extent that the Receivership Action had such an impact, it made the State Court in Austin the supervisor of the Alleged Debtor's liquidation throughout that 15-month period, the Alleged Debtor's principal place of business at all relevant times has lain in the Western District of Texas, not the Northern District.

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[35] *Royal Indem. Co. v. Am. Bond & Mortg. Co.*, 289 U.S. 165, 169 (1933).

[36] *Id.*

(B) Alleged Debtor's Principal Assets Located Outside the Northern District of Texas

45. Similarly, the Alleged Debtor's "principal assets" have never been located in the Northern District of Texas. All of the Alleged Debtor's assets are held in the custody of the State Court in Austin. In addition, the physical location of most of these assets is outside of the Northern District. The most important assets of the Alleged Debtor's estate are its insurance policies (even if they have a current liquidation value of less than the Alleged Debtor's cash on hand). Those policies are physically in the offices of the Receiver's portfolio manager in Oklahoma City, Oklahoma. Even if the Court focused exclusively on the Alleged Debtor's cash holdings, in deference to their greater immediate liquidation value to the Alleged Debtor's estate, the Alleged Debtor's principal cash holdings are also located elsewhere. While the Receiver maintains an operating account in Dallas, Texas, it holds less than half of the Alleged Debtor's cash; nearly twice as much of that cash resides in an account in New Braunfels, Texas.

46. However the phrase is read, whether focused on the long-term strategic importance of assets or on their current liquidation value, the Alleged Debtor's principal assets are located outside the Northern District of Texas and have been so located throughout the relevant six-month venue period.

(C) Improper Venue Requires Dismissal

47. The Northern District of Texas houses neither the Alleged Debtor's principal place of business, nor its principal assets. Venue is not proper in this Court. Accordingly, the Receiver asks the Court to dismiss.

ii. Petitioners not Qualified to File Involuntary, Due to Bona Fide Dispute as to Amount of Their Claims

48. Pursuant to Bankruptcy Code § 303(b)(1), it takes at least three (3) creditors, each of whom holds a claim "that is not contingent as to liability or the subject of a bona fide dispute

as to liability or amount," to bring an entity like the Alleged Debtor that has more than 900 creditors into an involuntary bankruptcy.

49. The Fifth Circuit has long interpreted this language to "adopt[] an objective standard" for determining whether a claim is subject to a bona-fide dispute.[37] According to the Court of Appeals, the Court "is to ascertain whether a dispute that is bona fide exists; the court is not to actually resolve the dispute."[38] Since Congress amended the section in 2005, whenever "any dispute regarding the amount [owed is present, it] should render the claim subject to a bona fide dispute."[39] Since Congress "intended to disqualify a creditor whenever there is any legitimate basis for the debtor not paying the debt, whether that basis is factual or legal[,]" the Bankruptcy Code requires the presence of at least three (3) Petitioners holding liquidated claims to force the Alleged Debtor into bankruptcy.[40] Whenever fewer than three (3) creditors holding fully liquidated claims file an involuntary against an alleged debtor with twelve (12) or more creditors, "the petition must be dismissed."[41]

50. All of the Petitioners' claims are subject to bona fide dispute as to their amount. Each of the Petitioners claims an entitlement to a share of "the amounts due upon the [post-Receivership Action] maturity of the PLI140 Policy and … any remaining premium reserves related to the PLI140 Policy."[42] There is a substantial dispute as to the amount and nature of the claims asserted by the Petitioners. The fundamental dispute here is whether the Petitioners are

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[37] *Norris v. Johnson* (*In re Norris*), 114 F.3d 1182, 1997 WL 256808, *4 (5th Cir. 1997) (citing *Subway Equip. Leasing Corp. v. Sims* (*In re Sims*), 994 F.2d 210, 220 (5th Cir. 1993)).

[38] *Id.*

[39] Reg'l Anesthesia Assocs. PC v. PHN Physician Servs., Inc. (In re Reg'l Anesthesia Assocs. PC), 360 B.R. 466, 470 (Bankr. W.D. Pa. 2007).

[40] *Riverview Trenton RR Co. v. DSC, Ltd.* (*In re DSC, Ltd.*), 486 F.3d 940, 945 (6th Cir. 2007).

