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11
12 **IN THE UNITED STATES BANKRUPTCY COURT**
13 **FOR THE DISTRICT OF ARIZONA**
14

15 In re:

16 RCS CAPITAL DEVELOPMENT, L.L.C.,
17 et al.,

18 Debtors.

Chapter 11 Proceedings

Case No. 2:11-bk-28746-RJH

Jointly Administered With:

2:11-bk-29741

2:11-bk-29742

19 This filing applies to:

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 All Debtors
 Specified Debtors

**SECOND AMENDED DISCLOSURE
STATEMENT CONCERNING FOURTH
AMENDMENT TO DEBTORS' PLAN
OF REORGANIZATION**

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3 RCS Capital Development, LLC, (“Debtor”) filed a petition for relief under
4 Chapter 11 of Title 11 of the United States Code (“Bankruptcy Code”) on October 12,
5 2011 (“Petition Date”) with the United States Bankruptcy Court for the District of
6 Arizona (“Bankruptcy Court”). American Child Care Properties, LLC and ACCP I,
7 LLC each filed a Petition pursuant to Chapter 11 on October 24, 2011. Collectively, the
8 parties will hereinafter be referred to as the “Debtor”. The Debtor remains in possession
9 of its property and continues to operate its business as debtor-in-possession in accordance
10 with Bankruptcy Code Sections 1107 and 1108.

11 The Debtor has prepared this Disclosure Statement (“Disclosure Statement”) in
12 connection with the solicitation of acceptances for the Fourth Amendment to Plan
13 Reorganization Proposed by Debtor dated June 14, 2012 (“Plan”). A copy of the Plan is
14 attached as “Exhibit 1” to this Disclosure Statement and is incorporated herein by this
15 reference. The Debtor is the Proponent of the Plan.

16 Capitalized terms used in this First Amended Disclosure Statement have the same
17 meanings ascribed to those terms in the Plan and the Bankruptcy Code. Terms defined in
18 this Disclosure Statement that are also defined in the Plan are defined herein solely for
19 convenience, and there is no intent to change the definitions of those terms from the Plan.

20 **Information Regarding the Plan and Disclosure Statement**

21 The object of a Chapter 11 case is the confirmation (i.e., approval by the
22 Bankruptcy Court) of a plan of reorganization. A plan describes in detail (and in language
23 appropriate for a legal contract) the means for satisfying the claims against and interests in
24 a debtor. After a plan has been filed, the holders of such claims and interests are
25 permitted to vote to accept or reject the plan. Before a proponent can solicit acceptances
26 of its plan, however, Section 1125 of the Bankruptcy Code requires the proponent to
27 prepare a disclosure statement containing adequate information of a kind, and in sufficient
28 detail, to enable those parties entitled to vote on the plan to make an informed judgment
about the plan and about whether they should accept or reject the plan.

The purpose of this Disclosure Statement is to provide the Debtor’s Creditors with
adequate information to make an informed judgment about the Plan. This information
includes, among other matters, a brief history of the Debtor, a summary of its Chapter 11
Case, a description of the Debtor’s assets and liabilities, a description of the terms under
which the Debtor’s assets will be administered in accordance with the Plan, and an
explanation of how the Plan will function.

It is important that Creditors read and carefully consider this Disclosure Statement
and the Plan, and that such Creditors vote promptly on the acceptance of the Plan.

**YOU SHOULD READ THIS DISCLOSURE STATEMENT IN ITS
ENTIRETY BEFORE VOTING ON THE PLAN. THIS DISCLOSURE
STATEMENT SUMMARIZES CERTAIN TERMS OF THE PLAN, BUT THE
PLAN ITSELF IS THE GOVERNING DOCUMENT. IF ANY INCONSISTENCY
EXISTS BETWEEN THE PLAN AND THE DISCLOSURE STATEMENT, THE
TERMS OF THE PLAN CONTROL.**

**IF YOU HAVE QUESTIONS CONCERNING YOUR TREATMENT
UNDER THE PLAN, PLEASE CONTACT COUNSEL TO THE DEBTOR,**

1 MICHAEL W. CARMEL, MICHAEL W. CARMEL, LTD., 80 EAST COLUMBUS
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FAX NUMBER (602) 277-0144, E-MAIL: MICHAEL@MCARME LLAW.COM.

3 A SUMMARY DESCRIPTION OF THE CLASSIFICATION OF THE
4 CLAIMS AND THE TREATMENT PROPOSED UNDER THE PLAN ARE
CONTAINED UNDER CLASSIFICATION AND TREATMENT UNDER THE
5 PLAN BEGINNING ON PAGE 11.

6 THE PROPONENTS RESERVE THE RIGHT TO AMEND, MODIFY, OR
7 SUPPLEMENT THE PLAN AT ANY TIME BEFORE THE CONFIRMATION OF
THE PLAN, PROVIDED THAT SUCH AMENDMENTS OR MODIFICATIONS
8 DO NOT MATERIALLY ALTER THE TREATMENT OF, OR DISTRIBUTIONS
TO, CREDITORS UNDER THE PLAN.

9 THE FINANCIAL PROJECTIONS CONTAINED IN THIS DISCLOSURE
10 STATEMENT REPRESENT THE DEBTOR'S ESTIMATES OF FUTURE
EVENTS BASED ON CERTAIN ASSUMPTIONS MORE FULLY DESCRIBED
11 BELOW, SOME OR ALL OF WHICH MAY NOT BE REALIZED. NONE OF
THE FINANCIAL ANALYSES CONTAINED IN THIS DISCLOSURE
12 STATEMENT ARE CONSIDERED TO BE A FORECAST OR PROJECTION AS
TECHNICALLY DEFINED BY THE AMERICAN INSTITUTE OF CERTIFIED
13 PUBLIC ACCOUNTANTS. THE USE OF THE WORDS, "FORECAST",
"PROJECT", OR "PROJECTION" WITHIN THIS DISCLOSURE STATEMENT
14 RELATE TO THE BROAD EXPECTATIONS OF FUTURE EVENTS OR
MARKET CONDITIONS AND QUANTIFICATIONS OF THE POTENTIAL
RESULTS OF OPERATIONS UNDER THOSE CONDITIONS.

15 ALL FINANCIAL INFORMATION PRESENTED IN THIS DISCLOSURE
16 STATEMENT WAS PREPARED BY THE DEBTOR AND REVIEWED BY THE
COMMITTEE. EACH CREDITOR IS URGED TO REVIEW THE PLAN IN
17 FULL BEFORE VOTING ON THE PLAN TO ENSURE A COMPLETE
UNDERSTANDING OF THE PLAN AND THIS DISCLOSURE STATEMENT.

18 THIS DISCLOSURE STATEMENT IS INTENDED FOR THE SOLE USE
19 OF CREDITORS, SHAREHOLDERS AND OTHER PARTIES-IN-INTEREST,
AND FOR THE SOLE PURPOSE OF ASSISTING THEM IN MAKING AN
20 INFORMED DECISION ABOUT THE PLAN. NO PERSON HAS BEEN
AUTHORIZED TO GIVE ANY INFORMATION OR MAKE ANY
21 REPRESENTATIONS IN CONJUNCTION WITH THE SOLICITATION OF
VOTES TO ACCEPT OR REJECT THE PLAN OTHER THAN THE
22 INFORMATION AND REPRESENTATIONS CONTAINED IN THIS
DISCLOSURE STATEMENT OR IN THE BALLOTS. IF GIVEN OR MADE,
23 ANY SUCH INFORMATION OR REPRESENTATIONS MUST NOT BE RELIED
UPON AS HAVING BEEN AUTHORIZED BY THE DEBTOR OR THE
24 COMMITTEE.

