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IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

In re: CASTLE ARCH REAL ESTATE INVESTMENT COMPANY, LLC; CAOP MANAGERS, LLC; CASTLE ARCH OPPORTUNITY PARTNERS I, LLC; CASTLE ARCH OPPORTUNITY PARTNERS II, LLC; CASTLE ARCH KINGMAN, LLC; CASTLE ARCH SECURED DEVELOPMENT FUND, LLC; and CASTLE ARCH SMYRNA, LLC, Debtors.	Bankruptcy Case No. 11-35082 Bankruptcy Case No. 11-35237 Bankruptcy Case No. 11-35240 Bankruptcy Case No. 11-35242 Bankruptcy Case No. 11-35243 Bankruptcy Case No. 11-35246 Bankruptcy Case No. 11-35241 (Jointly Administered) (Chapter 11) The Honorable Joel T. Marker

OBJECTION TO DISCLOSURE STATEMENT

The Hunt Law Corporation ("Hunt"), a creditor of Castle Arch Real Estate Investment Company, LLC ("CAREIC") by and through counsel, herein objects to the adequacy of the "Disclosure Statement For Chapter 11 Trustee's Plan of Liquidation Dated September 29, 2012" (the "Disclosure Statement") filed by D. Ray Strong (the "Trustee") Chapter 11 Trustee of the bankruptcy estates of CAREIC, CAOP Manager, LLC ("CAOP Manager"); Castle Arch

Opportunity Partners I, LLC ("CAOP I"); Castle Arch Opportunity Partners II, LLC ("CAOP II"); Castle Arch Kingman, LLC ("CAK"); Castle Arch Secured Development Fund, LLC ("SDF") *and* Castle Arch Smytra, LLC. ("CAS"). (Sometimes collectively, the "Debtors.")

BACKGROUND

Hunt is a Utah P.C. operated by David Hunt, a licensed Utah Attorney. In 2007, Hunt law was retained by CAREIC under the terms of a retainer agreement a copy of which is attached hereto as Exhibit "A." Under that agreement, Hunt's compensation was set at $200,000.00 per year. Hunt's services primarily consisted of securities work including, but not limited to drafting private placement memoranda and accompanying documents under which the CARIEC solicited investments and managing required filings with the Securities and Exchange Commission (the "S.E.C.").[1] At no time prior to the filing of bankruptcy was Hunt and officer or director of the Debtors. Hunt was not involved in the cash management of the company except as necessary to provide CPA prepared documents to the S.E.C. with periodic filings. Hunt holds 1,500,000 shares of common stock in CAREIC acquired by Hunt at various times as bonuses or incentives. That stock amounts to slightly more than 5% of the stock in CAREIC. It has never had any value absent the payment of all preferred shares of CAREIC stock. To Hunt's knowledge, there has never been a meeting of the holders of common stock in CAREIC or any proxy solicitation for a stockholder vote.

To the best of Hunt's knowledge, beginning in or about 2008, the business of CAREIC was compromised: (1) by the downturn of the real estate markets; and (2) disputes by and

[1] CAREIC generally employed litigation firms to assist in litigation matters. However, where assistance was needed and outside counsel had not been retained, Hunt would represent CAREIC in litigation matters and/or when requested, would review work of outside counsel and would provide input to the extent information was available to Hunt.

between current and former directors and officers of the Debtors – which continue to be evident in this bankruptcy proceeding. Because of the disputes, to the best of Hunt's knowledge, the Debtors' management took a proactive stance on evaluating the affairs of the Debtors. For instance, in 2009, CAREIC employed counsel (Parsons, Behle & Latimer) to perform "comprehensive internal investigation" of the securities related issues. *See Letter From Brent Baker* (now at Clyde Snow) attached hereto as Exhibit "B." Hunt (as the party who was involved in the S.E.C. filings) co-operated with that investigation and, according to the opinion of outside counsel (who had no reason for bias on the quality of Hunt's legal work) Hunt's work was both competent and necessary. *See Id.*