[41] *Id.*

[42] Emergency Motion for Appointment of Chapter 7 Interim Trustee [Docket No. 2], ¶ 12.

entitled to recover the gain promised them by Retirement Value or they are limited to the amount of their investment. As a matter of state law, the Petitioners are not entitled to recover more than they invested. First, victims of a fraudulent scheme are not entitled to recover the profits promised them. Second, Texas law prevents the payment of interest, such as that claimed by Petitioners, to the creditors of an insolvent entity in receivership. Third, Texas law provides that an entity in receivership may avoid contracts that are incomplete as of the date of the receivership. Fourth, assuming that Petitioners are allowed to recover based on the Alleged Debtor's fraudulent promises, the amount of their recovery is subject to dispute by other creditors based on their equitable claims to the proceeds of the PLI140 policy as well as on the uncertainty as to the amount of the Petitioners' unspent premiums. Fifth, the State Court prohibited payment of the Petitioners during the Receivership Action, leaving it questionable whether, as of the Petition Date, they are owed anything at all.

(A) Fraudulent Nature of the Alleged Debtor's Scheme Limits the Amount Due to Each Investor, including the Petitioners

51. The Alleged Debtor perpetrated a large and wide-ranging fraud on the investing public. That the Petitioners, along with 900 others, are victims of a fraud committed by the Alleged Debtor, significantly affects what they are entitled to recover. As a general matter, investors in fraudulent schemes such as that perpetrated by the Alleged Debtor are not entitled to recover what was promised to them in the fraud.[43] The Petitioners clearly disagree. They believe that they are entitled to the full amounts promised them despite the fraud inherent in those promises. This fundamental dispute is controlled by non-bankruptcy law and was due to be resolved by the state court on August 15th.

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[43] *Scholes v. Lehmann*, 56 F.3d 750, 757-58 (7th Cir. 1995)(holding that fraud victim must return amounts paid to him in excess of his investment even though they represented profits promised to him by the fraudster).

52. The Receiver's position is a matter of simple equity. As the Seventh Circuit reasoned in *Scholes v. Lehmann*, when requiring a fraud victim to return falsely-promised profits.

> He should not be permitted to benefit from the fraud at [the other investors'] expense merely because he was not himself to blame for their fraud. All he is being asked to do is to return the net profits of his investment – the difference between what he put in at the beginning and what he had at the end.[44]

The reasoning in *Scholes* has been widely adopted by courts dealing with the aftermath of a large fraud such as that perpetrated here.[45]

53. In cases involving fraudulent life-settlement investments of the type at issue here, courts have routinely refused to allow investors to be paid in accordance with the promises made by the fraudsters but instead limited them to the amount they invested. In *Liberte Capital Group v. Capwil*¸[46] the court was faced with a claim similar to that asserted by Petitioners here. Liberte Capital, like the Alleged Debtor, purchased life-settlement policies. It then solicited investors to "participate" in the policies, matching each investor with one or more policies and falsely promising the investors that they would become beneficiaries under the policies.[47] Upon the death of the insured, the "participants" were promised a certain sum of money based on the death benefit of the policy.[48] One of the policies matured and the "participants" in that policy demanded payment of the amount promised. The court held that the "participants" were not entitled to the amount promised but instead would be limited to a pro-rata share of the estate up to the amount invested.

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[44] *Id.*

[45] *E.g.*, *Donell v. Kowell*, 533 F.3d 762, 773 (9th Cir. 2008)(collecting cases and holding that "payments in excess of the amount invested are considered fictitious because they do not represent a return on legitimate investment activity.")

[46] 229 F. Supp. 2d 799, 803-05 (N.D. Ohio 2002)

[47] *Id.* at 800, 805.

[48] *Id.*

54. The participants in *Liberte Capital* raised two arguments, both of which were rejected by the court. First, they argued that they were able to trace their investment into particular policies and segregated accounts.[49] As a result, they claimed entitlement to the proceeds of those policies to the detriment of the other investors. The *Liberte Capital* court rejected this argument holding that a distribution plan that distributed the assets of the estate unequally among investors was inequitable. The court stressed that the particular policies in which the objectors claimed an interest had been maintained using funds from other investors.[50] The court found that allowing the objectors to elevate their position over other investors whose funds supported the objectors' policies was particularly objectionable.[51]

55. The same is true here. The Alleged Debtor regularly commingled funds among its reserve accounts. It routinely took funds reserved for one policy and used them to purchase another. The prevalence of the Alleged Debtor's commingling makes it impossible to determine whose money was used to purchase which policy. As examples, 81.8% of the money used to purchase policy PLI140 came from accounts other than that associated with the policy; 99.2% of the money used to purchase policy LFG740 came from other accounts; and 82.9% of the money used to purchase policy AXA091 came from other accounts. As in *Liberte Capital*, the use of funds reserved for one policy to acquire other policies makes it inequitable to allow any investor to recover the full contractual amount based on the maturity of any specific policy.