25 THIS DISCLOSURE STATEMENT HAS NOT YET BEEN APPROVED BY
THE BANKRUPTCY COURT. THE BANKRUPTCY COURT WILL CONSIDER
26 ANY OBJECTIONS TO AND DETERMINE THE LEGAL ADEQUACY OF THIS
DISCLOSURE STATEMENT IN CONJUNCTION WITH CONFIRMATION OF
27 THE PLAN. APPROVAL OF THE LEGAL ADEQUACY OF THIS DISCLOSURE
STATEMENT BY THE BANKRUPTCY COURT IS NOT A CERTIFICATION BY
28 THE BANKRUPTCY COURT AS TO THE TRUTH OR ACCURACY OF THE

1 **FACTUAL MATTERS THAT ARE CONTAINED IN THIS DISCLOSURE**
2 **STATEMENT.**

3 **THE DEBTOR STRONGLY URGES YOU TO VOTE FOR THE PLAN AS**
4 **IT BELIEVES THAT THE PLAN WILL PROVIDE FOR A SIGNIFICANTLY**
5 **LARGER DISTRIBUTION TO HOLDERS OF CLAIMS THAN WOULD**
6 **OTHERWISE RESULT IF AN ALTERNATIVE RESTRUCTURING PLAN**
7 **WERE PROPOSED OR THE DEBTOR'S ASSETS WERE LIQUIDATED UNDER**
8 **CHAPTER 7 OF THE BANKRUPTCY CODE.**

9 This Disclosure Statement has not been subject to a certified audit but has been
10 prepared in part from the information compiled by the Debtor from records maintained by
11 it in the ordinary course of business or from information received by the Debtor from third
12 parties. Every effort has been made to be as accurate as possible in the preparation of this
13 Disclosure Statement.

14 Other than as stated in this Disclosure Statement, the Debtor has not authorized any
15 representations or assurances concerning the Debtor, its operations, or the value of its
16 assets. Therefore, in deciding whether to accept or reject the Plan, you should not rely on
17 any information relating to the Debtor or the Plan other than that contained in this
18 Disclosure statement or in the Plan itself. You should report any unauthorized
19 representations or inducements to counsel for the Debtor, who may present such
20 information to the Bankruptcy Court for action as may be appropriate.

21 This is a solicitation by the Debtor only and is not a solicitation by any affiliates,
22 attorneys, agents, financial advisors, accountants, or any other professionals employed by
23 the Debtor.

24 Rick Sodja, the Debtor's Manager, is the individual who has provided the primary
25 information contained in this Disclosure Statement.

26 **SUMMARY OF CLASSIFICATION AND TREATMENT UNDER THE PLAN**

27 Set forth in the following section is a summary of the classification and treatment
28 of Claims under the Plan.

The Classes of Claims against and Equity Interests in the Debtor shall be treated under the
Plan as follows:

CLASS 1 – CITY OF NORTH LAS VEGAS SECURED CLAIM.

(a) Impairment and Voting. Class 1 is impaired by the Plan. The holder of the Class
1 Claim is therefore entitled to vote to accept or reject the Plan.

(b) Nature of Interest. The holder of the Class 1 Claim has a first position lien on the
property located at, and commonly described as, 3470 West Ann Road, North Las
Vegas, Nevada (the "Ann Road Property"), which resulted from Debtor's unpaid
development fees and property taxes. The Debtor estimates this Class has a claim
totaling approximately \$293,000.00. Interest will accrue at the rate of 5.25% *per*
annum. The Debtor believes the Ann Road Property is worth no less than
\$500,000.00. Accordingly, this Class is fully secured by the Ann Road Property.

1 (c) 11 U.S.C. § 363(c) Sale. Under, the Plan, the Debtor will sell the Ann Road
2 Property free and clear of the City of North Las Vegas's lien pursuant to 11 U.S.C. §
3 363(c). The proceeds from the sale will be used to pay the Class 1 Claim in full. The
remaining proceeds will be used to pay the allowed claims of other Classes.

4 **CLASS 2 – HILL CREST BANK SECURED CLAIM.**

5 (a) Impairment and Voting. Class 2 is impaired by the Plan. The holder of the Class
6 2 Claim is therefore entitled to vote to accept or reject the Plan.

7 (b) Nature of Interest. The holder of the Class 2 Claim has first position liens on the
8 properties located at, and commonly described as, 10560 South Valley View, Las
9 Vegas, Nevada (the "Valley View Property"), and 32555 Simmons Street, Las Vegas,
10 Nevada (the "Simmons Property"). Although these liens are under-secured, the Class
11 2 Claimant has no recourse against Debtor, other than by executing on its liens in the
Valley View and Simmons Properties. The debtor will convey the Valley View and
Simmons Properties to Hill Crest Bank. Hill Crest Bank will have no further claims
against the Debtor.

12 (c) Retention of Lien. The holder of the Allowed Class 2 Claim shall retain its lien
13 interests in the Valley View and Simmons Property.

14 **CLASS 3(A) – GENERAL UNSECURED CLAIMS OTHER THAN ABC LEARNING
CENTRES.**

15 (a) Impairment and Voting. Class 3A is impaired by the Plan. Each holder of a
16 Class 3A Claim is entitled to vote to accept or reject the Plan.

17 (b) Distributions. Each holder of a Class 3A Claim shall receive one hundred
18 percent (100%) of its Allowed General Unsecured Claim. Any net proceeds of
19 sale from the Ann Road property after payment to the Class 1 creditor shall be
20 paid on a pro-rata basis to holders of Class 3A claims. In addition, the Debtor
21 has a profit participation right in property located at, and commonly described
22 as 2488 East Russell Road, Las Vegas, Nevada (the "Russell Road Property").
23 The Russell Road Property is not part of the estate, but Debtor's profit
24 participation right is part of the estate. The Building has an estimated value of
25 \$2,800,000.00. There are liens in the approximate amount of \$1,200,000.00,
26 which leaves net equity in the approximate amount of \$1,600,000.00. The
27 debtor's Profit Participation is fifty percent (50%), or \$800,000.00. Debtor
28 shall use the proceeds it receives from the sale of the Russell Road Property, in
addition to any monies from the Ann Road sale after payment of all secured
claims, to pay each Allowed Class 3A Claim. The holders of each Class 3A
Claim shall be paid no later than thirty (30) days after Debtor receives the
proceeds from the sales of the Ann Road Property and the Russell Road
Property or (30) days after the Effective Date of the Plan, whichever is later.
It is anticipated these sales were occur no later than one (1) year from the
Effective Date. Any monies the Debtor collects on the balance owed from

1 ABC will be used *first*, to satisfy all Class 3 (A) Claims to the extent the sales
2 of property contemplated in the Plan are insufficient to fully satisfy all Class
3 3(A) Claims, and *second*, to be distributed to the holders of Class 5 Interests
4 on a *pro rata* basis Interest shall accrue on these claims at the Federal
5 Judgment Rate, until paid. The total amount of claims I this Class as of the
6 November 30, 2011 Claims Bar Date is \$65,296,326.31. The Debtor believes
7 the total allowed claims will be approximately One Million Dollars
8 (\$1,000,000.00), primarily because (1) the Jinbo, LLC \$63,000,000.00 claim
9 will be fully resolved without any payment as a result of the treatment of Class
10 3B, and (2) the Krynski claim is overstated by at least \$1,250,000.

11 **CLASS 3 (B)-ABC LEARNING CENTRES CLAIM**

- 12 (a) ABC Learning Centres Claim. The Class 3B claim is Unimpaired, and therefore
13 not entitled to vote on the Plan, as it will be immediately paid in full on its
14 allowed claim as determined by the Bankruptcy Court.
- 15 (b) ABC Learning Centres (“ABC”) has filed suit in Nevada against Debtor,
16 claiming monetary damages in excess of U.S. \$40,000,000.00. Debtor has a
17 right to pay ABC with its setoff claim against ABC, which is in the form of a
18 final judgment in the amount of approximately \$57,000,000.00, plus accruing
19 interest from the date of judgment, December 8, 2010. Debtor disputes it owes
20 ABC any monies. Nevertheless, Debtor will pay ABC the full amount of its
21 claim with its setoff, which allows for 100% payment. Pursuant to the Court’s
22 Ruling Dated June 7, 2012, and entered on June 8, 2012 at Docket # 153, the net
23 result of the setoff is that ABC owes the Debtor USD \$30,366,140.90, plus
24 interest.
- 25 (c) Following the Effective Date, any and all of ABC’s claims between ABC and
26 Debtor shall be subject to the ABC Mutual Release, as defined in subsection 1.1
27 of the Plan. ABC shall have no further claims against the Debtor, and the ABC
28 Release shall be triggered and in full force and effect as of the Effective Date.
- (d) ABC filed a claim on November 29, 2011 in the amount of
US\$41,000,000.00. The Debtor will be filing an Objection to this claim
and the Bankruptcy Court will retain jurisdiction to determine the allowed
amount of the ABC Claim.

