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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

SANTA ANA DIVISION

In re JAMES C. GIANULIAS, Debtor and Debtor-in-Possession.	Case No. 8:08-bk-13150-RK Jointly Administered With: Case No. 8:08-bk-13151-RK Chapter 11
CAMEO HOMES, a California corporation, Debtor and Debtor-in-Possession.	**MOTION FOR ORDER SUBSTANTIVELY CONSOLIDATING CHAPTER 11 ESTATE OF CAMEO HOMES INTO CHAPTER 11 ESTATE OF JAMES G. GIANULIAS; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF**

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RELATES TO BOTH DEBTORS

[DECLARATIONS OF SHAWN CONERTY, WILLIAM N. LOBEL AND RON GREENSPAN IN SUPPORT FILED SEPARATELY]

HEARING:
Date: December 3, 2008
Time: 2:00 p.m.
Place: Courtroom 5D
411 West Fourth Street
Santa Ana, CA 92701

James C. Gianulias ("Gianulias") and Cameo Homes, a California corporation ("Cameo"), the debtors and debtors-in-possession in these jointly-administered cases (collectively referred to herein as the "Debtors"), hereby move this Court for an order granting the following relief:

A) Substantively consolidating the Chapter 11 estate of Cameo (Case No. 08-bk 13151 RK) into Gianulias' Chapter 11 estate, as of June 6, 2008; and

B) Granting such further relief as the Court deems just proper.

This motion is made on the basis of the accompanying declarations of Shawn Conerty (the "Conerty Decl."), William N. Lobel (the "Lobel Decl.") and Ronald Greenspan (the "Greenspan Decl."), and the within Memorandum of Points and Authorities.

DATED: November 7, 2008

IRELL & MANELLA, LLP

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I

PRELIMINARY STATEMENT

Gianulias has been in the real estate development and construction business for forty years, building thousands of homes and apartment units throughout California, including the signature developments of Cameo Shores and Cameo Highlands along Pacific Coast Highway. To facilitate his development efforts, Gianulias has formed more than fifty separate legal entities. However, one entity is at the center of this corporate network – Cameo.

Gianulias founded Cameo in 1968 and he remains its sole stockholder. Although he no longer holds the chief executive post at Cameo, Gianulias held this position for over thirty-five years and he still serves as the chairman of Cameo's board of directors. Over the past forty years, Cameo has played an integral role in substantially every Gianulias development project. These roles include general partner, managing member, co-member, general contractor, capital source, agent and temporary corporate placeholder.

The longevity of the relationship between Gianulias and Cameo, and Gianulias' continuous utilization of this entity as a corporate partner in deal after deal has led to high degree of integration between their financial affairs. This integration is reflected in the form of shared legal relationships, shared ownership interests, shared liabilities and an inter-party history of thousands of exchanges, both formal and informal, relating to their mutual business affairs.

As part of their respective plan development efforts, the Debtors and their professional advisors have analyzed the integrated web of relationships and shared interests binding the Debtors together, and they have weighed the costs and benefits associated with attempting to separate, value and allocate these intertwined attributes. This analysis has led to the following conclusions:

1. The Debtors' *share* liability for approximately eighty percent of the claims (determined by amount) against their respective estates;
2. Substantially all of the claims against the Debtors' estates arise from guarantees relating to the same development projects;

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3. The value of the Debtors' assets is tied to the success of many of the same development projects;
4. Any effort to allocate assets and liabilities between the estates would be difficult, if not impossible, would be artificial, based on arbitrary assumptions, and could generate a plethora of inter-estate disputes;
5. Significant additional costs will be incurred if the two cases proceed separately, substantially reducing the distribution payable to all creditors;
6. Substantive consolidation will eliminate the foregoing problems, dramatically reduce costs and generate a more attractive and fair result for all creditors; and
7. Substantive consolidation will increase the value of the assets in the estate by vesting control of certain projects in a single entity, thereby creating a "control premium."

In addition to these facts, there are "case level" legal and ethical reasons which militate in favor of consolidation, including the conflicts inherent in the maintenance of a single creditors' committee for two bankruptcy cases. The creditors committee and its counsel are fiduciaries.[1] As a matter of law they *cannot* serve two masters, with conflicting claims. *Woods v. City Nat. Bank & Trust Co. of Chicago,* 312 U.S. 262, 268, 61 S.Ct. 493, 85 L.Ed. 820 (1941) ("Only strict adherence to these equitable principles can keep the standard of conduct for fiduciaries 'at a level higher than that trodden by the crowd'.").[2] As more fully explained herein, if the two estates remain separate, Cameo will be compelled to form a separate committee and to employ separate counsel and a separate financial adviser. The duplicative costs associated with this course of action would be substantial.

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[1] "A creditors' committee stands as a fiduciary to the class of creditors it represents. Its principal function 'is to advise the creditors of their rights and the proper course of action in the bankruptcy proceedings.' " *In re Caldor, Inc.-NY,* 193 B.R. 165, 169 (Bankr. S.D.N.Y. 1996) (citations omitted). The Bankruptcy Code grants committees the power to employ professionals. 11 U.S.C. § 1103(a). A professional employed to represent a committee "may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case." 11 U.S.C. § 1103(b).