56. Second, the *Liberte Capital* objectors argued that they should receive all of the proceeds of the policies in which they had participated because Liberte Capital had promised that

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[49] *Id.* at 804.

[50] *Id.*

[51] *Id.* at 805.

the objectors would be beneficiaries of those policies.[52] The *Liberte Capital* court rejected this argument finding that despite the promise to make the objectors beneficiaries, the defendants had not actually done so. There was nothing on file with the insurers establishing that the objectors were, in fact, beneficiaries of the policies.[53] Accordingly, the *Liberte Capital* court held that equity precluded the participants from recovering in accordance with their contracts.

57. The same factors are at play here. The Alleged Debtor made similar promises to the Petitioners. It promised to make them (and other investors) "irrevocable co-beneficiaries" under the policies that they participated in but failed to do so. There is no documentation informing any of the insurers that the investors are beneficiaries of the policies. The investors are entirely unknown to the insurers. Thus, the Petitioners (like all of the PLI140 participants) are not entitled to recover the payment promised by the Alleged Debtor. Instead, they are limited to a pro rata share of the estate's assets based on the amount they invested.

58. The court in another case involving a life settlement scam, *SEC v. Tyler*,[54] also found that the assets of the estate should be pooled for the benefit of all investors. Each of the investors in *Tyler* purchased an interest in life-settlement contracts and entered into an agreement with the defendant which provided that the policy would be held in the name of an affiliate with the investor being a unit-holder in the affiliate. Funds were to be escrowed to insure that premium payments would be made during the lives of the insureds.[55] Some of the policies had lapsed prior to the receivership and the receiver allowed other policies to lapse where the

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[52] *Liberte Capital*, 229 F. Supp. 2d at 805.

[53] *Id.*

[54] 2003 WL 21281646.

[55] *Id.* at *2.

premiums owed exceed the return on the policy.[56] The receiver in *Tyler* sought permission to use the proceeds from the sale of policies and any death benefits obtained to pay premiums on other policies which had not yet matured.[57] A number of investors objected arguing that they should recover all of the proceeds of the specific policies in which they had invested.[58]

59. In deciding to pool the assets of the estate for the benefit of all investors, the *Tyler* court expressly rejected segregating the claims of investors based on the investors' ability to trace their funds to specific assets under a constructive trust theory.[59] The court reasoned that

> All of the investors who purchased interests in insurance policies from AFS are in essentially a similar situation as victims of fraud. All received the same "sales pitch" …. All entered into the same agency/policy funding agreement with Trade Partners and the same tri-partite agreements between themselves, Trade Partners and Grand Bank, now known as Macatawa Bank Corp. Finally, all have either lost their individual investments through the lapse of policies or have suffered substantial, if not irreparable impairment of their investments. Under such circumstances the property and assets of AFS, Larry W. Tyler and the relief defendants should be pooled for the benefit of all AFS investors[60]

In so holding, the *Tyler* court relied on general principles of equity equally applicable in Texas courts as set forth by the Fifth Circuit in *SEC v. Forex Asset Management, LLC*.[61]

(B) Texas Law Does not Allow for the Payment of Interest to Creditors of Insolvent Entities in Receivership

60. Even if the Court were to determine that the returns payable to the Petitioners under their agreements with the Alleged Debtor were not fictitious, Petitioners would still not be entitled to the payment of the gain they expected under the agreements. It is well-established in

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[56] *Id.* at *3.

[57] *Id.* at *5.

[58] *Id.*

[59] *Id.* at *5 ("Notwithstanding an individual's ability to trace assets, where such a procedure places one victim in a position superior to that of other victims, equity dictates that tracing rules be suspended.").

[60] *Id.* at *6

[61] 242 F.3d 325, 331-32 (5th Cir. 2001)(affirming pro rata distribution among victims of securities fraud under general principles of equity and Texas law).