As is not uncommon with clients in the midst of financial troubles, beginning in 2008, CAREIC's payment to Hunt became irregular. In 2010, Hunt became aware that there may be a dispute regarding the amount of the fees owed him and the validity of the retainer agreement. In June 2010, Hunt filed a Declaratory Action seeking a determination of the validity of the retainer agreement. That action was resolved in December 2010, by stipulation entered into by CAREIC (through independent counsel) and Hunt, which contained compromises on the part of both parties. Judgment pursuant to that stipulation was submitted in December 2011 and executed by the Court in April 2011. Neither the Declaratory Action nor the resolution of it by stipulation reflects undue influence by Hunt on the Debtors. To the contrary, had Hunt had any control of the Debtors, he would have simply directed payment to himself, eliminating the need for a Declaratory Action. Upon entry of the judgment in the Declaratory Action, Hunt domesticated the judgment in Mohave County, Arizona. In March 2011, Hunt filed an attorney's lien against CAREIC property in Tooele that segregated out the amount estimated for work associated with

that property, which was at one point very nearly lost to foreclosure. Thereafter, CAREIC and CAOP I (through management) arranged a transfer of the property from CAREIC to CAOP I. Hunt prepared a rough draft of the document memorializing that agreement at management's request. As part of that transaction, in June 2011, Hunt was paid $55,000.00 for a release of the attorneys' lien.[2]

Hunt continued to advise CAREIC as requested by management, who, at that time, largely consisted of Jeff Austin and Doug Child (with Glen Martinsen as controller). At that time, both Jeff Austin and Doug Child and other past directors and officers were embroiled as defendants in a law suit initiated in New York referenced in the Disclosure Statement as the "Longview Action" *Disclosure Statement* p. 25. Hunt was informed that the management's ability to move forward with the business of the Debtors became nearly impossible. At that point, the Debtors' management decided that third party management of the Debtor could be helpful in both protecting the Debtors and providing an independent party with whom disgruntled officers, employees and creditors could negotiate to resolve claims. A stipulated Motion to Appoint a Receiver was, therefore, filed in the case pending by Hunt against the Debtors. That action was used simply because it provided an inexpensive forum to obtain the relief. It afforded Hunt no advantage in the receivership or thereafter.

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[2] While the Disclosure Statement infers that transfer was gratuitous, the facts, as known to Hunt, are that CAREIC had used $2.9 million in funds from CAOP I to largely resolve a dispute with the creditor holding a $9 million trust deed on the property – both averting foreclosure and reducing the debt of CAREIC. It was Hunt's understanding that the Tooele property did not sell as quickly as anticipated by management and the loan remained outstanding. The transfer of title, as far as it was understood by Hunt at the time was not an effort to be unfair to CAREIC, but was an effort by CAREIC to fairly allocate assets in accord with the financial contributions of CAOP I. Hunt did not make that business decision. He simply made an effort to formulate the agreement in writing. Dealing with this issue, as well as the numerous other litigation issues facing the Debtors was the purpose of ultimately seeking appointment of a receiver for CAREIC.

Trent Waddups, Esq. was appointed receiver in July, 2011 and (without the assistance of Hunt) Mr. Waddups prepared and filed petitions for the Debtors in October 2011. At the request of former director Jeff Austin, Hunt met with bankruptcy counsel to review the likely outcomes of the bankruptcies and the documents that had been filed by the receiver. In November 2011, Hunt agreed to assist Jeff Austin and Greg Martinsen (a C.P.A.) in management of the Debtor-in-possession with the understanding that all the Debtor entities would be represented by competent bankruptcy counsel. After that time, in Hunt's opinion, the bankruptcy suffered from many of the problems of the pre-petition Debtors. The same former director and or employees of CAREIC that had orchestrated litigation against the Debtors (Robert Geringer, Andrew Feola and Longview) became members of the creditors committee and the focus of the creditors committee appeared to be on attacking the Debtor-in-possession rather than resolving disputes or discussing the future of the Debtor.

For the record, during the six months that Hunt was involved in DIP management, the DIP was not unproductive. Indeed, the DIP developed the relationships with "Blackstar/Blackcastle" described in the Disclosure Statement that have, apparently, generated profits approximately $400,000.00. *Disclosure Statement* at pp. 36-37. Those business decisions were decisions made by the DIP, not the Trustee, in a manner consistent with the pre-petition business of CAOP I and II managed by CAREIC. Nonetheless, in April 2012, the DIP agreed to appointment of a Trustee. That stipulation was not because the DIP was engaging in misconduct; but because there was some hope that the appointment of a trustee would stop the expense associated with the creditors committee attacking the DIP and allow for more cost-effective and productive administration of the estates.