[2] In *Woods*, the court denied compensation even though there was no showing of harm. The existence of a conflict was sufficient by itself.

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Further, this split will compel the resignation of existing committee counsel, since a part of counsel's constituency will be split off, leaving counsel in possession of confidential information and holding a position of actual conflict. Cal. Rule Prof. Conduct 3-310[3]; *Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1255 Fn. 7 (5th Cir. 1986) ("The court should be guided by the principle that court-appointed attorneys are officers of the court, and fiduciaries (cite omitted), and the court must strictly apply the equitable principle that a fiduciary can only serve one master.").[4]

In summary, the financial and legal benefits that will result from substantive consolidation are both significant and undeniable. In contrast, the problems associated with separate reorganization efforts will be costly, complicated and avoidable. Given these facts, effectively merging the smaller Cameo Homes' estate into the financially dominant Gianulias estate is in the best interests of the creditors of both estates.

Although the case for consolidation is compelling, Cameo and Gianulias have incorporated into the proposed relief a condition that will eliminate any good faith objection premised upon a valid claim of harm asserted by a creditor: All creditors will receive a dividend equal to or greater than as much as they would receive without consolidation. Further, although this consolidation is being proposed for purposes of bankruptcy, it is not intended to impact or revise the taxation standing of either entity, thus, it will not have any tax impact on either estate as a result of consolidation. Finally, the consolidation will not impact or erase any intercompany claims. *In short, no one will be harmed and all will benefit if the relief is granted.*

In the Ninth Circuit, substantive consolidation will be authorized where the creditors dealt with two debtors as a single economic unit and did not rely upon their separate identity

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[3] This conflict exists now and it cannot be waived by counsel or the members of the committee. It can only be solved through consolidation.

[4] Although this issue is for the Court, the U.S. Trustee and the unsecured creditors to resolve, the Debtor would note that the U.S. Trustee has mentioned to counsel for Gianulias that consolidation would seem the prudent course. Further, a resolution of this kind of ethical problems along clear lines is always in the best interests of all involved, since it will avoid the risk of future litigation by the parties.

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when extending credit or where the affairs of parties are so entangled that consolidation will benefit all creditors. *In re Bonham*, 229 F. 3d 750 (9th Cir. 2000). In this case, both of these tests are satisfied and all of the equities militate strongly in favor of this relief.

II

BACKGROUND

A) Introduction. Gianulias has been in the real estate development business for forty years. *Conerty Decl. ¶ 7.* During this time, the development entities that Gianulias owns and controls have constructed thousands of homes and apartment units throughout California. *Conerty Decl. ¶ 7.* As of the petition date, Gianulias held controlling interests, directly or indirectly, in over twenty separate entities involved in the development, ownership or management of real property assets. *Conerty Decl., Ex. "1."*

Cameo was one of the first business entities formed by Gianulias when he started in the development business forty years ago, and it has played an integral role in substantially every Gianulias development. *Conerty Decl. ¶ 8.* Decades of interrelated business transactions, and a web of common ownership interests and shared assets and liabilities bind these two debtors together. *Conerty Decl., Ex. "3."* Substantive consolidation would merely complete this integration and allow Gianulias, the dominant member of this forty year relationship, to complete their common business objectives and solve their common financial problems through a singular and cost effective reorganization effort.

B) The Chapter 11 Filings. In late 2006, residential real estate prices began to decline. *Conerty Decl. ¶ 11.* This trend accelerated in 2007, with the collapse of the subprime mortgage industry. *Conerty Decl. ¶ 11.* By 2008, there was a severe glut of residential product in Southern California and home prices had fallen, on average, by over twenty percent. *Conerty Decl. ¶ 11.*

When the foregoing conditions developed, Cameo and Gianulias were heavily invested in a series of ongoing residential projects. *Conerty Decl. ¶ 12.* The collapse in prices and consumer demand rendered much of this inventory unsalable, leaving Cameo and Gianulias with massive debt service obligations, but limited revenues and cash flow. *Id.* Although Cameo and

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Gianulias attempted to obtain additional capital to mitigate these problems, these efforts were largely unsuccessful due to the state of the credit markets and the number of real estate projects seeking funding. *Conerty Decl.* ¶ *12.*

On June 6, 2008, three creditors holding delinquent claims filed involuntary Chapter 7 petitions against Gianulias and Cameo. *Conerty Decl.* ¶ *13.* On July 2, 2008, Cameo and Gianulias consented to the relief in these petitions and converted their cases from Chapter 7 cases to Chapter 11 cases. *Conerty Decl.*¶ *14.* On July 25, 2008, the United States Bankruptcy Court entered an order administratively consolidating the Debtors' Chapter 11 cases in order to reduce costs and promote administrative efficiencies. *Conerty Decl.,* ¶ *15.*

C) **The Structure of Mr. Gianulias' Real Estate Business**. Gianulias vested title to each new development project in a separate ownership entity – either a limited partnership or a limited liability company (the "Project Level Entity"). *Conerty Decl.* ¶ *16.* Cameo was typically assigned a small ownership interest in each Project Level Entity and installed as the general partner or managing member. Gianulias (or other related parties/entities) would hold the balance of the ownership interests as either a limited partner or a non-managing member. *Id.*