Texas that entities in receivership cannot pay interest to their creditors if they are insolvent, as the Alleged Debtor is. Nearly 100 years ago, the Texas Supreme Court wrote:

> For this reason the judgment heretofore directed to be entered will be modified, so as to direct the district court to render judgment for the interveners, Gaston & Ayres, for the principal of the note sued on, with interest as specified in the note up to the date of the judgment, if the company shall be found to be solvent, together with its attorney's fees; but, if said company should be found to be insolvent, then interest should be allowed up to the 14th day of February, 1908, when the receivership proceedings began, and the court is directed to enter judgment accordingly.[62]

This basic tenet of Texas law remains in force today.[63]

61. There is no question that the Petitioners seek the payment of interest. They concede that their investment was in the form of a note by which the Alleged Debtor promised to a pay a sum of money to each investor who invested. For those Petitioners (all but Dunn) who invested through an IRA, the anticipated gain is expressly denominated as interest. Their paperwork (called "Qualified Paperwork") is in the form of a note. It is called a "loan agreement" and describes the investor as a "lender."[64] It provides that the "lender" will "Loan to [the Alleged Debtor] certain funds from an Individual Retirement Account" to be used to enable the Alleged Debtor to "acquire, purchase and be sole owner" of life insurance policies.[65] In exchange, the Alleged Debtor promised that when "maturity occurs due to the passing of the Insured, even if the Insured's passing is prior to the expiration of the calculated LE, the Loan Agreement will result in the Individual Retirement Account receiving a full return of all the

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[62] *Gaston & Ayres v. J.I. Campbell Co.*, 141 S.W. 515, 515 (Tex. 1911)(emphasis added).

[63] *E.g., Huston v. FDIC*, 800 S.W.2d 845, 849 (Tex. 1990)(refusing to allow FDIC to recover interest where neither statute nor common law allowed payment of interest by entities in receivership)

[64] Loan Agreement (Rogers Exh. 39 at 12).

[65] *Id*. at 13.

original Loan amount plus all promised baseline expected interest."[66] The investor would receive "income" in the form of interest.[67]

62. The same is true for Dunn who invested individually by virtue of a Policy Participation Agreement. The Policy Participation Agreement, like the Qualified Paperwork, was a written agreement to pay a sum of money. It provides that the investor (now called a "participant") will provide money to enable the Alleged Debtor "to acquire, purchase and become sole owner of certain re-sale life insurance policies."[68] In exchange, the Alleged Debtor promised that when "maturity occurs due to the passing of the Insured, even if the Insured's passing is prior to the expiration of the calculated LE, Participant will receive a full net disbursement of their original participation plus targeted gains for the full term of this Agreement and will not be paid only a pro-rated partial return."[69] Although not called interest, the expected gain was "paid for the use of your funds during the time contained in the Agreement.[70]" Interest is, of course, defined in Texas law as "compensation for the use, forbearance, or detention of money.[71]" The Alleged Debtor's principal, Wendy Rogers, admitted that the "baseline expected gain" provided by the Agreement was actually interest.[72]

63. There can also be little question that the Alleged Debtor is and has always been insolvent under Texas law. Texas generally applies a balance-sheet test to determine solvency. Thus, an entity is insolvent if the sum of the debtor's debts is greater than all of the debtor's

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[66] *Id.* at 15 (emphasis in original).

[67] *Id.* at 25.

[68] Policy Participation Agreement (Non-Qualified) (Rogers Exh. 33 at 10).

[69] *Id.* at 5 (emphasis in original).

[70] *Id* at 3.

[71] TEX. FIN. CODE § 301.002(a)(4).

[72] Rogers Dep. at 237 (acknowledging that "baseline expected gain" meant interest).

assets at a fair valuation.[73] In making the insolvency determination, the fair value of a debtor's assets is determined by "estimating what the debtor's assets would realize if sold in a prudent manner in current market conditions.[74]" The Alleged Debtor's assets consisted primarily of the insurance policies it purchased with the money loaned to it by the investors as well as $25 million in cash received from investors. It had debts of between $77 million (investment value) and $125 million (contract value).

