

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

In re:

WOODBRIDGE GROUP OF COMPANIES, LLC,  
*et al.*<sup>1</sup>

Debtors.

Chapter 11

Case No. 17-12560 (KJC)

(Jointly Administered)

Objection Deadline: April 24, 2018 at 4:00 p.m. (ET)  
Hearing Date: May 1, 2018 at 11:00 a.m. (ET)

**MOTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS  
PURSUANT TO 11 U.S.C. §§ 105(a), 1103(c), AND 1109(b) FOR  
ENTRY OF AN ORDER GRANTING LEAVE, STANDING, AND  
AUTHORITY TO PROSECUTE CERTAIN CAUSES OF ACTION ON  
BEHALF OF CERTAIN DEBTORS AND THEIR ESTATES**

The Official Committee of Unsecured Creditors (the “Committee”) of Woodbridge Group of Companies, LLC and its affiliated debtors (collectively, the “Debtors”) hereby submits this motion (the “Motion”) pursuant to sections 105(a), 1103(c), and 1109(b) of title 11 of the United States Code (the “Bankruptcy Code”) for an order authorizing the Committee, derivatively on behalf of the estates of the MezzCo Debtors and the PropCo Debtors (as defined below), to prosecute certain claims and/or causes of action against the Debtor Funds (as defined below). Attached hereto as Exhibit A is a draft of the complaint against the Debtor Funds (the “Complaint”).<sup>2</sup> The Committee incorporates the Complaint by reference and respectfully refers the Court to the facts, allegations, and causes of action stated therein. In further support of this Motion, the Committee respectfully represents as follows:

<sup>1</sup> The last four digits of Woodbridge Group of Companies, LLC’s federal tax identification number are 3603. The mailing address for Woodbridge Group of Companies, LLC is 14140 Ventura Boulevard #302, Sherman Oaks, California 91423. Due to the large number of debtors in these cases, which are being jointly administered for procedural purposes only, a complete list of the Debtors, the last four digits of their federal tax identification numbers, and their addresses are not provided herein. A complete list of such information may be obtained on the website of the Debtors’ noticing and claims agent at [www.gardencitygroup.com/cases/WGC](http://www.gardencitygroup.com/cases/WGC), or by contacting the undersigned counsel for the Debtors.

<sup>2</sup> Capitalized terms shall have the meanings ascribed to them herein or in the Complaint, as applicable. In the event that this Motion is granted, the Committee reserves the right to revise the Complaint prior to filing.

**Preliminary Statement**

1. At least since August 2012, the Debtors were operated by their founder and principal, Robert Shapiro, as a Ponzi scheme. Investors were often told that they were investing money in particular properties and would have the benefit of security interests and/or mortgages against such properties. In fact, the Debtors commingled investor money on a prepetition basis and used such funds however they saw fit. Mr. Shapiro created a complex web of affiliated companies operating under the umbrella of the Debtors' principal funding entities (the Debtor Funds, as defined below) that included intermediate holding companies (the MezzCo Debtors) and property-owning subsidiaries (the PropCo Debtors).

2. Although certain properties were acquired by the PropCo Debtors, the funds used for these purposes generally had no relation to the loan amounts reflected in the Debtors' books and records. Because the Debtors were operated as a fraud for years, the only certainty from an accounting perspective is how much each investor put into the enterprise and ultimately received out of it, if anything. The putative intercompany liens and claims that allegedly exist between and among the various Debtors are nothing more than fiction. They are reflected on the Debtors' books and records, but have no correlation to reality. Hence, the purpose of this lawsuit is to set aside such intercompany liens and claims so that the assets in the Debtors' estates can be distributed fairly and proportionately to all holders of valid claims.

3. By this Motion, the Committee seeks standing, derivatively on behalf of the estates of the MezzCo Debtors and the PropCo Debtors, to assert any necessary claims and causes of action against the Debtor Funds (together, the "Claims"), as set forth in the Complaint (as it may be revised), in order to (a) avoid the liens and claims of the Debtor Funds against the MezzCo Debtors and the PropCo Debtors pursuant to sections 544 and 548 of the Bankruptcy

Code and applicable state law; (b) obtain a declaratory judgment that any liens and claims asserted by the Debtor Funds against the MezzCo Debtors and the PropCo Debtors are avoided, invalid, and unenforceable; and (c) disallow pursuant to section 502(d) of the Bankruptcy Code the Debtor Funds' liens and claims against the MezzCo Debtors and the PropCo Debtors.