(e)

CLASS 4 – ADMINISTRATIVE CLAIMS

Claims for Professional Fees. Each Person seeking an award
by the Bankruptcy Court of Professional Fees: (a) must file its final
application for allowance of compensation for services rendered and
reimbursement of expenses incurred through the Confirmation Date within
thirty days after the Confirmation Date; and (b) if the Bankruptcy Court
grants such an award, each such Person must be paid in full in Cash in such

1 amounts as are allowed by the Bankruptcy Court as soon thereafter as
2 practicable. It is estimated the Administrative Claims will be less than
\$100,000.00.

3 *Post-Confirmation Professional Fees.* All Professional Fees
4 for services rendered in connection with the Chapter 11 Case and the Plan
5 after the Confirmation Date, including those relating to the prosecution of
6 Litigation Claims preserved under the Plan and the resolution of Disputed
7 Claims, are to be paid by the Debtor upon receipt of an invoice for such
8 services, or on such other terms to which Debtor may agree, without the
9 need for further Bankruptcy Court authorization or entry of a Final Order.
10 The Debtor shall have ten days after the receipt of any such invoice to object
11 to any item contained in such invoice. If the Debtor and any Professional
12 cannot agree on the amount of post-Confirmation Date fees and expenses to
13 be paid to such Professional, such amount is to be determined by the
14 Bankruptcy Court.

15 **CLASS 5 – INTERESTS OF MEMBERS**

16 (a) Impairment and Voting. Class 5 is impaired by the Plan. Each holder of a
17 Membership Interest is conclusively presumed to have accepted the Plan.

18 (b) Nature of Interest and Distributions. The holders of Membership Interests shall
19 retain their interests in the debtor, provided all payments under the Plan are made.
20 The members shall receive their pro-rata distribution of any monies available
21 for distribution after payment(s) to all other creditors.

22 **DESCRIPTION OF THE PLAN OF REORGANIZATION**

23 As noted, a copy of the Plan accompanies this Disclosure Statement as Exhibit 1.

24 The following summary of the material provisions of the Plan is qualified in its
25 entirety by the specific provisions of the Plan, including the Plan's definitions of certain
26 terms used below. The following is intended to provide a general description of the Plan.
27 For more specific information, please refer to the Plan itself. The Debtor has attempted to
28 minimize the use of defined terms in describing the Plan. However, any capitalized terms
that are not defined in this section of the Disclosure Statement are defined in the Plan. It
is recommended that one refer to those definitions when reading this document.

Debtor will sell the Ann Road Property pursuant to 11 U.S.C. § 363(c) and pay off
the lien held by the City of North Las Vegas for unpaid property taxes and development
fees. To the extent any proceeds remain after paying the City of North Las Vegas Secured
Claim, the proceeds will be used to pay Allowed non-priority unsecured claims.

Hill Crest Bank owns liens on two properties owned by Debtor, the Valley View
and Simmons Properties. The liens are worth more than the properties, but Hill Crest has
no recourse against Debtor other than through the properties. Under the Plan, the Hill
Crest liens will remain in place.

1 Debtor will use the equity it owns in the Ann Road Property and its profit
2 participation interest in the Russell Road Property to pay 100% of all Allowed general
3 unsecured claims, except any claim made by ABC. All Allowed non-ABC unsecured
4 claims will receive a payment on the Allowed claim, plus accruing interest, either thirty
5 (30) days after the sale of the Ann Road Property, and a separate payment after the
6 Russell Road Property is sold or thirty (30) days after the Effective Date of the Plan,
7 whichever is later.

8 ABC claims to be owed approximately AUD\$42,000,000 as of March 2009, when
9 the Australian Dollar was worth 65 cents US, which means ABC is owed approximately
10 USD\$27,300,000, plus interest. The Debtor filed a Motion for Summary Judgment (DE #
11 88) asserting it has a right to setoff as a matter of law. The Court heard oral argument on
12 the Motion on May 22, 2012. The Debtor's Motion was granted. The Court also denied a
13 Motion for Summary Judgment filed by ABC asserting various claims. The Minute Entry
14 reflecting the Court's rulings is at Docket # 145. The signed ruling is at Docket # 153.
15 The net setoff results in ABC owing the Debtor USD \$30,366,140.90, plus interest.

16 **Voting and Confirmation Procedures**

17 This Disclosure Statement is accompanied by copies of the following: (a) the Plan,
18 attached as Exhibit 1 to this Disclosure Statement; (b) the Bankruptcy Court's Order: (1)
19 Setting Hearing on Approval of Adequacy of Disclosure Statement and Plan
20 Confirmation; (2) Setting Objection Deadlines thereon; (3) Setting Record Date; (4)
21 Approving Ballots and Solicitation Protocol; (5) Setting Ballot Deadlines; and (6) Related
22 Matters (the "Solicitation Order"); and (c) a Ballot to accept or reject the Plan.

23 Appropriate forms of Ballots must be used.

24 **Who May Vote**

25 Under the Bankruptcy Code, impaired Classes of Claims are entitled to vote to
26 accept or reject a plan of reorganization. A Class that is not impaired under a plan is
27 deemed to have accepted a plan and does not vote. A Class is impaired under the
28 Bankruptcy Code when the legal, equitable, and contractual rights of the holders of
Claims or Equity Interests in that Class are modified or altered. For purposes of this Plan,
holders of Claims of all Classes are entitled to vote on the Plan.

If, however, the Debtor files an objection to your claim, you are responsible to
request that the Bankruptcy Court temporarily allow your claim for voting purposes. Rule
3018 of the Federal Rules of Bankruptcy Procedure provides that the Bankruptcy Court
after notice and hearing may temporarily allow the Claim in an amount which the
Bankruptcy Court deems proper for the purpose of voting. If the Debtor files an objection
to your claim, you should seek an attorney's assistance with respect to this matter.

29 **Voting Instructions**

All votes to accept or reject the Plan must be cast by using the appropriate form of
Ballot enclosed with this Disclosure Statement. Only votes using such Ballots will be
counted, except to the extent the Bankruptcy Court orders otherwise.

1 **For your vote to count, your Ballot must be properly completed according to**
2 **the voting instructions on the Ballot and received no later than the Voting Deadline**
3 **by the Debtor’s counsel. Any Ballot not indicating an acceptance or rejection will be**
4 **deemed an acceptance of the Plan.**

5 If you have any questions concerning the Plan, please contact:

6 Michael W. Carmel, Esq.
7 Michael W. Carmel, Ltd.
8 80 East Columbus Avenue
9 Phoenix, Arizona 85012
10 Telephone: (602) 264-4965
11 Facsimile: (602) 277-0144
12 E-Mail: michael@mcarmellaw.com

13 **Acceptance or Rejection of the Plan**

14 Under the Bankruptcy Code, a Class of Claims entitled to vote is deemed to have
15 accepted the Plan if it is accepted by creditors in such Class who, of those actually voting
16 on the Plan, hold at least two-thirds in amount and more than one-half in number of the
17 Allowed Claims of such Class.

18 **Confirmation Hearing; Objections**

19 Section 1128(a) of the Bankruptcy Code requires the Bankruptcy Court, after
20 notice, to hold a Confirmation Hearing. Section 1128(b) of the Bankruptcy Code provides
21 that any party-in-interest may object to Confirmation of the Plan. Under Section 1128
22 of the Bankruptcy Code and Rule 3017(c) of the Bankruptcy Rules, the Bankruptcy Court
23 has scheduled the Confirmation Hearing before the Honorable Randolph J. Haines, United
24 States Bankruptcy Judge, at the United States Bankruptcy Court, District of Arizona, 230
25 North First Avenue, 6th Floor, Phoenix, Arizona 85004 for **[to be inserted after**
26 **approval of the Disclosure Statement]** The Solicitation Order setting forth the time and
27 date of the Confirmation Hearing has been included along with this Disclosure Statement.
28 Pursuant to the Solicitation Order, the Confirmation Hearing has been set to consider the
adequacy of this Disclosure Statement, as well as to consider Confirmation of the Plan.
The Confirmation Hearing may be adjourned from time to time by the Bankruptcy Court
without further notice, except for an announcement of such adjourned hearing date by the
Bankruptcy Court in open court at such hearing.

 Any objection to the adequacy of this Disclosure Statement or to Confirmation of
the Plan must be in writing, must comply with the Bankruptcy Rules and the Local Rules
of the Bankruptcy Court, and must be filed and served by **5:00 p.m. (Mountain Standard
Time)** on the date as required in the Solicitation Order.