64. As part of the Receivership Action, the Receiver obtained a solvency opinion from a forensic accountant, Todd Burchett, as well as a valuation of the policies that the Alleged Debtor owned from Scott Gibson, an actuary with substantial experience in the life settlement industry. Gibson opined that the policies were worth between $4.4 million and $7.1 million.[75] Based on his own analysis and on Gibson's opinion as to the value of the policies, Burchett concluded that the Alleged Debtor was currently insolvent and had been insolvent for its operating history.[76]

(C) The Receiver has not Adopted the Agreements by Which the Petitioners Invested in the Alleged Debtor

It is also well-established in Texas that an entity in receivership is not bound by a pre-receivership agreement unless the receiver affirmatively adopts the agreements.[77] Here, the Receiver has not adopted the false agreements by which the Alleged Debtor perpetrated its fraud

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[73] *E.g.*, TEX. BUS. & COMM. CODE § 24.003(a).

[74] In re Erstmark Capital Corp., 73 Fed.Appx. 79, 2003 WL 21756460, at *2 (5th Cir. 2003) (quoting Orix Credit Alliance, Inc. v. Harvey (In re Lamar Haddox Contractor, Inc.), 40 F.3d 118, 121 (5th Cir. 1994)); In re Brentwood Lexford Partners, LLC, 292 B.R. 255, 268 (Bankr. N.D.Tex. 2003).

[75] Retirement Value, however, paid approximately $28 million for these policies. Gibson's reports setting out his analysis of the portfolio were admitted into evidence at the last hearing as Petitioners' Exhibit No. 11.

[76] Burchett Affid. at ¶¶ 7-12.

[77] *Ketch v. Weaver Bros.*, 276 S.W. 676, 677 (Tex. Comm'n App. 1925, holding approved) ("A receiver is not bound by the unperformed contracts of the party whose property is placed in a receivership unless he adopts them").

against the Petitioners and other investor-victims. Instead, the Receiver has repeatedly and consistently taken the position that no investor-victim is entitled to recover in accordance with the Alleged Debtor's false promises but is instead limited to recovery of the amount that he or she invested. As discussed above, the Receiver's position is in accordance with the applicable law of Texas and elsewhere governing recovery from fraudulent schemes.

(D) The Proceeds of Policy PLI140 are Subject to the Claims of Other Creditors

65. The Petitioners are no more entitled to the proceeds of the PLI140 policy then are other victims of the Alleged Debtor. In selling the loans to the Petitioners and other investors, the Alleged Debtor represented that it would set up an escrow arrangement whereby the money loaned towards a particular policy would be segregated for that policy. It also represented that it would make the investors beneficiaries of each policy in which they "participated" or loaned money towards. These representations turned out to be lies. The Alleged Debtor did none of these things. No escrow was created, no funds were segregated, and no investor ever became a beneficiary of a policy.

66. Instead, the Alleged Debtor treated the money received from the investors as a common pool. It routinely commingled investor funds using money loaned towards one policy to pay expenses for another policy. As a result, there is little correlation between what investors were told would be done with their investments and what was actually done with them. It is, therefore, next to impossible to trace any particular investor's investment to any particular policy. Moreover, the commingling and related mishandling of funds caused many reserve accounts to be under funded relative to the Alleged Debtor's promised reserves.

67. For purposes of determining the amount due to the Petitioners, the rampant commingling raises two issues. First, other creditors have claims to the proceeds of the PLI140

policy. Only 18% of the money used to purchase the PLI140 policy came from funds loaned toward that policy. The remaining 82% came from loans made on other policies. As the investors in the other policies paid for the PLI140 policy, they have an equal or greater right to its proceeds. Second, the commingling means that there is more money in the PLI140 account than there is supposed to be. As the Petitioners claim an entitlement to their pro rata share of the remaining premium reserves, the actual amount of the premium reserves will need to be determined and the excess reserves moved to other accounts. That cannot be done without completely unwinding the commingling committed by the Alleged Debtor over the course of a year.

(E) The State Court Prohibited Payment of the Petitioners

68. Pursuant to the Texas Securities Act and the Texas Deceptive Trade Practices Act, the State Court entered a TRO and later a preliminary injunction against the Alleged Debtor. Among other things, the State Court enjoined payments to any person for any reason.[78] The Receiver's ability to make payments to the investor-victims, including the Petitioners, is expressly limited to the payment of "fair restitution" in accordance with a "plan to be approved by the Court after a diligent investigation."[79]

69. Accordingly, *none* of the Petitioners held a non-contingent claim at the Petition Date. The claim of each is subject to bona-fide dispute as to its amount. All of the Petitioners are disqualified from filing the Involuntary and, without at least three (3) qualified petitioners, the Court must dismiss the Involuntary as improperly filed.[80]

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[78] Agreed TI at 4, §II, ¶ 1.