4. The Debtors cannot assert the Claims because they involve intercompany liens and obligations amongst the Debtors. To avoid any actual or potential conflict of interest, the Committee is the proper party to bring the Claims. The purpose of the Claims is to prevent the preferential treatment of certain investor claims over others and thereby benefit all general unsecured creditors. The Claims constitute a substantial and valuable asset of the bankruptcy estates of the MezzCo Debtors and the PropCo Debtors. Hence, the Committee urges the Court to grant standing in favor of the Committee to prosecute the Claims.

#### Jurisdiction and Venue

5. This Court has jurisdiction over this action under 28 U.S.C. § 157(a) and 1334. This proceeding is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2). Venue is proper in this District pursuant to 28 U.S.C. § 1408 and 1409.

6. The statutory predicates for the relief requested herein are sections 105(a), 1103(c), and 1109(b) of the Bankruptcy Code.

#### Background

7. Beginning on December 4, 2017 and on various dates thereafter (collectively, the "Petition Dates"), the Debtors each commenced a case by filing a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Petition Dates for the MezzCo Debtors and the PropCo Debtors are identified on Exhibit 1 of the Complaint.

8. The Debtors are operating their businesses and managing their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. These cases are being jointly administered for procedural purposes pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy Rules”). No trustee or examiner has been appointed in these cases.

9. On December 14, 2017, the Office of United States Trustee appointed the Committee.

10. Prior to December 4, 2017, the Debtors marketed themselves as an organization in the business of buying, improving, and selling high-end luxury homes, and as owning and operating full-service real estate brokerages, a private investment company, and real estate lending operations.

11. As of December 4, 2017, the Debtors’ principal assets consisted of a portfolio of 138 real estate properties in various stages of development or renovation.

12. The “Debtor Funds” consist of Woodbridge Commercial Bridge Loan Fund 1, LLC, Woodbridge Commercial Bridge Loan Fund 2, LLC, Woodbridge Mortgage Investment Fund 1, LLC, Woodbridge Mortgage Investment Fund 2, LLC, Woodbridge Mortgage Investment Fund 3, LLC, Woodbridge Mortgage Investment Fund 3A, LLC, and Woodbridge Mortgage Investment Fund 4, LLC, each of which is a debtor and debtor-in-possession in these cases.

13. Prior to December 4, 2017, the Debtors purported to manage their fundraising operations through Debtor WMF Management, LLC, which directly owns the Debtor Funds. The Debtor Funds raised money from thousands of retail investors (the “Noteholders”)

by selling investments referred to as notes (the “Notes”). The Debtors also sold units in the Debtor Funds to certain investors.

14. As of December 4, 2017, the Debtor Funds were collectively indebted under approximately 9,328 Notes, with a cumulative total outstanding amount of the Notes of approximately \$778,418,972.

15. Each of the Notes is evidenced by an individual promissory note issued pursuant to a loan agreement (individually, a “Loan Agreement”). Pursuant to the terms of each Loan Agreement, each Noteholder loaned a fixed amount to an individual Debtor Fund for the stated purpose of partially funding one of three types of secured loans from such Debtor Fund to an individual mezzanine Debtor (*i.e.*, a MezzCo Debtor) or property-owning Debtor (*i.e.*, a PropCo Debtor). The “MezzCo Debtors” and the “PropCo Debtors” are identified on Exhibit 1 of the Complaint.

16. With respect to each PropCo Debtor, up to three secured loans (collectively, the “MezzCo/PropCo Secured Loans”) were created: (i) a loan from a Debtor Fund to a PropCo Debtor secured by a first lien mortgage on the property owned by such PropCo Debtor, (ii) a loan from the same Debtor Fund to the same PropCo Debtor secured by a second lien mortgage on such property, and (iii) a mezzanine loan from the same Debtor Fund to the entity that owns the sole membership interest in such PropCo Debtor, secured by a pledge of that MezzCo Debtor’s ownership interest in the PropCo Debtor. The MezzCo/PropCo Secured Loans were, in turn, pledged in favor of the Noteholders to purportedly secure the obligations under the Notes.