**GENERAL BACKGROUND OF THE DEBTOR AND EVENTS LEADING TO
BANKRUPTCY FILING**

I. INTRODUCTION

 ABC Learning Centres, Ltd., an Australian corporation, (“ABC”) used to be the
world’s largest childcare operator, but that changed on November 6, 2008, when ABC

Field Code Changed

1 declared itself insolvent. ABC's insolvency involved billions and billions of dollars. ABC
2 was Australia's equivalent of Enron.

3
4 ABC's insolvency and resulting defaults impacted many companies in the United
5 States, several of which are involved directly or indirectly in this bankruptcy. The main
6 victim of ABC's insolvency is RCS Capital Development, the debtor in this case. RCS
7 had various contractual relationships with ABC that resulted in litigation in Maricopa
8 County, Arizona. That litigation ultimately resulted in a verdict against ABC and
9 judgment worth USD\$56,456,732.63 as of November 15, 2011. Interest accrues in this
10 judgment at a rate of \$13,469.76 a day or about \$404,000.00 per month.
11

12 Another victim of ABC's insolvency was a company called American Child Care
13 Properties, a limited liability company organized in Nevada. It had borrowed about \$US27
14 million from ABC. The sole member of American Child Care was a man named Ken
15 Krynski. Mr. Krynski was a close friend of the CEO of ABC Learning Centres, and it was
16 this friendship that led to Krynski's company borrowing from ABC before ABC went
17 insolvent.
18

19
20 ABC's insolvency left American Child Care Properties' Mr. Krynski in an
21 intractable situation because American Child Care was dependent upon ABC for
22 operating and development funds. American Child Care properties lost the ability to
23 operate when those funds dried up, and Krynski, who had personally guaranteed loans
24 from lenders within the United States, was headed toward bankruptcy.
25

26 Mr. Krynski did not end up in bankruptcy, however, because RCS Capital
27 Development purchased Mr. Krynski's membership interests in American Child Care.
28

1 American Child Care Properties and its related entities were immediately liquidated into
2 RCS Capital, and RCS expressly assumed all of the liabilities of American Child Care
3 and, of course, got the assets as well.
4

5 The receivers in ABC's insolvency proceedings undertook the collection and
6 liquidation of ABC's assets on the same day ABC declared itself insolvent, November 6,
7 2008. The receivers for ABC sued both RCS Capital and the American Child Care entities
8 as part of their collection efforts in early 2009. The receivers actually work for a syndicate
9 of banks that had loaned money to ABC before its insolvency. The receivers' goal has
10 always been to get money for these banks.
11

12 Understanding the business of ABC Learning Centers, American Child Care
13 Properties, and RCS Capital, is important so that this reorganization plan may be viewed
14 from a proper perspective. There are, likewise, important legal issues to be considered,
15 including (1) the effects of the international insolvency of ABC's Australian proceedings;
16 ABC filed a Chapter 15 bankruptcy in the Delaware bankruptcy court soon after RCS
17 obtained its \$50 million verdict; and (2) the legal effect of Nevada's laws on ABC's
18 litigation against RCS Capital in Nevada; RCS Capital has a USD\$56 million judgment it
19 wishes to use as a set off against ABC's unliquidated USD\$27 million claim against RCS
20 and the entities RCS acquired when it bought American Child Care Properties.
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24 This case is really about (A) ABC Learning Centres' history, (B) its expansion of
25 its child care business into the United States, (C) financial problems that began for ABC
26 in February 2008, (D) its defaults as it spiraled down into insolvency, and, ultimately, (E)
27
28

1 the resulting litigation between ABC and RCS Capital in the United States. The following
2 background, therefore, will be divided into these five sections.

3 II. ABC LEARNING CENTRES

4 A. ABC's Beginnings

5 Edmund (Eddy) Groves is the important player so far as ABC Learning Centres is
6 concerned. Mr. Groves purchased his first child care facility on the Gold Coast in
7 Australia in 1987. He was fabulously successful in the development of child care
8 facilities, so he had about thirty locations in 2000 when he took ABC public. ABC had
9 over 300 locations in Southeast Asia, the south Pacific, and other commonwealth
10 countries by 2004. Indeed, ABC was the company in which to invest because it was
11 everywhere, supported by the Australian government, which had substantial funds
12 invested in the company, and everyone's kids were pretty much taken care of at an ABC
13 Learning Centre facility. ABC Learning Centres had thirty-eight direct or indirect
14 subsidiaries when ABC Learning Centres placed itself into "voluntary administration" on
15 November 6, 2008.

16 A "voluntary administration" and a receivership is roughly equivalent to a
17 bankruptcy in the United States, but the equivalency is only in the most general terms.
18 This rough equivalency will be discussed *infra* in conjunction with the discussion about
19 ABC's Chapter 15 filings in Delaware.

20 B. ABC's Expansion into the United States

21 *1. Ken Krynski/American Child Care Properties.* Ken Krynski is an
22 important player so far as ABC's expansion into the United States is concerned. He
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1 became Eddy Groves' friend in October 1997 when Mr. Groves bought a custom
2 residential lot in Las Vegas. Krynski and Groves became "mates," an Australian idiom for
3 a close friend, as a result of Groves' acquisition of property in Las Vegas. Indeed, Mr.
4 Groves and Mr. Krynski formed a construction company called Castle Development
5 Group as a result of their close friendship. As will be discussed *infra*, Castle Development
6 Group later is the recipient of funds that ABC loaned to Krynski's company, American
7 Child Care Properties.
8
9

10 Groves and Krynski got along so well that Groves asked Krynski to move to
11 Australia in 2004 to help with finding and developing child care locations in Australia.
12 Krynski lived in Australia and worked for one of the ABC entities doing site and
13 development work until March 2006, when Krynski moved back to the United States.
14

15 Krynski moved back to the United States because ABC Learning Centres had
16 acquired all of the stock of a publicly traded company called Learning Care Group out of
17 Novi, Michigan. ABC de-listed Learning Care Group after it was acquired. The idea was
18 that Krynski, Groves' mate, would run Learning Care Group. But that did not sit
19 particularly well with the officers and directors of Learning Care Group, which had been
20 in the child care business for years in the United States, who were not interested in Mr.
21 Krynski's intervention.
22

23 As a result, Krynski moved from Novi, Michigan to Las Vegas, Nevada, where he
24 formed American Child Care Properties. The relationship between Mr. Krynski and his
25 mate, Eddy Groves, continued to be both fast and informal. Groves and Krynski had the
26 general notion that Krynski would find child care sites and build child care facilities that
27
28

1 ABC would then have its wholly-owned American subsidiary, Learning Care Group, buy.
2 Neither Krynski nor his company, of course, had any money, so the arrangement was that
3 ABC would either capitalize American Child Care Properties or loan it money so that it
4 could operate, purchase real estate, and build these child care facilities that would then be
5 purchased by Learning Care Group at substantial profits for Krynski. The profits would be
6 more than enough, of course, to enable Krynski to pay the loans American Child Care
7 Properties received from ABC, and leave him well off.
8
9

10 Groves was true to his mate. American Child Care Properties received money from
11 ABC on an almost monthly basis. The money was received in U.S. dollars via wire
12 transfers. An example of the frequency and the amount of these transfers is as follows:
13

14	March 15, 2006	USD\$331,580.00
15	April 10, 2006	USD\$1,300,000.00
16	May 6, 2006	USD\$200,000.00
17	June 23, 2006	USD\$355,000.00
18	August 4, 2006	USD\$235,000.00
19	November 1, 2006	USD\$1,950,000.00
20	December 31, 2006	USD\$267,000.00
21	December 31, 2006	USD\$1,270,000.00
22	January 5, 2007	USD\$1,257,494.70
23		
24		
25		
26		
27		
28		

1	February 4, 2007	USD\$5,248,315.00
2		
3	April 26, 2007	USD\$435,000.00
4		
5	May 20, 2007	USD\$843,844.00
6		
7	June 3, 2007	USD\$1,044,000.00
8		
9	June 19, 2007	USD\$588,392.00

10 There was no paperwork for any of these capital contributions or loans. These were
11 handshake deals between Ken Krynski and Eddy Groves. The only documentation that
12 exists for any of these loans are letters that were sent by ABC, audit acknowledgments
13 that Ken Krynski signed as part of the annual and semi-annual audits of ABC Learning
14 Centres. One of these acknowledgments is attached as **Exhibit 2**.