[79] *Id.* at 6, §III, ¶ 4.

[80] Additionally, only one of the four petitioners is actually a creditor of the Alleged Debtor with the standing to file any claim against the Alleged Debtor. Hugh Dunn and Richard Stafford are beneficiaries of an IRA that invested in the Alleged Debtor's scheme, but are not creditors themselves. Yvonne Staley is neither a creditor, nor a beneficiary of an IRA that invested in the Alleged Debtors. She appears to be the spouse of a beneficiary of an

iii. <u>No Applicable § 303(h) Trigger</u>

70. Furthermore, the Court should dismiss the Involuntary, because it cannot enter an order for relief in this case. The Bankruptcy Code only allows the Court to enter an order of relief in this contested Involuntary if:

> (1) the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount; or (2) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.

11 U.S.C. § 303(h). Neither of the statutory triggers for an order of relief is present in the Involuntary, so it must be dismissed.

71. In the Amended Petition, the Petitioners admit that Bankruptcy Code § 303(h)(2)'s trigger does not apply to this Involuntary – the Receiver has been in place for 15 months, so no new custodian has been appointed over the last 120 days before the Petition Date. Still, the Petitioners contend that that the Alleged Debtor "is generally not paying [its] debts as such debts become due, unless such debts are the subject of a bona fide dispute." As explained at length above, this contention is flatly wrong. The Alleged Debtor *is* paying its debts as they come due; furthermore, nearly all of its liabilities are subject to bona fide dispute.

(A) Receiver Paying Debts as They Come Due

72. Throughout the Receivership Action, as authorized and instructed by the State Court, the Receiver has paid all the administrative costs of the Receivership Action as they arose, except for the fee claims of his professionals. The professional fees were paid only upon

IRA that invested in the Alleged Debtor's scheme. At the August 22, 2011 hearing, the Petitioners suggested that this impropriety was cosmetic and that they would easily cure it in 30 minutes or less. Two weeks have passed since that blasé pronouncement and the Petitioners have still not addressed their lack of standing in any fashion.

approval from the State Court and after notice and a hearing.[81] No other amounts came due for the Alleged Debtor during the Receivership Action.

73. This is true despite the fact that there are investors in the Alleged Debtor holding pre-Receivership-Action documents indicating that amounts became due to them during the Receivership Action. As explored at length above, the only liability even arguably going unpaid as it arose during the Receivership Action was the claim of those "participants" in PLI140 to recover the proceeds of that policy's death benefits and those "participants" (including the Petitioners) had no enforceable right to be paid those proceeds at that time.

74. Simply put, fraud has no due date and the investor-victims are all equally entitled to recover their damages from the Alleged Debtor, as they have been since providing money to the Alleged Debtor under false pretenses. The alleged "maturity event" for "participants" in PLI140 changed nothing.

75. Accordingly, in paying the receivership's non-professional administrative expenses as they arise, the Receiver has paid all amounts coming due against the Alleged Debtor during the Receivership Action. Bankruptcy Code § 303(h)(1) provides no basis for the entry of an order of relief. Without that or any other such basis being available, the Court should dismiss the Involuntary.

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[81] The State Court ordered the Receiver "[t]o collect, preserve and maintain the Receivership Assets" until the State Court approves a plan for the use of the Alleged Debtor's assets "under control of the Receiver" "[t]o effect fair restitution if possible" to the Alleged Debtor's investor-victims. While the State Court authorized and required the Receiver to "pay reasonable and necessary expenses incurred in connection with [his receivership] duties out of the receivership estate" and to "advance his own funds, if necessary in his sole discretion, to pay any expense incurred carrying out his responsibilities under the [State] Court's orders and to reimburse himself immediately for any funds advanced," the State Court did not authorize the Receiver to make payments to the Alleged Debtor's defrauded investor-victims until a plan of distribution was subsequently approved.

(B) All Investor-Victim Claims Subject to Bona Fide Dispute as to Amount

76. As set out in detail, above, the amount of all the investor-victims' restitution claims at issue in the Receivership Action are subject to bona-fide dispute as to their amount.