Cameo's role as the general partner or managing member of the Project Level Entities was limited. Actual control remained with Gianulias, as Cameo's president and sole shareholder, until March 2007, when Gianulias relinquished his role as president. *Conerty Decl.* ¶ *18.* The day-to-day business affairs of the Project Level Entities were managed by another corporation owned and controlled by Gianulias, G Companies Management, LLC ("G Company"), or one of its subsidiaries (collectively the "G Companies").[5] *Conerty Decl.* ¶ *2-4.*

With the development of the securitized loan markets, the ownership structure of the Project Level Entities became somewhat more complex. *Conerty Decl.,* ¶ *19.* Each new Project Level Entity was structured as single purpose entity[6] ("SPE"), and a second SPE was typically

[5] With the exception of property management, which is performed by Mesa Management, Inc., another entity wholly owned by Mr. Gianulias, all management, accounting and other financial functions within Mr. Gianulias real estate business are performed by the G Companies.

[6] These covenants limit, inter alia, the scope of activities that the entity can perform, restrict the entity's ability to incur debt and restrict its ability to file a bankruptcy proceeding.

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inserted into the ownership chain. *Conerty Decl., ¶ 20.* This second entity served as the control entity (the managing member or general partner) for the Project Level Entity owning the underlying assets. *Conerty Decl. ¶ 20.* Cameo would then serve as the control entity for this SPE, holding a small percentage interest, with Gianulias and his affiliates owning the balance of the equity interests. *Conerty Decl. ¶ 20.*

III

THE DEBTORS WERE TREATED AS A SINGLE ECONOMIC UNIT BY SUBSTANTIALLY ALL OF THEIR CREDITORS.

Funding for the Project Level Entities came from two primary sources. *Conerty Decl. ¶ 22.* The equity component was provided by either Cameo or Gianulias: The funding choice between these parties depended, in part, upon which party had the necessary cash when the acquisition was made. *Conerty Decl., ¶ 21.* The debt component was provided by one or more institutional lenders and it was secured by either a first or second priority lien on the project within the entity being funded. *Conerty Decl., ¶ 21.* Exhibit "2" to the Conerty Declaration summarizes the debts against the Project Level Entities on a per entity basis, prior to any reduction as a result of foreclosure.

A substantial number of the lenders that provided financing to the Project Level Entities insisted that Cameo and Gianulias guarantee their obligations. *Conerty, ¶ 22.* The claims from this creditor constituency against Gianulias total approximately $135 million. *Conerty Decl. ¶ 24.* These claims comprise eighty-eight percent of the total claims against his estate. *Conerty Decl., ¶ 24.* The claims from this constituency against Cameo total approximately $117 million and they comprise ninety-three percent of the claims against Cameo's estate. *Conerty Decl., ¶ 25.* Since substantially all of the guarantee claims filed against Cameo's estate are co-guaranteed by Gianulias, Cameo's claims base is effectively a subset of Gianulias' claims base. *Conerty Decl. Ex. "3."*

The creditors who obtained guarantees from Cameo and Gianulias did not delineate what part of each claim was being guaranteed by Gianulias and what part was being guaranteed by Cameo, or otherwise take any action that would suggest they relied upon the separate credit or

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status of either entity. *Conerty Decl., ¶ 27.* To the contrary, the evidence confirms that these claimants viewed Cameo's and Gianulias' assets and liabilities *as a common and obligatory recovery pot*, in the event of nonpayment, since they made no effort to allocate their debts between the two obligors. *Conerty Decl. , Ex. "3."*

The guarantee claimants' decision in this regard was intentional. They were fully aware of the close relationship between Gianulias and Cameo and they made no effort to change this state of affairs, or to otherwise restrict how these parties conducted business prospectively. *Conerty Decl., ¶ 30.* In summary, the major creditors of the two estates did not rely upon the separate credit of either Gianulias or Cameo when deciding whether to advance funds. To the contrary, they treated the Debtors as a *"single economic unit,"* which satisfies the first of the two alternative tests necessary for substantive consolidation relief in this Circuit. *In re Bonham*, 229 F. 3d at 766 (9th Cir. 2000).

IV

THE DEBTORS' AFFAIRS ARE ENTANGLED AND CONSOLIDATION WILL BENEFIT ALL CREDITORS

A) **The Debtors' Assets Are Intertwined**. Gianulias owns equity interests in twenty-seven (27) Project Level Entities. *Conerty Decl., ¶ 29; Ex. "2"*. These entities own four mixed use projects, eight stabilized commercial/retail projects, one commercial/retail project in the lease-up stage, eight stabilized multifamily projects, three multifamily projects in the construction and/or lease-up stage, and three multifamily land development projects. *Id.* Cameo owns equity interests in fifteen (15) Project Level Entities. Gianulias and Cameo share ownership interests in thirteen (13) of these Project Level Entities (the "Shared Interests"). *Conerty Decl., ¶ 30.* Accordingly, the Cameo estate holds an interest in approximately fifty percent of the Project Level Entities within the Gianulias estate and the Gianulias estate holds an interest in approximately 90% of the Project Level Entities within Cameo estate. *Conerty Decl., ¶ 30*