15 The acknowledgments made it clear that these were unsecured loans payable on
16 demand. The understanding between Mr. Krynski and Mr. Groves, of course, was that
17 ABC would not demand payment of these loans until American Child Properties had
18 acquired the real estate, built a child care facility on it, and ABC's other U.S. entity,
19 Learning Care Group had purchased the site at a substantial profit for Krynski. The actual
20 obligation for Learning Care Group to acquire the properties Krynski was developing was
21 never formalized. It remained amorphous and undocumented.

22 There were no restrictions, apparently, on Krynski's use of the unsecured,
23 undocumented loans he received from ABC. Indeed, one of the schedules kept by Mr.
24 Krynski, a schedule that was disclosed as part of the discovery in the Nevada litigation
25 instituted by ABC, is attached as **Exhibit 3**. This document shows that Krynski treated

1 these unsecured loan funds as unrestricted money he could use any way he wanted. He
2 used some of it for his house. He gave some of it to Eddy Groves for gambling when Mr.
3 Groves was in Las Vegas, and over a million dollars was funneled into the company Eddy
4 Groves and Ken Krynski owned together, Castle Development Group, or "CDG" on the
5 attached ledger. The ledger even shows that some of this money was deposited into Castle
6 Development Group without running that money through American Child Care Properties
7 "without routing through PMA." "PMA" is a registered trademark of Wells Fargo Bank; a
8 Wells Fargo PMA® account is a special type of account for large depositors that allows
9 them flexibility not accorded ordinary depositors.
10

11
12 There is documentation that was produced in the Las Vegas litigation from which
13 one might conclude that millions of dollars of the loan proceeds from ABC never went
14 into either site acquisition or construction costs for properties owned by American Child
15 Care when it was acquired by RCS Capital.
16

17 2. *Learning Care Group/Tutor Time*. Reference has been made in the
18 foregoing section to Learning Care Group and its acquisition by ABC Learning Centres in
19 early 2006. Learning Care Group had about 400 locations in the United States when ABC
20 acquired it, so it was a good sized acquisition for ABC Learning Centres' movement into
21 the child care industry in America. The company was de-listed and became a wholly-
22 owned subsidiary of ABC, and, as already mentioned, Ken Krynski moved to Novi,
23 Michigan, the headquarters of Learning Care Group and its various subsidiaries to run the
24 company. It was when that failed that Krynski moved to Las Vegas and started American
25 Child Care Properties.
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1 Learning Care Group was the owner of perhaps, the largest, child care franchise
2 operation in the United States, Tutor Time. Tutor Times have become virtually ubiquitous
3 in the United States, so ABC's acquisition of Learning Care Group was a big deal, 400
4 locations across the United States.
5

6 *3. Rick and Cheryl Sodja/Tutor Time/RCS Capital Development.* Rick and
7 Cheryl Sodja are siblings. They were the principals of various entities that, taken together,
8 were the largest Tutor Time franchise operation under the umbrella of Learning Care
9 Group. They were also the most financially successful and were busy developing
10 additional sites to strengthen their presence in the child care industry. Eddy Groves took
11 note of the Sodjas when he acquired Learning Care Group because he wanted to acquire
12 the Sodjas' operation and make them developers for ABC.
13
14

15 Eddy Groves and Bill Davis, the president of Learning Care Group, began to court
16 the Sodjas in 2006, telling the Sodjas that they wanted to control the child care market in
17 the United States. The Sodjas, however, were not interested in selling because their
18 operation was both lucrative and had potential to become even more so as they continued
19 to develop child care locations within Arizona and other states.
20

21 Ultimately, however, the economic incentives offered by Mr. Groves induced the
22 Sodjas to sell their business to an ABC entity, but the deal was not signed until there had
23 been extensive negotiation over many months. The essential terms of the November 2007
24 asset purchase agreement provided that ABC would pay the Sodjas \$66,950,000.00 in
25 cash for their twenty-six operating Tutor Time locations, and the Sodjas were given the
26 exclusive right to develop more Tutor Time locations across the United States with certain
27
28

1 limited exceptions, including, essentially, the areas where Ken Krynski was developing
2 sites in Nevada and Virginia. The Sodjas had additional sites in their development
3 pipeline and Groves agreed to purchase these pipeline sites based upon a formula; it was
4 understood that additional sites would be developed, but the prices for these additional
5 sites were to be the subject of further negotiations. The contract with ABC gave the
6 Sodjas, essentially, \$70 million for the operating sites, another \$50–100 million for the
7 pipeline sites, and an additional \$100 million or so for sites to be developed around the
8 United States.
9

10
11 The money to buy out the Sodjas came from ABC in Australia, but the money was
12 funneled through ABC's American subsidiaries, including Learning Care Group. It was
13 anticipated that Learning Care Group would be the operator of the Sodjas' operating
14 locations and would be the entity acquiring the pipeline and other sites. In essence, the
15 Sodjas were becoming development partners with ABC in the United States through
16 ABC's wholly-owned subsidiary, Learning Care Group.
17

18
19 C. ABC's Financial Problems, February 2008

20 February 2008 was a watershed month for ABC Learning Centres. ABC was in the
21 process of finalizing the development agreements it had promised to both Ken Krynski's
22 American Child Care Properties, and Rick and Cheryl Sodjas' RCS Capital Development.
23 Those deals did not come together as contemplated, however, because of a very black
24 Tuesday for ABC, February 26, 2008. February 26, 2008, was the day the semi-annual
25 report was issued by ABC Learning Centres. The shocking result was that ABC missed its
26 revenue projections by over 43%, and that left ABC in a precarious financial situation.
27
28

1 Cash reserves were inadequate to cover debt service, and CitiBank, one of ABC's lenders,
2 shorted the stock: ABC's stock fell from AUUSD\$7.20 to AUUSD\$1.34 in a single
3 afternoon.
4

5 Eddy Groves and ABC Learning Centres had to scramble to find cash, but neither
6 the Sodjas nor Krynski knew about ABC's financial problems, so they kept going forward
7 with their development plans and operations, even though ABC began to slow down on its
8 funding of Krynski's American Child Care Properties. Indeed, Ken Krynski was
9 encouraged by his mate, Eddy Groves, to sell the centers he was developing to any buyer
10 he could find. Groves even put Krynski in touch with Rick Sodja to see if Sodja's
11 operation would be interested in buying these locations.
12

13 Krynski knew something was up because cash was tight, and he was being urged to
14 reduce expenses. Krynski left for Australia on April 12, 2008, for a meeting with Eddy
15 Groves to determine the fate of American Child Care Properties. Krynski met with his
16 mate, Groves, and financial officers of ABC Learning Centres. Groves told Krynski that
17 ABC is only going to provide funding for the sites Krynski had in his pipeline at the time,
18 and only just enough funding to keep contractors from walking off the job. This meeting
19 took place on April 19, 2008, in Australia.
20

21 Krynski, of course, was not happy with this shift in the tectonic plates, and he was
22 even less pleased when Eddy Groves sent one of his financial gurus from Australia to Las
23 Vegas to help Groves arrange for financing from lenders in the United States to complete
24 funding of Krynski's pipeline sites. Ultimately, Krynski obtained a letter of credit from a
25 company in Denver, Colorado, CapTerra, for USD\$3.912 million, but Krynski had to
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27
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1 personally guaranty this line of credit, a guaranty that threatened to bankrupt him when
2 ABC declared itself insolvent in November 2008.