77. Even if the Receiver's inability to pay pre-Receivership-Action claims during the Receivership Action *could* qualify as a failure to make payments when due during the Receivership Action, that lack of payment would not meet the threshold to authorize the entry of an order for relief under Bankruptcy Code § 303(h)(1). The Court still could not enter an order for relief and would still be required to dismiss the Involuntary.

iv. <u>Dismissal in Best Interest of All Involved</u>

78. Bankruptcy Code § 305(a)(1) provides that:

> The court, after notice and a hearing, may dismiss a case under this title, or may suspend all proceeding in a case under this title, at any time if the interests of creditors and the debtor would be better served by such dismissal or suspension….

11 U.S.C. § 305(a)(1). "Section 305(a)(1) requires the Court to consider not only the interests of a particular creditor, but the interests of *all creditors* and the Debtor."[82] Dismissal of the Involuntary is proper because it would serve the best interest of the Debtor and all its creditors, including the Petitioners.

79. For more than thirty years, courts have recognized that the best interests of creditors and debtors are often served by achieving administrative efficiency.[83]

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[82] *In re Uno Broadcasting Corp.*, 167 B.R. 189, 200 (Bankr. D. Ariz. 1994) (emphasis in original).

[83] *In re R.V. Seating, Inc.*, 8 B.R. 663, 665-666 (Bankr. S.D. Fla.) ("To allow the recovery of the alleged debtor's claims … to be eaten up by the expenses of bankruptcy administration would serve the interests of neither the Petitioners nor the alleged debtor. This factor and the adequacy of the remedies available to the petitioning creditor under [state law in a state forum] lead the Court to conclude that the interests of the petitioning creditor and the alleged debtor would be better served by the dismissal of the case.").

80. Here, the Receivership Action has been pending for 15 months. It has afforded parties interested in the administration of the Alleged Debtor's estate the opportunity to participate in its liquidation. No good would be achieved by restarting this process in a second forum at this late date, with all the administrative costs that a bankruptcy would entail. Those unnecessary administrative costs would include those the Alleged Debtor would incur pursuing a plan-confirmation process; they would also include those that an unsecured creditors committee and its professionals would incur at the estate's expense, in order to revisit the same issues that intervening creditors have already vetted in the State Court.

81. Like other courts facing a scenario where an existing forum would allow the efficient conclusion of an entity's liquidation, the Court should dismiss the Involuntary to serve the interests of the Alleged Debtor and its creditors.

v. <u>Bad-Faith Filing of Petition</u>

82. Finally, the Court should consider the Petitioners' bad-faith in filing the Involuntary and dismiss this case. In determining whether the Petitioners acted in good-faith in filing the Involuntary, the Court must examine the totality of the circumstances surrounding their action.[84] In doing so, it should examine "whether the petition was ill advised or improperly motivated" as a subjective matter, "whether the [P]etitioner[s] took affirmative steps to ensure that the petition as filed was proper, and whether the [P]etitioner[s] made sufficient inquiry into the facts and law surrounding the case to determine the total number of claim holders" needed to properly file it.[85] The Court should consider "whether a reasonable person in the position of the [Petitioners] would have initiated the [Involuntary]." Should the Court agree with the Receiver that the Petitioners filed the Involuntary in bad faith, the Court should dismiss the Involuntary

[84] *In re Elsub Corp.*, 66 B.R. 189, 192 (Bankr. D.N.J. 1986).

[85] *Id.* at 196.

and award the Receiver not only his costs and fees in defending the Involuntary, but his actual and punitive damages, as well.[86]

83. The Petitioners filed the Involuntary as a Chapter 7 on the afternoon of the final business day before the Receiver was set to go forward with what would otherwise have been the final hearing of the active portion of the Receivership Action. They did so without ever having objected to the substance of any detail of the Receiver's plan and without having even bothered to intervene in the Receivership Action until after the relevant deadline had passed, despite having had actual notice of the Receivership Action's course for more than a year. They did so despite the Receiver's agreement to let them nonetheless intervene in the Receivership Action to fully participate in the State Court's consideration of his proposed plan, so long as they did not seek to re-litigate issues already decided by the State Court, and without ever so much as asking the Receiver whether he would give them more time to properly prepare to contest the approval of his plan. They did so just hours after discovering that all similarly-situated parties in the Receivership Action planned to support the Receiver's well-grounded plan to pay all investors pro-rata restitution over time. They filed the Involuntary without the participation of a single creditor qualified under the Bankruptcy Code to help propose an involuntary bankruptcy.