Hunt has filed a claim in the amount of $336,449.99. That claim includes the amount of Hunt's judgment (with accrued interest) totaling $307,449.99 that represents the CAREIC's obligation for unpaid fees for services rendered from 2008 through September, 15, 2010. That judgment is secured by the judgment lien filed in Mohave, Arizona to the extent that there is equity in that property. The claim also includes $28,903.00 which is the amount of the unpaid attorney's fees owed to Hunt for services after September, 2010 and before the appointment of the receiver in July, 2011).[3]

THE DISCLOSURE STATEMENT

A. The Law Regarding Adequacy of a Disclosure Statement.

A disclosure statement intended to accompany solicitation of votes on a Plan of Reorganization must be approved by the bankruptcy court as having "adequate information" for a hypothetical investor holding claims or interests in a relevant class to make an "informed judgment" about the Plan. At its core, that simply means that a disclosure statement circulated with a Plan must contain adequate information to permit impacted creditors and shareholders (and/or members of other classes of claimants) to make an informed decision on whether the Plan is in their best interest. H.R. Rep. No 95-5945, 95th Cong 1st Sess. At minimum, the disclosure statement should provide financial information, including an approximation of the value of assets and the amount of the claims against the estate as well as an estimated the cost of the proposed reorganization (administrative fees). *See* 7 Collier on Bankruptcy ¶ 1125 .02[2] (Alan. N. Resnick & Henry J. Sommer Eds. 16th ed. 2010). That financial information permits

[3] The amended proof of claim filed by Hunt (Claim 35-2) inadvertently notes that post judgment services are those performed after September 2011. In fact, the judgment covers fees through September 15, 2010 and services performed after that time are those charged as post-judgment fees.

the creditor/shareholder to estimate what the creditor/shareholder will receive under the Plan. The Disclosure Statement must also provide a liquidation analysis – comparing the cost of pursuing the proposed plan with the costs of liquidation under a Chapter 7. *Id.* Such an analysis permits the creditor/ shareholder to determine whether their interests are best served by supporting the Plan or simply having a case converted to a case under Chapter 7 of the Bankruptcy Code.

B. The Hunt Claim

The Disclosure Statement provides very little narrative about Hunt's claim and no narrative that is inconsistent with the Background as set forth above except as follows: On page 12, the Disclosure Statement says that "CAREIC employed [Hunt] in various roles." In fact, Hunt is a lawyer. And, pre-petition, he was employed solely as counsel for CAREIC. On page 67, the Disclosure Statement states that "Insiders" of the Debtor include officers or directors of the legacy debtors, Hunt and Longview. The Disclosure Statement then declares: "Based on his investigation to date, the Trustee has determined that the Insiders received excessive distributions, engaged in gross mismanagement and breached their fiduciary duties." As a result, the Disclosure Statement concludes that there exist sufficient grounds to "subordinate" the allowed claim of Hunt to all claims against and equity interests in the Debtors. As noted in the Disclosure Statement, the Plan therefore creates a class of "Insider claims" (Class A7) that include Hunt, which are: (a) automatically deemed subordinated to unsecured creditors and equity holders; (b) allegedly not entitled to vote with those classes; and (c) deemed to reject the Plan. *See e.g. Disclosure Statement* pp. 69 -71. There are multiple problems with that approach.

In the first instance, the Disclosure Statement appears to classify Hunt as an "insider" by fiat. The Disclosure Statement does not (and could not) state that, prior to the filing of bankruptcy, Hunt was an officer, director or describe any manner in which Hunt controlled the Debtors in order to qualify Hunt as an "insider" as that term is defined in 11 U.S.C. § 101(31)(B) or any other provision of the Bankruptcy Code. The Disclosure Statement does not explain how his claim is in any way similar to the claims of the other parties deemed to be "insiders" under the Disclosure Statement for purposes of satisfying the requirements of 11 U.S.C. § 1122. Moreover, even if Hunt were an insider, "insider status alone is insufficient evidence for equitable subordination." *Farr v. Phase-I Molecular Toxicology, Inc., et al. (In re PHASE-I MOLECULAR TOXICOLOGY, INC,)* 287 B.R. 571, 581 (D.N.M. 2002). The Disclosure Statement indicates the Trustee believes that an extreme remedy for all "Insider" creditors is appropriate. The claims are not simply to be subordinated to other claims, nor are they to be re-characterized as equity interests. *See e.g. Sender v. The Bronze Group (In re Hedged Investments Association)* 380 F. 3d 1292, 1297-1303 (10th Cir. 2004) (setting forth the grounds for subordination of a claim to another claim and re-characterization of a loan as an equity interest). In this case, the Disclosure Statement indicates that the Trustee has concluded that "Insider claims" should be subordinated to equity interests. Yet the entire substance of the explanation for that conclusion is that the Trustee has determined that Insiders "received excessive distributions, engaged in gross mismanagement and breached their fiduciary duties."