3
4 At the same time Krynski was arranging financing that obligated him personally,
5 he was giving tours of his sites to Rick Sodja, who traveled to Las Vegas to look at them
6 because Groves had told Krynski to find someone to buy the sites so that cash advanced to
7 American Child Care Properties could be repaid. For a variety of reasons, Sodja was not
8 interested in Krynski's sites.
9

10 Eddy Groves' world would have probably collapsed in April or May 2008 but for
11 an agreement he was able to finagle with Morgan Stanley Private Equity. Morgan Stanley
12 was interested in buying 60% of ABC's interest in Learning Care Group for USD\$420
13 million, cash. ABC and Groves, of course, were desperately in need of cash, so they
14 worked to put this deal together.
15

16 There were two roadblocks that prevented Morgan Stanley from closing the deal
17 with ABC Learning Centres. Morgan Stanley was only interested in paying the USD\$420
18 million if Learning Care Group had no executory obligations for further development.
19 That meant Groves had to negotiate his way out of the development obligations Learning
20 Care Group had with both American Child Care Properties and RCS Capital
21 Development. Neither Krynski nor the Sodjas, however, were willing to let Learning Care
22 Group off the hook for nothing because they both had huge exposure. Krynski had taken a
23 lot of money from ABC and would have no way of repaying it if Learning Care Group
24 was not obligated to buy the sites he had under development. The Sodjas had sold their
25 operating Tutor Times with the understanding that they would continue to develop
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1 pipeline and other sites that Learning Care Group would be obligated to purchase, so the
2 prospect of releasing Learning Care Group was not something that the Sodjas were
3 interested in doing either. But Eddy Groves, ever the businessman, negotiated deals with
4 Ken Krynski's American Child Care Properties and the Sodjas' RCS Capital
5 Development that enabled ABC to sell 60% of its interests in Learning Care Group and
6 get Morgan Stanley's USD\$420 million.
7

8 The deal with RCS Capital was very straightforward. Rather than having RCS
9 Capital Development enter into a development agreement with Learning Care Group, it
10 was agreed that RCS Capital would enter into development agreement with two ABC
11 entities: (1) A.B.C. Developmental Learning Centers (U.S.A.), Inc., a Delaware
12 corporation, and (2) ABC Learning Centres, Ltd., the Australian corporation that was
13 getting the USD\$420 million from Morgan Stanley. The Sodjas thought that this was a
14 great deal because they would then have a development agreement with the multi-billion
15 dollar international company headquartered in Australia rather than the much smaller U.S.
16 entity, Learning Care Group, headquartered in Novi, Michigan. That satisfied the Sodjas
17 and they executed a complete release of Learning Care Group. This release took the form
18 of a third amendment to the original asset purchase agreement and is attached as **Exhibit**
19 **4.**
20
21
22

23 Krynski was likewise induced to enter into a release of Learning Care Group's
24 obligation to buy his sites by way of the termination and release agreement, attached as
25 **Exhibit 5.** This termination and release agreement released both Ken Krynski, personally,
26 and American Child Care Properties from any obligation to pay any of the money that had
27
28

1 been loaned by ABC Learning Centres to American Child Care Properties and Ken
2 Krynski over the years: this release forgave all of the debt in the following language:

3
4 From and after the date hereof [ABC Learning Centres, Ltd.,
5 an Australian corporation, *inter alia*] . . . hereby remises,
6 releases, and forever discharges, and by these presents does
7 release and forever discharge [American Child Care
8 Properties] and its subsidiaries, affiliates, successors and
9 assigns, and their respective officers, directors, employees,
10 shareholders, members, agents, executives, consultants,
11 independent contractors, attorneys, and advisors, jointly and
12 severally, of and **from any and all actions, causes of action,
suits, debts**, accounts, bonds, bills, covenants, contracts,
controversies, agreements, liabilities, damages, costs,
expenses, demands, judgments, executions, variances, claims
and other obligations **of whatever kind and nature**, in law or
in equity, known or unknown, arising from, connected or
related to, or caused by any event, occurrence, cause or thing,
of any type, whatsoever, arising or existing or occurring, in
whole or in part, at any time **from the beginning of the world
through the date hereof**. . . .

13 *Id.* (emphasis added).

14 The releases by both American Child Care Properties and Ken Krynski in Nevada,
15 and RCS Capital Development and the Sodjas in Arizona, enabled ABC Learning
16 Centres' sale of a controlling interest in Learning Care Group so that ABC Learning
17 Centres got the USD\$420 million it so desperately needed for liquidity.

18
19 There was more to each of the release agreements involving American Child Care
20 Properties and RCS Capital Development. American Child Care Properties entered into a
21 "deed of acknowledgment" with ABC Learning Centres. This deed of acknowledgment is
22 problematic. It is, as a legal matter, nothing more than an agreement to agree that is
23 unenforceable under both Australian law and U.S. law. It also references the forgiven
24 loans to American Child Care Properties as being in an amount that has no correlation to
25 the funds that were actually given as the unsecured loans to American Child Care
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1 Properties. The biggest problem to this document, attached as **Exhibit 6**, is the very clear
2 agreement-to-agree language. The document contains the following language:

3
4 In consideration of the payment of the [loans which have been
5 forgiven] (receipt of which is hereby acknowledged by ACCP
6 [American Child Care Properties] pursuant to clause 2.2 [there
is no clause 2.2]), ACCP agrees to enter into the Contracts
with ABC US for the sale and purchase of the Properties
[meaning the properties in American Child Care's pipeline].

7 *Id.* at § 1.2.

8 It is nice to have a "contract" that says one will enter into a contract, but § 7
9 exacerbated the problem:

10
11
12 7. Purchase Price

13 During the due diligence period under the Contracts [that are
14 to be negotiated in the future] the parties will negotiate in
15 good faith to determine the Purchase Price for each of the
Properties. The total of the Purchase Prices may be re-
allocated between each of the Properties in the manner agreed
between the parties from time to time (acting reasonably).

16 *Id.* at § 7.

17 The document says, in other words, that American Child Care Properties will enter
18 into contracts with an ABC entity in the United States, the terms of which are not set
19 forth, including the fact that the purchase price that U.S. subsidiary of the Australian
20 company will pay is left to future negotiation.

21
22 It is this agreement-to-agree that was attached to all of the complaints filed by ABC
23 in its Nevada litigation against RCS Capital. The most recent of those complaints is the
24 second amended complaint, attached as **Exhibit 7**. This latest complaint was filed in June
25 2011, and is the operative complaint for the action stayed in Nevada when RCS Capital's
26 bankruptcy was filed.
27
28

1 The agreement attending RCS's release of Learning Care Gropu from obligation
2 was the exclusive development agreement attached as **Exhibit 8**. This exclusive
3 development agreement formed the basis of the jury verdict and resulting judgment
4 entered against ABC filed in Arizona.

6 D. ABC Defaults, Declares Insolvency

7 1. *RCS Capital Development*. The exclusive Development with RCS Capital
8 and ABC Learning Centres was signed on June 19, 2008. Neither the Sodjas nor RCS
9 Capital had any idea that ABC was in financial difficulties until ABC failed to make a \$7
10 million payment on September 3, 2008. ABC only paid \$2 million, and attempted to work
11 out an arrangement with RCS Capital to pay the balance over a period of time. These
12 workout attempts, however, came to a screeching halt when Eddy Groves was removed as
13 CEO of ABC Learning Centres on September 30, 2008.

16 Eddy Groves' dismissal as CEO was more than ominous to RCS Capital, so notices
17 of default, as required under the development agreement, were sent out for a variety of
18 defaults, some monetary and some non-monetary. RCS Capital then filed suit against
19 ABC Learning Centres on October 20, 2008. The defendants in that law suit were ABC's
20 Delaware corporation, A.B.C. Developmental Learning Centers, (U.S.A.) Inc., and the
21 Australian corporation itself, ABC Learning Centres, Ltd. It is this law suit that resulted in
22 a verdict in favor of RCS Capital and against both of these ABC entities in May 2010.

25 2. *American Child Care Properties and Krynski*. The termination of Eddy
26 Groves at the end of September 2008 had a devastating effect on Ken Krynski and his
27 company, American Child Care Properties. Krynski had no idea where he stood with ABC
28

1 Learning Centres after his mate was fired, so he went to Australia and held a meeting with
2 those left standing. Krynski hoped he could still sell his locations to any ABC entities
3 because that was his escape from personal liability on loans he had taken out to assist in
4 finishing these projects. This October 15, 2008, meeting, however, was a disaster. He was
5 told in no uncertain terms that no ABC entity was going to purchase any of the properties
6 he was then developing. No contracts would be made for the purchase of these properties.
7

8
9 Krynski returned to the United States with no real hope to resolve the intractable
10 situation in which he found himself. His situation became even bleaker when Learning
11 Care Group, now controlled by Morgan Stanley, sent notices of default with regard to
12 properties it was occupying as a tenant that were part of the development deal Krynski
13 thought he had with ABC in Australia. Indeed, ABC Learning Centres and “thirty-eight of
14 its direct and indirect subsidiaries” went insolvent on the very day, November 6, 2008,
15 that Ken Krynski was begging ABC to fulfill its obligations with respect to the properties
16 that Learning Care Group had declared in default.
17