Although the Debtors are still analyzing the value of the equity ownership interests within the two estates, specificity with respect to the value of the Shared Interests versus the

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individually owned assets within each estate, is not necessary to establish the two estates' common interest in substantially the same asset pool. As more fully detailed herein, the Debtors' share over $100 million in contingent guarantee liabilities. The ultimate amount of these liabilities will be determined by the value of Project Level Entities, since it is this value that will either retire the primary debt backed by these guarantees, or leave a deficiency. *Conerty Decl.*, ¶ *31*. Accordingly, the success or failure of the two reorganization efforts is tied to essentially the same core assets.[7]

B) Consolidation Is Necessary To Realize The Value of The Shared Interests. Five of the Project Level Entities in which Gianulias owns a substantial ownership interest hold projects that are in the construction or lease-up stage. *Conerty Decl.*, ¶ *32*. Both Gianulias and Cameo have guaranteed the obligations secured by these assets. *Conerty Ex. "3."* Accordingly, their estates have a common interest in maximizing their value. To achieve this objective, Gianulias and his team of development and construction professionals will have to continue working on the projects. *Conerty Decl.*, ¶¶ *33-34*.

Outside of a bankruptcy proceeding, Gianulias and his development team could perform the required work without interference and delay. Performing this work within the bankruptcy process is more complicated. The process will require consultations, reviews and in some circumstances court approval. When a second committee is formed, and as indicated above it must be formed if the estates remain separate, the executive process will become even more attenuated. Management will have to work with two sets of financial professionals and two sets of lawyers, and it will have to consider two viewpoints, which may be very different in outlook. The potential for delay, additional cost and conflict in such an arrangement is obvious. In contrast, consolidation will allow the creditors to benefit from the efficiencies and cost savings

[7] This Motion, however, will not modify the existing rights of the Debtors with respect to the abandonment of assets. The assets currently held by Gianulias' estate will continue to be subject to abandonment on the same basis as if they continued to be part of an individual bankruptcy estate and not affected by the consolidation for this purpose. Similarly, the assets currently held by the Cameo estate will not be subject to abandonment as a result of the consolidation.

inherent in a single chain of command that that interfaces with a single committee, a single financial professional and a single lawyer.

C) **The Debtors' Liabilities Are Intertwined**. Ninety-three percent of the liabilities against Cameo's estate are attributable to guarantee claims and eighty-eight percent of these claims are co-guaranteed by Gianulias. *Conerty Decl., ¶ 26.* Eighty-eight percent of the claims against Gianulias' estate are attributable to guarantee claims and seventy-six percent of this total is co-guaranteed by Cameo. *Conerty Decl., ¶ 25.* These claims are based upon guarantees issued by the Debtors to secure obligations incurred by the Project Level Entities. Accordingly, on a percentage basis, there is a high degree of congruence between the claims being asserted against the two estates and the fate of these claims is tied to the same shared asset base. *Ex. "3", Conerty Decl.*

D) **The Debtors' Legal Affairs Are Intertwined**. Cameo and Gianulias have been doing business together for forty years. Cameo has served as Gianulias' corporate shield, co-partner, co-member, co-obligor and corporate stand-in a host of deals and both parties continue to hold common interests in thirteen of the Project Level Entities. The parties' past and present relationships can and will create complicated and disputatious distribution issues unless consolidation is ordered. To provide a few significant examples:

1. Cameo's Corporate Indemnity Rights. Cameo serves as the general partner or managing member of the Project Level Entities with the Shared Interests, or it serves this role in the SPE that is one level up the corporate chain. *Conerty Decl., ¶ 35(a).* Substantially all of these entities include provisions in their operating agreements (or limited partnership agreements) requiring the corporate entity to indemnify the manager or the general partner against any liability arising from external claims, including guarantee claims. *Id.* Although the subrogation and contribution waivers in the lender guarantees may bar claims between Mr. Gianulias and Cameo based upon their guarantee liabilities, these waivers would not bar Cameo's claim against the corporate entities where it serves as manager, if these entities did not guarantee the primary liability. *Id.* Indemnity claims of this nature could have a material affect upon the flow of funds to the Debtors' estates from the Project Level Entities, since these claims

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would have to be paid in full before any funds were paid out on account of Gianulias' equity position. *Id.*

Cameo could also assert indemnity claims against the Project Level Entities (or against the SPE one level up on the corporate chain) for homeowner claims, vendor claims, and other project level claims asserted against Cameo. *Id.* Once again these indemnity claims would have a higher priority than Gianulias' equity level claims, leaving Cameo's estate with an effective distribution priority. *Id.*

2. Gianulias' Corporate Indemnity. Gianulias could assert claims against Cameo, in his capacity as an officer and director of Cameo, under a similar corporate indemnity provision to that described above. *Conerty Decl., ¶ 35(b).* Moreover, as of the Petition Date, Cameo owed Gianulias approximately $9.9 million under the complicated inter-company balance of payments account between the two parties. *Id.* Although consolidation will not eliminate these inter-company claims, it will provide the Debtors with a means of addressing these claims while avoiding disputes between the estates that might materially affect the distribution rights of creditors.