That is an unsubstantiated accusation not a disclosure. As such it pushes the boundary of the Rule 3 of the Utah Standards of Professionalism and Civility, which requires circumspection in the use of hostile, demeaning or humiliating words when addressing an adversary. The

accusation is particularly inappropriate in a disclosure statement that is compiled to be widely circulated to third parties without prior response from the "Insiders." While allegations made inside a court proceeding may be privileged, that does not make circulations of unfounded allegations within a bankruptcy proceeding proper. [4] Further, such an approach, serves no purpose. The Trustee apparently believes that, by announcing his "conclusions" regarding the claims of "Insiders," he can concoct a class of disparate creditors, label them "subordinated insiders" and have them treated as a class of claims subordinated to equity such under a Plan. The Trustee has no such power. To the contrary, equitable subordination is not a vehicle for categorically reordering the priorities of claims in a manner that is contrary to the priorities set forth in 11 U.S.C. § 507. *U.S. v. Noland* 517 U.S. 535, 543 (1996). Equitable subordination is an exception to the priorities set forth in 11 U.S.C. § 507 applied when justified by a particular set of facts. *Id.* at 540. Likewise, 11 U.S.C. § 510(c) requires "notice and a hearing" before a claim is equitably subordinated. If the Disclosure Statement is intended to be notice of the Trustee's objection to Hunt's claim with a request to subordinate that claim, it fails to be at all adequate because it is completely bereft of disclosure of the facts that the Trustee believes support his objection. By the same token, if the hearing on the Trustee's objection is proposed to be at the time of the Plan confirmation, the Trustee is proposing that the confirmation hearing includes an evidentiary hearing on the propriety of subordinating Hunt's claim under either 11 U.S.C. § § 105 or 510(c). Absent that hearing, there will be no way to determine *inter alia* whether the Plan is proposed in good faith and provides Hunt with an amount equal to the

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[4] For the record, Hunt, through David Hunt, asked the Trustee, through Trustee's counsel, what exactly, the Trustee believed Hunt did wrong. Mr. Hunt was told only that the Trustee had not commenced an investigation – but that the Trustee was a forensic accountant and would be able to "find" something.

amount he would receive if the case were a case under Chapter 7. If that approach is taken, the Trustee is electing to pursue the entire confirmation of the Plan with confirmation still contingent upon the outcome of the dispute over Hunts claim. That problem is not unfamiliar to bankruptcy experts, who note, generally, that the "more logical approach to the classification of an equitably subordinated claim would be to classify the claim as it would be classified but for the subordination problem." 7 Collier on Bankruptcy ¶ 1122.03[3][d][iii].

This is not a case wherein it appears that the amount of the Hunt claim promises to unfairly skew the vote of any class. Disclosing, classifying and treating the Hunt claim in a manner consistent with the filing of the claim, while describing any alleged grounds for subordination, would have done no harm to the estate – but would have saved Hunt and the estate the expense of debating the issue in the context of the Disclosure Statement or Confirmation of the Plan. Absent that common sense approach, the Trustee is bound to provide adequate information in the Disclosure Statement to permit Hunt to respond and prepare for a hearing on the validity of his claim in the context of the confirmation hearing.

C. Financial Information.

Assuming that Hunt were classified as a secured/unsecured creditor in accord with his filed claim, the Disclosure Statement provides Hunt (and similarly situated creditors) almost no financial information with which to determine whether the Plan is in his best interest. As a starting point, the premise of the Plan is that the financial records of the Debtors were in such disarray that all of five of the seven Debtor entities must be substantively consolidated but two (CAOP 1 and CAOP II) need not be included in the consolidation. As a logical proposition that seems tenuous. As a financial proposition, the Debtors consistently employed CPAs, including

the controller of the Debtors who was employed in 2009 and continues to work for the Trustee. While the Trustee may not wish to vouch for the Debtors' financial records or may wish to point out where he believes they are incorrect, financial records regarding the assets and liabilities of each Debtor (including inter-company obligations) existed. Hunt does not believe that they necessarily reflect that all of the creditors of all of the entities are entitled to the same distribution. It may be, with that information in hand coupled with the costs of pursuing other avenues, creditors and shareholders would vote for the Plan. Without any financial information (other than the Trustee's conclusion that the books and records are confused beyond repair) no creditor or equity security holder can conclude whether consolidation is in their best interest (and counsel for at least two of COAP I and COAP II have apparently concluded that it is not).