17. In theory, each MezzCo Debtor or PropCo Debtor used the proceeds advanced from the applicable Debtor Fund to fund purchases or construction of, or

improvements upon, individual real properties. In reality, there was no direct relationship between the amount of money that went from a particular Debtor Fund to a MezzCo Debtor and/or PropCo Debtor and the amount of the MezzCo/PropCo Secured Loans issued in favor of that Debtor Fund. Stated another way, the MezzCo/PropCo Secured Loans are pure fiction, not based on any actual dollars that flowed from a particular Debtor Fund to a particular MezzCo Debtor or PropCo Debtor.

18. Since at least August 2012, the Debtors were operated by their founder and principal, Robert Shapiro, as a Ponzi scheme. The funds received by the Debtors from investors were commingled and used by the Debtors as they saw fit to, among other things, fund operations, distributions to Mr. Shapiro and his friends and family, payments to investors, and the acquisition and development of real estate. The MezzCo/PropCo Secured Loans are one example of the fraud perpetrated by Mr. Shapiro on the Debtors' investors.

19. The Committee has conferred with the Debtors and reached agreement that the Committee is the proper party to assert the Claims against the Debtor Funds given that the Claims involve intercompany liens and obligations amongst the Debtors. The Claims are valuable because they will allow all creditors to have equal status and eliminate any assertion that certain Noteholders are entitled to preferential treatment *vis-à-vis* other unsecured creditors.

20. As demonstrated below, all of the legal requirements for granting the Committee derivative standing to commence and prosecute the Claims have been satisfied.

**Relief Requested**

21. The Committee hereby requests that this Court grant the Committee leave, standing, and authority to prosecute the Claims, derivatively on behalf of the estates of the MezzCo Debtors and the PropCo Debtors. If the Committee proposes to settle any of the

Claims, it will seek further order of this Court or satisfy the procedures and requirements of any chapter 11 plan that may be confirmed and become effective in these cases.

**Basis for Relief**

**A. Standard for Derivative Standing**

22. The Third Circuit has held that sections 1103(c)(5) and 1109(b) of the Bankruptcy Code implicitly authorize a court to grant a creditors' committee derivative standing when the trustee or debtor in possession cannot or will not do so, or when the debtor in possession is unlikely to act. *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 568-69 (3d Cir. 2003) (en banc); *see also In re Exide Techs., Inc.*, 299 B.R. 732, 739 (Bankr. D. Del. 2003) ("Cybergenics makes clear that a bankruptcy court may utilize its equitable powers to grant a creditors-committee standing to pursue avoidance actions"). Thus, bankruptcy courts are empowered to confer standing upon creditors' committees to bring claims and causes of action under section 544 of the Bankruptcy Code, including the Claims that the Committee seeks to bring in the instant cases. *See Cybergenics*, 330 F.3d at 568-69 (holding that creditors' committee had standing to bring a cause of action under section 544 of the Bankruptcy Code).

23. The practice of conferring standing upon creditors' committees to pursue actions on behalf of a bankruptcy estate is also widely followed and accepted in other jurisdictions. *See, e.g., In re Baltimore Emergency Servs. II, Corp.*, 432 F.3d 557, 560 (4th Cir. 2005) (noting that "[u]nder the doctrine of 'derivative standing,' some of our sister circuits allow a creditor or creditor's committee to file an action in bankruptcy court in place of the debtor-in-possession or trustee"); *In re Louisiana World Exposition*, 832 F.2d 1391, 1397 (5th Cir. 1987) ("A number of bankruptcy courts have held that in some circumstances a creditors' committee

has standing under 11 U.S.C. § 1103(c)(5) and/or § 1109(b) to file suit on behalf of debtors-in-possession or the trustee.”); *In re STN Enters.*, 779 F.2d 901 (2d Cir. 1985) (agreeing with those bankruptcy courts that have held that sections 1103(c)(5) and 1109(b) imply a qualified right for creditors’ committees to initiate litigation with the approval of the bankruptcy court); *see also In re Spaulding Composites Co., Inc.*, 207 B.R. 899, 903 (9th Cir. B.A.P. 1997) (finding that “[i]t is well settled that in appropriate situations the bankruptcy court may allow a party other than the trustee or debtor-in-possession to pursue the estate’s litigation.”).

24. A creditor seeking derivative standing must establish the following three elements: (i) a trustee’s refusal or inability to pursue a claim; (ii) a colorable claim; and (iii) permission from the bankruptcy court to initiate the action. *In re Yes! Entertainment Corp.*, 316 B.R. 141, 145 (D. Del. 2004); *Official Comm. of Unsecured Creditors v. Pardee (In re Stanwich Fin. Servs. Corp.)*, 288 B.R. 24, 27 (Bankr. D. Conn. 2002).