3. Inter-Debtor And Third Party UFTA Claims. Cameo's ownership interest in the Project Level Entities, where Gianulias and Cameo hold shared interests, is typically less than eight percent. *Id.* In contrast, Gianulias' ownership interest, either directly or indirectly is generally in excess of fifty percent. *Conerty Decl., ¶ 35(c).* However, both parties executed the same guarantee and incurred the same liability. The creditors of Cameo that provided goods and services to this entity may seek to set aside the guarantee claims based upon California Civil Code 3439.01 et. seq. as fraudulent transfers, given the disparity between the liability incurred and Cameo's relative ownership in the underlying Project Level Entity. Litigation of this nature could consume substantial sums of money and substantially delay both reorganization efforts; and

4. Inter-Debtor Preference Claims. Cameo and Gianulias are both "insiders" inter se, as that term is defined in 11 U.S.C. § 101(32). Accordingly, all transfers made by either party to the other within the past year, out of the ordinary course, are potentially recoverable

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preferences. A review of the inter-company account between the parties reveals over $4.4 million of such claims. *Ex. "5", Conerty Decl.*

Although consolidation will not eliminate these inter-company claims, it will provide the Debtors with a means of addressing these claims while avoiding disputes between the estates that might materially affect the distribution rights of creditors and will yield a more attractive and expedited distribution for all creditors.

E) <u>The Costs of Retaining Separate Estates Would Damage All Creditors</u>. The costs associated with preserving two separate estates in this case would be substantial. The most obvious and significant cost variable would be the additional time and expense incurred in the design, preparation and filing of two separate reorganization plans and two separate disclosure statements, and the additional time and expense associated with obtaining approval of the same. Since these plans will be endeavoring to maximize the value of many of the same assets and to pay substantially the same creditor constituency (at least the extent of ninety percent of the assets and liabilities), the additional seven figure price tag associated with this course of conduct is pure waste. The better course is to grant consolidation through an order that mitigates any potential prejudice to those objecting creditors (if any) who can establish that they relied upon the separate credit of either of the Debtors, and who can further establish that they would suffer prejudice through consolidation.

F) <u>The Creditors Will Substantially Benefit From Consolidation</u>. The Debtors weighed the costs and benefits of preserving separate estates as opposed to consolidating the same. This analysis establishes that the benefits of consolidation, from a financial perspective[8], are significant for two primary reasons. First, consolidation will vest a controlling interest in six Project Level Entities of particular value. This "control premium" has a significant value that can only be realized through consolidation. *Greenspan Decl.* Second, the reduced costs resulting

[8] The Debtors' tax professionals have analyzed the potential tax implications of substantive consolidation and concluded that consolidation for bankruptcy case purposes has no effect on tax treatment on each individual estate, and therefore will be a tax "neutral" event.

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from consolidations will improve cash flow, allowing the Gianulias estate to make a larger percentage distribution to all creditors than would otherwise be possible.

G) **Summary of Facts Supporting Consolidation**. The evidence filed herewith establishes the following material facts:

1) The guarantee claims against Gianulias' estate arising from the Project Level Entities are estimated to be $135 million *Conerty Decl., Exhibit "3"*;

2) The guarantee claims against Cameo arising from the Project Level entities are estimated to be $117 million;

3) The claims co-guaranteed by the two estates are estimated to be $103 million – or approximately 76% of the claims in Gianulias estate and eighty-eight percent of the claims in the Cameo estate;

4) Both estates have a vested interest in the same pool of assets;

5) The value in the projects that are the subject of the Shared Interests will be maximized through substantive consolidation;

6) Consolidation will avoid the necessity of two creditors committees, two financial advisors and two sets of committee counsel;

7) Consolidation will eliminate the potential for inter-estate litigation;

8) The creditors holding approximately 80% of the claims against the Debtors, by amount, treated the two parties as a single economic unit for the purposes of recourse;

9) The problems and increased cost associated with separating, allocating and valuing the assets and liabilities of the two estates and endeavoring to equitably accommodate their respective legal rights in two separate reorganization efforts would be substantial. In contrast, consolidation would eliminate these problems and cost and enable the singular estate to generate a more attractive dividend to all affected creditor; and

10) Consolidation will substantially reduce the reorganization costs and generate a more attractive dividend for creditors.

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To summarize, the forty year business relationship between Gianulias and Cameo, his wholly owned corporation, has bound the two Debtors together through a web of legal and financial relationships creating what amounts to a *de facto* integration. Consolidation would simply confirm this reality and allow the Debtors to move forward with a less expensive and more favorable plan of reorganization.

V

SUBSTANTIVE CONSOLIDATION

IS IN THE BEST INTEREST OF CREDITORS

A) **Substantive Consolidation Generally**. Substantive consolidation results in a combining of the assets of, and the claims against, two or more entities. Consolidation has the effect of (i) allowing the liabilities of both entities to be satisfied from the resulting common fund and (ii) combining the creditors of the consolidated companies for purposes of voting on reorganization plans. *See, 5 King Collier on Bankruptcy*, ¶ 1100.06, at 1100-33 n.1 (15th Ed. 1996).