Likewise missing is any financial information regarding the cost of executing the Plan after confirmation. Indeed, the entire premise of the Plan is that the cash of Debtors (meaning the Debtors other than CAOP I and CAOP II) will be transferred into "Reserved Funds" to pay claims under the Plan. Patently missing is any disclosure of even an estimate as to the amount of the Reserved Funds.. The Trustee knows what amount of money comes into the estate of each of the Debtors and from what source it is generated, which should give him some ability to project a minimum amount the Trustee anticipates will be in the Reserved Funds at confirmation. At the same time, the Disclosure Statement fails to disclose the cost incurred in administration of the estate since the filing of the bankruptcy that are to be paid out of the "Reserved Funds." That information is available to the Trustee and should be disclosed. Moreover, the Disclosure Statement indicates that "Post-Effective Date Administrative Costs" (meaning costs of administration after confirmation of the Plan), will be paid from the Reserved Funds. The

Disclosure Statement does not, however, provide an estimate of the amount of administrative fees that will be incurred after confirmation and paid from the Reserved Fund. It is certainly fair to place qualifications and reservations for unexpected events that occur, *inter alia*, in the course of litigation. It could also be true that the costs of administration under the existing management team may exceed amounts that a Chapter 7 Trustee (operating under a presumed cap set forth in 11 U.S.C § 326 with professionals fees subject to bankruptcy approval). There is no way for a creditor to make an informed judgment on that topic unless there is some proposed budget for management and professionals (including the "Conflicts Referee"[5] who is proposed to be employed and paid by the estate).

Indeed, totally absent from the Disclosure Statement is any liquidation analysis. The Trustee concludes that, in the event that Plan is not confirmed all of the Debtors will be converted to Chapter 7 bankruptcy proceedings, which will all be administered separately and will distribute less money. The question remains: Upon what numbers is the Trustee relying upon to reach that conclusion? Again, a disclosure statement is the place to disclose information not simply conclusions.

In short, the Disclosure Statement as filed is long on opinion and short on facts. The Trustee is not prescient and he is not expected to guaranty the future. At the same time, he is not without tools for disclosure of financial information. Hunt is informed that the Trustee is a

[5] The Disclosure Statement is also less than clear on how the "Conflict Referee" is to function. There are clearly claims by and between the Debtors that have not been resolved under the Plan, but the Trustee remains manager of the consolidated Debtors and CAOP I and II after confirmation. How the "Conflict Referee" is to resolve, for instance, a dispute between the Trustee as manager of the consolidated Debtors and the Trustee as CAOP I is, at best, unclear. Is the Trustee to present both sides of that dispute to the "Referee"? If a settlement agreement is to be negotiated: What side is the Trustee to take? While that Disclosure Statement continues to refer to the Trustee, as "Trustee" post-confirmation, it is unclear how he can possible be a true fiduciary of all entities given the disputes between the Debtors.

C.P.A. and he works with a C.P.A. firm . This is not a bankruptcy proceeding with insignificant assets. The unanswered question is whether there is a reason to continue the efforts to "reorganize" the Debtor under the Trustee's proposal. The Disclosure statement contains insufficient financial information from which creditors or shareholders of each of the Debtors can make an informed determination on that point.

CONCLUSION

Based upon the forgoing points and authorities, Hunt respectfully requests that the Court hold that the Disclosure Statement does not contain adequate information to permit the Disclosure Statement to be circulated for the purpose of soliciting votes to the "Chapter 11 Trustee's Plan of Liquidation."

DATED this 26th day of November, 2012.

COHNE, RAPPAPORT & SEGAL, P.C.

/s/ Julie A. Bryan
Julie A. Bryan

CERTIFICATE OF SERVICE

I hereby certify that on the 26th day of November, 2012, the foregoing was filed with the Court and served via the Court's CM/ECF system upon all parties that receive electronic notice in the above-captioned, jointly administered bankruptcy case including but not limited to:

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