84. They claimed in their initial pleadings that they were motivated in filing the Involuntary by the "waste" inherent in the Receiver's State-Court-approved fees and those of his professionals in the Receivership Action. They never explained how these costs could legally be gauged by this Court as wasteful after the State Court's finding that they were reasonable, never identified how they were wasteful, never compared the Receiver's costs incurred to the benefits

[86] *See* 11 U.S.C. 303(i)(2); *In re S. California Sunbelt Dev., Inc.*, 608 F.3d 456, 464 (9th Cir. 2010) (holding that a bankruptcy court may grant judgment against Petitioners for attorneys' fees, costs, and punitive damages for bad faith filing).

he achieved, and seemingly never compared them to the administrative costs of liquidations of comparably sized complex frauds. They never compared the allegedly objectionable cost of finishing a nearly completed Receivership Action to the apparently unobjectionable, additional costs of the Involuntary and a plan-confirmation process. They simply made the bare assertion in a pleading seeking to replace the Receiver with a trustee and obtained an emergency setting from the Court on that basis.

85. Then, on the evening of the final business day before that hearing on their motion to appoint a Chapter 7 "gap" trustee, after the Receiver had objected, they amended their involuntary petition and motion to shift this Involuntary into Chapter 11 and seek the interim appointment of a Chapter 11 trustee under an entirely different, but equally inapplicable, statutory basis. In their amended pleading they continued to claim, erroneously, both that the Alleged Debtor was not paying its debts as they came due and that the appointment of a trustee was required to prevent "waste."

86. Finally, at the hearing on their motion to appoint a Chapter 11 trustee, the Petitioners abandoned any pretense that the Receiver's fees were unreasonable or even subject to second-guessing by this Court, instead focusing their argument exclusively on the contention that the Receivership Action could not go forward because it would supposedly both deny the Alleged Debtor's investor-victims due process for the State Court to complete its liquidation proceedings and because of an alleged lack of finality should the Receivership Action conclude with a State Court order approving a plan of distributions.

87. As set out, above, these contentions are also wrong as a matter of law.

88. Every element of the Petitioners' story smacks of bad faith, from their pattern of timing their repeated shifts of forum or legal theory until last-minute filings, to their

transparently false alleged concern for the costs of the Receivership, expressed while seeking to require the estate to incur even more fees in a second proceeding. Finally and most egregiously, their subjective bad-faith is demonstrated by their current posture. They complain of the State Court's personal jurisdiction over out-of-state investor-victims of the Alleged Debtor's fraud, even while the most active intervenor in the Receivership Action has its offices in Las Vegas, Nevada and as *their own involuntary petition freely admits that all of the Petitioners are residents of Texas subject to the State Court's jurisdiction.* They complain about the potential "collapsing" of the Alleged Debtor's estate to maximize value and allow a 100¢ recovery of restitution to investor-victims, even when three of the four Petitioners would fare worse in purely economic terms in liquidation without such consolidation and when all four would do substantially better if the Receiver's plan were adopted. And they complain that the Receiver has inadequately investigated the potential to maintain the Alleged Debtor as a going-concern, even though the Alleged Debtor is *not* a going concern and has not been one since two separate State agencies and the State Court, at the request of the Attorney General of Texas, enjoined it from doing further business. They claim that the same duped, out-of-state investor-victims that the Receivership Action was filed to protect and who have relied on the Attorney General, the State Court, and the Receiver to obtain a recovery for them would somehow be better served by allowing the fraud to restart, while subordinating those parties' recovery to a new layer of investor-victims.

89. None of these positions is defensible. The Court should dismiss the Involuntary out of recognition of the Petitioners' bad faith in ever filing it.

IV. PRAYER

WHEREFORE, the Receiver respectfully requests that this Court: (i) abstain from adjudicating the Involuntary; or (ii) dismiss it; and, in either case, (iii) grant such other and further relief as the Court deems just and proper.

DATE: September 6, 2011

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on September 6, 2011, a true and correct copy of the attached Answer was served via email through the Bankruptcy Court's Electronic Case Filing System on those parties that have consented to such service and via first class U.S. Mail upon the parties listed below.

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