The roots of substantive consolidation can be traced back to the Bankruptcy Act of 1898 (the "Act"). Like the Bankruptcy Code, the Act did not contain an express statutory basis for substantive consolidation, outside of a plan of reorganization. Instead, the power to grant this relief was found in the court's general equitable powers. *See, Pepper v. Litton*, 308 U.S. 295, 304 60 S. Ct. 238, 244 (1939) ("courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity"). In 1940, the United States Supreme Court tacitly gave its approval of the bankruptcy court's exercise of the power to substantively consolidate two estates. *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 61 S. Ct. 904 (1940).[9] More recent cases under the Bankruptcy Code also cite to Section 105 of the Bankruptcy Code as a basis for this power. *See, e.g., In re Donut Queen, Ltd.*, 41 B.R. 706, 708-709 (Bankr. E.D.N.Y. 1984); *In re Richton Int'l Corp.*, 12 B.R. 555, 557 (Bankr. S.D.N.Y. 1981).

[9] We note that the Pepper and Sampsell decisions do not specifically use the words "substantive consolidation."

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As a result of the absence of direct statutory authority or other prescribed standards for substantive consolidation outside of a plan of reorganization, judicial standards were developed to determine whether substantive consolidation should be granted in a given case. According to the case law, the only legitimate goal of substantive consolidation is to ensure the equitable treatment of all creditors. *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 518 (2d Cir. 1988). The burden of proof in substantive consolidation contests is on the party seeking this relief, *In re Steury*, 94 B.R. 553, 554 (Bankr. N.D. Ind. 1988); *In re DRW Property Co.*, 82, 54 B.R. 489, 495 (Bankr. N.D. Tex. 1985), and due to the inherent risks associated with forcing creditors of one debtor to share on a parity with creditors of a less solvent debtor, the courts generally state that such relief is granted sparingly. *Id.*; *In re Continental Vending Machine Corp.*, 517 F.2d 997, 1001 (2d Cir. 1975), *cert. denied*, 424 U.S. 913 (1976); *In re Nite Lite Inns*, 17 B.R. 367, 371 (Bankr. S.D. Cal. 1982).

B) **The Standard In The Ninth Circuit**. The seminal case on substantive consolidation in the Ninth Circuit is *In re Bonham*, 229 F. 3d 750 (9th Cir. 2000). In *Bonham* the Court adopted the test employed by the Second Circuit when assessing whether consolidation is appropriate:

> The Second Circuit has applied an independent test which requires the consideration of two factors: "(1) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit; or (2) whether the affairs of the debtor are so entangled that consolidation will benefit all creditors." *In re Reider,* 31 F.3d at 1108 (citing *In re Augie/Restivo,* 860 F.2d at 518); *see also Colonial Realty,* 966 F.2d at 61. The presence of either factor is a sufficient basis to order substantive consolidation. *See id.* The first factor, reliance on the separate credit of the entity, is based on the consideration that lenders "structure their loans according to their expectations regarding th[e] borrower and do not anticipate either having the assets of a more sound company available in the case of insolvency or having the creditors of a less sound debtor compete for the borrower's assets." *In re Augie/Restivo,* 860 F.2d at 518-19. Consolidation under the second factor, entanglement of the debtor's affairs, is justified only where "the time and expense necessary even to attempt to unscramble them [is] so substantial as to threaten the realization of any net assets for all the creditors" or where no accurate identification and allocation of assets is possible. *Id.* at 519.
>
> The Second Circuit's approach is more grounded in substantive consolidation and economic theory; it is also more easily applied.

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229 F. 3d at 766.[10]

Where the party seeking consolidation in reliance on the first test establishes that there is a substantial identity between the entities to be consolidated, and that consolidation is necessary to avoid some harm or to realize some benefit, a creditor opposing the relief must show that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation. *Bonham,* at 767 ("The burden rests on the investors to overcome the presumption that they did not rely on the separate credit of WPI or APFC.").

Consolidation under the second test, entanglement of the debtor's affairs, is justified under *Bonham* where "the time and expense necessary even to attempt to unscramble them [is] so substantial as to threaten the realization of any net assets for all the creditors" or where no accurate identification and allocation of assets is possible. 229 F. 3d at 767.

C) **Application of the First Test In *Bonham* To The Facts of This Case**. When the facts in this case are considered in light of the first test set forth in *Bonham*, consolidation is clearly appropriate. Approximately 80% of the claims in both estates are held by a common group of creditors - the lenders that provided loans to the Project Level Entities. These lenders insisted *that both Gianulias and Cameo sign the exact same guarantee.* These contracts allowed these creditors recourse to all of their respective assets of both Debtors, without allocation or distinction of any kind, which is the focus of the first test. On these facts, the first test is satisfied.