**B. The Committee Satisfies the Test for Derivative Standing**

**i. Demand Has Been Made and Debtors Consent**

25. A party seeking derivative standing to commence an action on behalf of a debtor absent the debtor’s consent may obtain authority to do so by showing that: (a) demand was made of the debtor and the debtor unjustifiably failed to bring suit or abused its discretion in determining not to bring suit, or (2) demand would be futile. *STN*, 779 F.2d at 901-904; *In re G-I Holdings, Inc.*, 313 B.R. 612, 630 (Bankr. D.N.J. 2004).

26. Here, the Committee and the Debtors have agreed that the Committee is the proper party to assert the Claims against the Debtor Funds. The Debtors cannot assert the Claims because they involve intercompany liens and obligations amongst the Debtors. To avoid any appearance of a conflict of interest, the Debtors have consented to the Committee bringing the Claims. Further, the purpose of the Claims is to equalize the treatment of creditor claims

against the Debtors Funds and thereby benefit all general unsecured creditors, so it makes sense for the Committee to prosecute the Claims and the Committee is properly motivated to do so.

**ii. The Claims Alleged in the Adversary Proceeding are Colorable**

27. Second, the derivative standing test requires that the Committee show that colorable claims exist against the Debtor Funds.

28. The case law construing the requirement for “colorable” claims clearly provides that the requisite showing is a relatively low threshold to satisfy. *See, e.g., In re Adelphia Communications Corp.*, 330 B.R. 364, 376 (Bankr. S.D.N.Y. 2005) (holding that the requisite standard for presenting a “colorable” claim is relatively easy to meet); *In re America’s Hobby Ctr.*, 223 B.R. 275, 288 (Bankr. S.D.N.Y. 1998) (observing that only if the claim is “facially defective” should standing be denied). Courts have held that, in determining whether a colorable claim exists, the court must engage in an inquiry “much the same as that undertaken when a defendant moves to dismiss a complaint for failure to state a claim.” *In re iPCS, Inc.*, 297 B.R. 283, 291 (Bankr. N.D. Ga. 2003); *see also In re Valley Park*, 217 B.R. 864, 869 n.4 (Bankr. D. Mont. 1998) (holding that the committee “does not have to satisfy the quantum of proof necessary for a judgment in order to show a colorable claim”).

29. Courts have also held that, in determining whether a claim is colorable, the court is not required to conduct a mini-trial. Instead, the court may “weigh the ‘probability of success and financial recovery,’ as well as the anticipated costs of litigation, as part of a cost/benefit analysis conducted to determine whether pursuit of colorable claims are likely to benefit the estate.” *In re iPCS*, 297 B.R. at 291. Thus, the Committee is only required to establish the existence of plausible claims and that the claims to be brought have some value to the debtors, their estates, and unsecured creditors.

30. Here, the draft Complaint includes six Counts, all of which are colorable. All Counts are based upon either (a) the allegation that the MezzCo Debtors, the PropCo Debtors, and Defendants were the instrumentalities of a Ponzi scheme and a fraud perpetrated by Robert Shapiro or (b) the allegation that the MezzCo Debtors and the PropCo Debtors did not receive adequate consideration for the MezzCo/PropCo Secured Loans. Because there was no direct relationship between the amount of money that went from a particular Debtor Fund to a MezzCo Debtor and/or PropCo Debtor and the amount of the MezzCo/PropCo Secured Loans issued in favor of that Debtor Fund, the MezzCo/PropCo Secured Loans are pure fiction, not based on any actual dollars that flowed from a particular Debtor Fund to a particular MezzCo Debtor or PropCo Debtor.

31. Specifically, Counts One, Two, Three, and Four of the Complaint allege that the MezzCo/PropCo Secured Loans and any related liens on and security interests in the MezzCo Debtors' and the PropCo Debtors' assets should be avoided as actual and constructive fraudulent transfers pursuant to sections 548(a)(1)(A) and (B) of the Bankruptcy Code and applicable state law to the fullest extent permitted by section 544(b) of the Bankruptcy Code. Count Five of the Complaint alleges that the MezzCo/PropCo Secured Loans and the liens and security interests granted in the MezzCo Debtors' and the PropCo Debtors' assets in connection therewith should be declared avoided, invalid, and unenforceable. Count Six of the Complaint alleges that the Mezzco/PropCo Secured Loans and any liens and security interests granted in favor of Defendants in connection therewith should be disallowed pursuant to section 502(d) of the Bankruptcy Code.