18
19 It was Krynski’s disastrous situation that led him to his agreement to sell all of his
20 interests in American Child Care Properties and related entities to RCS Capital
21 Development on November 11, 2008. The agreement to purchase his interests is attached
22 as **Exhibit 9**. Under this agreement, RCS Capital took all of Krynski’s and American
23 Child Care Properties’ assets and liabilities in exchange for paying Krynski \$4.7 million.
24 The purchase price was paid with a cash payment of USD\$1.2 million and a carry-back
25 promissory note of USD\$3,500,000.00 secured by a deed of trust on a shopping center
26 property that RCS Capital owned free and clear in Maricopa County.
27
28

1 3. *ABC's insolvency*. Insolvency in Australia is not like a bankruptcy in the
2 United States. In fact, Australia has no bankruptcy law. Insolvencies are governed by
3 Australia's *Corporations Act of 2001*.
4

5 ABC's insolvency was initiated when ABC's board of directors voted to place
6 ABC into what is known in Australia as a "voluntary administration". A voluntary
7 administration places a corporation under the control of external administrators who try to
8 preserve the business or wind it up. The administrative proceedings initiated by ABC on
9 November 6, 2008, resulted in an administrative proceeding that is similar to a bankruptcy
10 in that it is a collective, court-supervised, and qualifies the administrators or
11 administrators-turned-liquidators as debtors under Chapter 15 of the United States
12 bankruptcy code.
13

14 ABC's voluntary administration, however, triggered a second proceeding, a
15 receivership for the benefit of lenders who are in a position similar to secured creditors in
16 the United States. However, the lenders are not secured lenders in the sense that that term
17 is understood in America. Rather, lenders give money in exchange for debentures and
18 charges against the borrowers' property. The receivership, which is not a collective
19 proceeding and does not qualify for recognition under Chapter 15 of the Bankruptcy
20 Code, permits receivers to take possession of assets for the benefit of the debenture
21 holders. The initiation of a voluntary administration "crystallizes" the charges held by the
22 owners of the debentures. This crystallization gives the holders of the charge title to the
23 property, so they can do with it what they want, including liquidating it and paying the
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1 holders of the debentures, without having to account for any of their actions to anyone
2 other than the owners of the charge.

3
4 In my judgment, when the defendants appointed a receiver,
5 they did not thereby acquire rights, but exercised a power
6 which had been acquired when the debenture was executed.
7 The exercise of this power did not alter any rights. It is true
8 that the floating charge was crystallized by the appointment,
9 but no new rights were acquired. The debenture itself created
10 an equitable charge on the assets of the company in the favor
11 of the defendants and a license to a company to deal with
12 those assets in the ordinary course of business. **The**
13 **appointment of the receiver revoked the license to the**
14 **company to deal with its assets in the ordinary course of**
15 **business and placed the receiver in a position to exercise**
16 **powers which had been created by the debenture under**
17 **which he was appointed.**

18 *Watson v. Duff Morgan & Vermont (Holdings) Ltd.*, [1974] 1 WLR 450, 456 (emphasis
19 added).

20 An Australian insolvency results in the formation of two separate entities. First,
21 there is the judicially-supervised, collective administration proceeding, which is at least
22 analogous to a bankruptcy in the United States, and, second, there is the receivership
23 proceeding which is neither collective nor judicially-supervised, and for which there is no
24 analogue in the United States.

25 All of ABC's assets were subject to the charges held by the various banks that had
26 loaned ABC money. Therefore, ABC's insolvency crystallized ownership of all of these
27 assets in the banks that held ABC's debentures, debentures that were supported by charges
28 against all of ABC's property. ABC's receivers therefore, took control and management
of the litigation filed by RCS Capital in Arizona, and ultimately, it was the receivers who
filed suit against RCS Capital in Nevada.

1 The receivers also made decisions about American Child Care Properties and Ken
2 Krynski. It is not clear whether the receivers were immediately aware of the forgiveness-
3 of-debt transaction between American Child Care Properties and ABC before Eddy
4 Groves was terminated, but it is clear that ABC's receivers were aware of the deed of
5 acknowledgment, the agreement-to-agree that contemplated contracts being made for
6 purchase of properties by an ABC entity. On December 11, 2008, ABC's receivers sent
7 Ken Krynski a letter that discussed the deed of acknowledgment's contemplation of
8 agreements being negotiated for the purchase of properties, but the receivers said:

11 As contracts for the remaining Properties have not been, and
12 will not be, entered into, the Deposits [how the forgiven loan
13 funds are described in the deed of acknowledgment] are now
14 immediately due and payable to ABC Learning

14 . . .

15 We therefore hereby demand that the sum of
16 AUD\$39,064,074.39 to be paid to ABC Learning within 7
17 days from the date of this letter. Should you not pay within 7
18 days, we will take steps to instruct our lawyers to commence
19 proceedings against ACCP.

20 **Exhibit 10.**

21 The receivers repeated this declamation on December 19, 2008, and December 26,
22 2008. The only thing the receiver wanted was money.

23 ABC was similarly abrupt with RCS Capital. ABC stopped paying rent on four
24 properties where Learning Care Group had been operating centers. Notices were sent to
25 ABC declaring it in default of leases ABC had on these four properties, but ABC
26 disregarded those notices.

27 E. Resulting Litigation

1 There are three different pieces of litigation that have resulted as a result of ABC's
2 insolvency. These include (1) RCS Capital's law suit against ABC in Arizona; (2) ABC's
3 litigation against RCS Capital in Nevada; and (3) the Chapter 15 proceedings pending
4 before Judge Gross in the District of Delaware. Each of these cases will be considered in
5 turn.
6

7 *1. The Arizona action.* The Arizona action was filed in October 2008 after
8 ABC Learning Centres failed to cure its defaults. The trial started on May 3, 2010, and the
9 jury returned a verdict in favor of RCS Capital on May 14, 2010. Judgment was entered
10 on December 22, 2010, **Exhibit 11**, and the calculation of the total amount owing on that
11 judgment as of December 1, 2011, is attached as **Exhibit 12**, USD\$56,658,779.03.
12

13 Interest accrues at the daily rate of \$13,469.76.
14

15 *2. The Nevada action.* The receivers for ABC filed their action against RCS
16 Capital on March 10, 2009. RCS Capital Development, the judgment creditor against
17 ABC Learning Centres, is a defendant, and the plaintiffs are the very judgment debtors in
18 the Arizona action, ABC Learning Centres Ltd., and A.B.C. Developmental Learning
19 Centers (U.S.A.), Inc. There is a perfect identity of parties between the two law suits so
20 far as RCS Capital's judgment against the plaintiffs in the Nevada action are concerned. A
21 copy of the latest complaint and the one effective in Nevada at the time of RCS Capital's
22 bankruptcy has already been identified as **Exhibit 7**.
23

24 ABC's claims in the Nevada litigation are based on the agreement-to-agree that
25 was made with American Child Care Properties after ABC forgave the debt American
26
27
28

1 Child Care Properties owed to ABC Learning Centres. The prayer for relief is very clear.
2 ABC only wants money.

3
4 There is a claim for a constructive trust in ABC's Nevada complaint, and there is a
5 request for:

6 The imposition of a constructive and/or resulting trust and a
7 judicial declaration the Defendants hold title to the Properties,
whether directly or indirectly, for the sole benefit of Plaintiffs.

8 *Id.* at p. 33, ¶ 7(A) of the prayer.

9 There are some fundamental problems with ABC's constructive trust claim, which
10 is really just a remedy that must be based on its claim for money damages. "[A]

11 constructive trust is a remedial device. *Locken v. Locken*, 650 P.2d 803, 804 (Nev. 1982).