In granting substantive consolidation in *Soviero v. Franklin National Bank,* 328 F.2d 446

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[10] The lower court in *Bonham* ordered substantive consolidation of the debtor with the estates of two closely held corporations (formed pre-bankruptcy) in order to enable the trustee to pursue avoidance claims in bankruptcy. The consolidation order was made effective *nunc pro tunc* to the date of the filing of the involuntary petition, so that the trustee could take advantage of the time frame for filing avoidance actions, since virtually no assets were available for distribution to Bonham's creditors.

Bonham is cited herein for the legal standard. The facts in the case are not particularly apposite with those presented in this case. Bonham, an individual debtor in a bankruptcy arising from an involuntary chapter 7 bankruptcy, operated a Ponzi scheme through investment contracts issued in the name of two corporations, WPI and APFC, in the four to five years prior to the involuntary filing. Absent consolidation, debtor's creditors, who held approximately $50 million in claims, would recover nothing.

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(2d Cir.1964), the second circuit found it particularly relevant that the creditors were advised that the bankrupt was a "consolidated enterprise" and creditors received consolidated financial statements listing assets of the affiliated companies as those of the bankrupt. In this case, the creditors were well aware of the close relationship between Cameo and Gianulias, and insisted upon recourse to their *collective assets* without distinction. Substantive consolidation will not change the rights of these creditors, who comprise approximately 80% of the claims base, it will simply give them what they bargained for. *See*, *Bonham* at 766 ("The bankruptcy court also did not err in according little weight to the investors' affidavits stating that they had relied on the separate credit of WPI and APFC in entering into investment contracts. On appeal, the investors again point to these affidavits and contend that the bankruptcy court "ignored" them. The burden rests on the investors to overcome the presumption that they did not rely on the separate credit of WPI or APFC.")

D) <u>Application of the Second Test In *Bonham* To The Facts of This Case</u>. Under the second test set forth in *Bonham* consolidation is appropriate where the debtors' affairs are entangled and "the time and expense necessary even to attempt to unscramble them [is] so substantial as to threaten the realization of any net assets for all the creditors" or where no accurate identification and allocation of assets is possible. 229 F. 3d at 767. There are a series of factors that the courts consider when making a decision on whether or not the level of entanglement warrants substantive consolidation. These factors include the following:

(1) The presence or absence of consolidated financial statements;

(2) The unity of interests and ownership between various corporate entities;

(3) The existence of parent and inter-corporate guarantees on loans;

(4) The degree of difficulty in segregating and ascertaining individual assets and liabilities;

(5) The existence of transfers of assets without formal observance of corporate formalities;

(6) The commingling of assets and business functions;

(7) The profitability of consolidation at a single physical location.

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Holywell Corp. v. Bank of New York, 59 B.R. 340, 347 (S.D.Fla.1986); *In re Brentwood Golf Club, LLC*, 329 B.R. 802, 814 (Bankr.E.D.Mich. 2005); *In Re Donut Queen,* 41 B.R. 706, 709 (Bankr. E.D.N.Y.1984); *In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515, 519.

As the following analysis establishes, *all* of the factors are satisfied[11]:

(1) Presence of Consolidated Financial Statements. Gianulias and Cameo regularly published consolidating quarterly and year-end Statements of Financial Condition

(2) Unity of Interests and Ownership. Gianulias owns 100% of Cameo, and approximately 80% of the claims against the two Debtors are shared liabilities. In addition, both estates have common ownership interests in thirteen Project Level Ownership Entities. Maximizing the value of the assets owned by these entities is critical to the success of both of their reorganization efforts. It is difficult to imagine a more complete unity of interests and ownerships between two debtors;

(3) Inter-corporate guarantees. In this case, Gianulias and Cameo are awash in common guarantee claims - $135 million in the Gianulias case and $117 million in the Cameo case. The overlap between these claims in the two cases is approximately 80%.

(4) The Degree Of Difficulty In Separating Assets And Liabilities. As explained in the factual section above, Cameo's and Gianulias' financial fate is tied, in part, to the same development projects. Although their ownership interests in these assets are distinguishable, a plethora of inter-entity claims could be asserted by the Debtors against each other that could render any separation complex and expensive.

(5) Informal Transfer of Assets. Attached to the Conerty Declaration as Exhibit "5" is a printout of the Gianulias/Cameo inter-company account. Although entries were made for each transaction, formal records regarding these transfers were not retained due to the close relationship between the parties, notwithstanding the fact that the values being transferred back and forth were substantial. Although consolidation will not eliminate these inter-company

[11] Not all of the factors have to be satisfied for the application of consolidation. *Holywell Corp. v. Bank of New York,* 59 B.R. 340, 347 (S.D.Fla. 1986).

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claims, it will provide the Debtors with a means of addressing these claims while avoiding disputes between the estates that might materially affect the distribution rights of creditors.

(6) Commingling of Assets. The commingling reflected in Exhibit "5" to the Conerty Declaration is obvious. The two Debtors transferred cash, interests and other assets back and forth routinely without considering the relative value of the exchanges, potentially leaving one party with the assets of the other.

(7) The Profitability of Consolidation. The financial benefits of consolidation are unquestionable. Substantial administrative costs and potential legal fees will be eliminated, while a "control premium" is creating more value, leaving more funds for creditors.