32. The foregoing Claims are both colorable and have substantial value to the estates. The MezzCo/PropCo Secured Loans are one example of the fraud perpetrated by Mr.

Shapiro on the Debtors' investors. Avoidance of the liens and claims of the Debtor Funds against the MezzCo Debtors and the PropCo Debtors will have substantial benefits for the Debtors' estates and their unsecured creditors by equalizing the treatment of creditor claims across the board.

**iii. The Committee is Seeking Prior Court Approval to Commence and Prosecute the Adversary Proceeding**

33. Finally, the derivative standing test requires that the Committee seek permission from the bankruptcy court to initiate the action. This element is satisfied by the filing of this Motion and the relief requested herein.

**C. Additional Considerations**

34. Other considerations warrant granting standing to the Committee under the circumstances. First, the Committee is the appropriate party to commence and prosecute the Claims because its purpose is to defend the interests of unsecured creditors and to ensure that the assets of the estates are maximized for unsecured creditors. *See, e.g., In re Nationwide Sports Distrib., Inc.*, 227 B.R. 455, 463 (Bankr. E.D. Pa. 1998) (“the purpose of such [unsecured creditors’] committees is to represent the interests of unsecured creditors and to strive to maximize the bankruptcy dividend paid to that class of creditors.”). Pursuit of the Claims on behalf of the MezzCo Debtors’ and the PropCo Debtors’ estates will maximize recovery for all unsecured creditors, which is consistent with the Committee’s objectives and in the best interests of these estates.

35. In addition, the Committee does not expect that the costs and expenses to be incurred in connection with prosecuting the Claims will be excessive compared to the potential benefits for the estates. While litigation costs are one factor to consider, the Committee only needs to provide comfort that the prosecution represents a sensible expenditure of the

estates' resources. *See, e.g., Adelphia Communications*, 330 B.R. at 386. In these cases, the potential benefits of prosecuting the Claims clearly outweigh the costs to be incurred in connection therewith. The Claims, to the extent that they are even contested, are valuable because they will allow all creditors to have equal status and eliminate any assertion that certain Noteholders are entitled to preferential treatment *vis-à-vis* other unsecured creditors.

**Reservation of Rights**

36. The Committee reserves its right to seek authority to commence and prosecute other claims and/or causes of action against the Debtor Funds or other parties, on behalf of the Debtors' estates.

**Notice**

37. This Motion has been served on (a) the Office of the United States Trustee for the District of Delaware; (b) the Debtors and their counsel; (c) counsel to the Ad Hoc Committee of Noteholders; (d) counsel to the Ad Hoc Committee of Unitholders; and (e) all entities that have filed a request for service of filings pursuant to Bankruptcy Rule 2002.

**No Prior Request**

38. No prior application for the relief sought in this Motion has been made to this or any other court in connection with these chapter 11 cases.

**WHEREFORE**, the Committee requests that the Court enter an order, substantially in the form annexed hereto (a) granting the Committee leave, standing, and authority to commence and prosecute the Claims, derivatively on behalf of the MezzCo Debtors' and PropCo Debtors' estates, and (b) providing the Committee such other and further relief as the Court may deem just, proper and equitable.

Dated: April 9, 2018

PACHULSKI STANG ZIEHL & JONES LLP

/s/ Colin R. Robinson

Richard M. Pachulski (CA Bar No. 90073)

James I. Stang (CA Bar No. 94435)

Jeffrey N. Pomerantz (CA Bar No. 143717)

Bradford J. Sandler (DE Bar No. 4142)

Colin R. Robinson (DE Bar No. 5524)

919 North Market Street, 17th Floor

P.O. Box 8705

Wilmington, DE 19899 (Courier 19801)

Telephone: 302-652-4100

Faxsimile: 302-652-4400

E-mail: rpachulski@pszjlaw.com

jstang@pszjlaw.com

jpomerantz@pszjlaw.com

bsandler@pszjlaw.com

crobinson@pszjlaw.com

Counsel for the Official Committee of Unsecured  
Creditors