The ruling the court in *Brentwood* case, *supra*, , is instructive:

> In this case, the Court finds that all seven factors weigh in favor of substantive consolidation. First, Debtor and Tavern have consolidated business records. There were no separate financial records for Tavern and Golf Course prior to the Chapter 11 filing. Second, Debtor and Tavern have a unity of interest and ownership. The fact that Tavern leases its space for fifty-cents per square foot from Debtor, well under market value, shows a unity of interest between the entities. The fact that Farrell Moore has an interest in both entities and is the father of all other owners shows a unity of ownership. Third, Debtor and Tavern have commingled assets and business functions as evidenced by Debtor's and Tavern's shared a bank account and joint loan agreement with Bank. Fourth, Debtor and Tavern did not observe corporate formalities. See discussion, section IV.(A), *supra.* Fifth, there were many inter-corporate transfers or loans. The corporate records of both Tavern and Golf Course are replete with transfers between them (or payments on behalf of one another) with no appropriate documentation or observance of any corporate or other legal formalities and no connection to the actual costs of operating each business. Additionally, there was at least one inter-corporate guarantee, that being Tavern's guaranty of Bank's loan to Debtor.[FN2] Sixth, the books and records of Tavern and Debtor were in such disarray as to make it very difficult to segregate assets and liabilities of Tavern and Debtor. In fact, both Tavern and Debtor shared the same bank account for over a year. Seventh, Tavern and Debtor are only profitable if they exist at a single location. Debtor needs a restaurant and liquor license to attract golfers while Tavern needs a golf course to provide customers for its restaurant and to provide a setting to attract weddings and special events.

329 B.R. 802, 814 -815

In this case, the Debtors' estates are tied together by shared ownership rights, shared liabilities, indemnity rights and inter-company claims. This level of integration substantially exceeds what has been considered sufficient in the above cases. *See, In re Richton International*

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Corp., 12 B.R. 555 (Bankr.S.D.N.Y.1981) ("[T]he debtors operated as a single business entity; significant operational and policy decisions respecting the debtors were made and implemented by the parent of the debtor corporations; funds were shifted between the debtors to provide for operating expenses; the debtors filed consolidated federal tax returns; and there were extensive cross corporate guarantees of bank and trade obligations. "What is present in this case is a situation akin to what was found by the court in the *Soviero* case, that many creditors dealt with [the debtor corporations] as one entity.").

E) **Substantive Consolidation Is In The Best Interests of Creditors.** In this case substantive consolidation will benefit all creditors by eliminating the substantial costs associated with trying to segregate and value assets that are inextricably woven together, and it will eliminate disputes over the allocation of shared liabilities, while also creating a "control premium" on a select number of assets. In short, all creditors will benefit. Moreover, as explained above, to the extent that any creditor can establish that it would have received a larger dividend without consolidation, Gianulias will commit the resources necessary to make up this difference, effectively insuring a win-win for all creditors.

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VI

CONCLUSION

The primary purpose of substantive consolidation "is to ensure the equitable treatment of all creditors." *Bonham*, at 765. The relief proposed herein will not only achieve this end, it is the only means through which it can be accomplished. Accordingly, the relief prayed for should be granted.

DATED: November 7, 2008

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WINTHROP COUCHOT P.C.

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PROOF OF SERVICE

I am employed in the County of Orange, State of California. I am over the age of 18 and not a party to the within action. My business address is 840 Newport Center Drive, Suite 400, Newport Beach, California 92660-6324.

On November 7, 2008, I served the foregoing document described as **MOTION FOR ORDER SUBSTANTIVELY CONSOLIDATING CHAPTER 11 ESTATE OF CAMEO HOMES INTO CHAPTER 11 ESTATE OF JAMES G. GIANULIAS FILED BY JAMES C. GIANULIAS; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** on each interested party, as follows:

Office of the United States Trustee Attn: Michael Hauser, Esq. 411 W. Fourth Street, #9041 Santa Ana, CA 92701-4593
Committee Counsel Victor A. Sahn, Esq/Elissa D. Miller, Esq. SulmeyerKupetz 333 South Hope Street, 35th Floor Los Angeles, CA 90071
Counsel for Cameo Homes Paul J. Couchot, Esq. Winthrop Couchot PC 660 Newport Center Dr., 4th Fl. Newport Beach, CA 92660-5946
James C. Gianulias Cameo Homes 1105 Quail Street Newport Beach, CA 92660

[X] (BY MAIL) I placed a true copy of the foregoing document in a sealed envelope addressed to each interested party, as set forth above. I placed each such envelope, with postage thereon fully prepaid, for collection and mailing at Irell & Manella LLP, Newport Beach, California. I am readily familiar with Irell & Manella LLP's practice for collection and processing of correspondence for mailing with the United States Postal Service. Under that practice, the correspondence would be deposited in the United States Postal Service on that same day in the ordinary course of business.

Executed on November 7, 2008, at Newport Beach, California.

I declare under penalty of perjury that the foregoing is true and correct.

Lori Gauthier
(Type or print name)

(Signature)

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