12 A remedy is "relief . . . given to a plaintiff once that plaintiff has established a substantive
13 right by appropriate in-court procedures." Dan B. Dobbs, *Law of Remedies*, § 1.1, 1 (2d

14 ed. 1993). As the Ninth Circuit Bankruptcy Appellate Panel has noted, "in Nevada, a
15

16 constructive trust arises when the holder of the property is *determined* to be the trustee of
17 that property . . ." *In re Commercial Money Ctr.*, 392 B.R. 814, 831 (9th Cir. BAP 2008)

18 (*emphasis added*). The court "imposes" a constructive trust. *Id.* The bankruptcy court for
19

20 the district of Nevada is even more explicit: "Since it is a remedy rather than a substantive
21 right, a constructive trust arises only when imposed by a court." *In re Western World*

22 *Funding, Inc.*, 54 B.R. 470, 475 (Bankr. D. Nev. 1985).
23

24 The question of the constructive trust distills to a simple issue: does justice (equity)
25 require that ABC get a remedy for recovery of an unsecured loan that was forgiven so that
26 ABC Learning Centres could get USD\$420 million from Morgan Stanley? ABC's claims,
27
28

1 it says, are based upon an agreement-to-agree that was signed a couple of days after ABC
2 had forgiven the debt, but that does not help ABC. Another vexing problem for ABC's
3 receivers is that all of this money really did not go into these properties because Eddy
4 Groves and Ken Krynski diverted a lot of it to their own personal uses. But the real *coup*
5 *de gras* to the receivers' law suit is that ABC Learning Centres and ABC's US subsidiary,
6 the two plaintiffs in the Nevada action, are judgment debtors who owe RCS Capital more
7 than \$56 million. Judge Gross has already ruled that RCS can use this judgment as an
8 offset against ABC's claims in the Nevada litigation, so there really is nothing to litigate
9 in Nevada. RCS is willing to avoid the fight by offsetting its liquidated judgment amount
10 against ABC's improbable and unliquidated claim. In light of the Court's rulings on May
11 22, 2012, the Debtor will proceed with its setoff, and ABC's constructive trust/fraudulent
12 conveyance claims no longer exist.

13
14
15
16 *3. ABC's Chapter 15 proceeding.* ABC filed for recognition under Chapter
17 15 of the Bankruptcy Code on May 26, 2010, about two weeks after RCS obtained its
18 verdict. Hearings were held before Judge Gross in June and August, and he entered an
19 order on November 16, 2010, that recognized the Chapter 15 proceeding, but allowed
20 RCS to convert its judgment to a verdict and set off its judgment amount against ABC's
21 claims. Judge Gross's November 16, 2010, order is attached as **Exhibit 13**. Judge Gross's
22 opinion supporting his order is attached as **Exhibit 14**. The portion of Judge Gross's
23 opinion allowing RCS to convert its verdict to a judgment and set off against ABC's claim
24 begin at page 31.

1 Following entry of Judge Gross's order and opinion, RCS filed a motion to amend
2 because of what RCS respectfully urged were inconsistencies in Judge Gross's opinion.
3
4 Judge Gross, on January 21, 2011, granted RCS's motion in part. That order is attached as
5 **Exhibit 15**. Judge Gross specifically held that Chapter 15 recognition was not granted to
6 the receivership proceedings, but he also ruled that the debtor for Chapter 15 purposes
7 included both the receivership proceedings and the liquidation proceedings in Australia.
8
9 RCS Capital disagrees with the decision by Judge Gross and has appealed it to the United
10 States District court in Delaware. The appeal is fully briefed and awaiting decision. It is
11 anticipated that there will be an appeal to the Third Circuit irrespective of the decision by
12 the District Court, as this case presents a matter of first impression in the United States
13 under Chapter 15.
14

15 Judge Gross has entered an order holding RCS in contempt for violation of the
16 automatic stay. That order is attached as **Exhibit 16**. The essence of this order is that
17 RCS Capital violated the automatic stay by selling property against which ABC claims a
18 constructive trust and had therefore filed *lis pendens*. RCS took the position, and still
19 maintains that property subject to a *lis pendens* can be sold without violation of the
20 automatic stay because the buyer takes subject to the outcome of pending litigation. No
21 decisions in the United States have been found that deal with the property interests a
22 debtor has because a debtor has filed a *lis pendens* based on a remedy defendant upon
23 unadjudicated claims for money. Moreover, Nevada law is clear that a claim of a
24 constructive trust does not result in a property interest or support a *lis pendens* even
25
26
27
28

1 though the trial judge in the Nevada case held that a constructive trust did support a *lis*
2 *pendens*. In an action seeking money damages, the Nevada Supreme Court held:

3
4 *Lis pendens* is one of the few remaining provisional remedies
5 available at its inception without prior notice to the adversary.
6 Due process is said to be provided for by subsequent notice
7 and an expungement procedure which casts the burden upon
8 the proponent of the *lis pendens*, but a *lis pendens* may cause
9 substantial hardship to the property owner before relief can be
10 obtained. A commentator has expressed reservations as to . . .
11 [a] broad endorsement of *lis pendens* in claimed constructive
12 trust actions on the ground that it tends “to create a right
13 substantially similar to an *ex parte* prejudgment attachment of
14 the defendant’s assets, a remedy disfavored in California and
15 severely limited because of its due process problems” (*Cal.*
16 *Lis Pendens Practice*, § 2.7, p. 32 (citations omitted)).
17 Overbroad definition of “an action . . . affecting the title or the
18 right of possession of real property” would invite abuse of *lis*
19 *pendens*.

20 *Id.* at 320.
21 NRS 14.010 (1) indicates that it is applicable “in an action for
22 the foreclosure of a mortgage upon real property, or affecting
23 the title or possession of real property” The instant action
24 is not of the type envisioned under this statute. The Stable
25 never had title to property which is now being “corralled to
26 satisfy a money judgment.

27 *Levinson v. Eight Judicial District*, 109 Nev. 747, 751–52, 857 P.2d 18, 20–21 (1993).

28
29 Judge Gross is reserving judgment with regard to any damages until there is a
30 resolution of whether or not the receivers for ABC actually have a constructive trust on
31 property. The Debtor believes the offset and accompanying ABC Release as defined in
32 the Plan moots any issue of damages. Indeed, in light of the Court’s June 7, 2012 Ruling
33 ABC owes the Debtor USD \$30,366,140.90.

34
35 In March, 2009, while the Arizona Litigation was ongoing, ABC sued
36 American Child Care Properties and ACCP I in Nevada (“the Nevada Litigation”).
37 As part of the same case, ABC also sued RCS, which had purchased the two LLCs
38 in November 2008. ABC alleged that it paid approximately \$42,000,000 Australian

1 dollars to American Child Care Properties and/or ACCP I to purchase land to
2 develop into child care centers. ABC further alleged that the purchased land was
3 not transferred to ABC as purportedly agreed but, rather, sold to third parties and to
4 RCS. Trial was set to begin on November 1, 2011, but was stayed by RCS's
5 bankruptcy, as well as the bankruptcy of American Child Care Properties and
6 ACCP I. Importantly, from the time American Child Care Properties/ACCP I
7 transferred the properties to third parties through the time ABC filed its complaint
8 in the Nevada Litigation, the Australian dollar was worth approximately 65 cents
9 American. Thus, ABC's claim for AUD\$42,000,000 is worth approximately
10 US\$27,300,000.
11

12 At the initial hearing on approval of the Disclosure Statement, the Court
13 allowed ABC to file a statement of its position. ABC filed the Statement on
14 February 6, 2012. (DE #79.) A copy of the Statement is attached as **Exhibit 22**.

15 **Post-Petition Operations**

16 Since the Petition Date, the Debtor has continued to operate the business as a
17 "debtor-in-possession" under Sections 1107(a) and 1108 of the Bankruptcy Code. The
18 Debtor has not required any Post-Petition Debtor-in-Possession financing. The Debtor
19 will file monthly operating reports that detail its financial condition, as required by the
20 Bankruptcy Code.

21 The U.S. Trustee appointed an Official Committee of Unsecured Creditors on
22 December 1, 2011 at DE #35.

23 On December 2, 2011, ABC filed a Motion for Relief from Stay. (DE #38.) ABC
24 sought permission to pursue litigation in Nevada State Court. The Bankruptcy Court held
25 a hearing on the Motion on January 25, 2012 and denied the Motion without prejudice.
26 The Debtor anticipates file a Motion for Summary Judgment on the set-off issue on or
27 before February 22, 2012. On December 19, 2011 a "Statement of Creditor Morris
28 Nichols, Arshat & Tunnell LLP with respect to Motion for Relief from Stay" ("Statement")
at Docket #51. The Statement did not focus on the Motion for relief from Stay. Rather, it
raised issues regarding disclosures in the Debtor's Statement of Financial Affairs

1 (“SFA”). The SFA disclosed receipt of \$2,141,062.20 from the proceeds of a sale
2 involving Robindale and Summerlin. The Statement noted the sale price was
3 \$6,363,212.00. Attached hereto as **Exhibit 18** is a copy of the settlement statement,
4 which identifies the debtor in fact received the amounts identified in the SFA. The
5 remaining sales proceeds were disbursed as set forth in the Settlement Statement. The
6 SFA also disclosed no monies were received by the Debtor as a result of the Russell sale.
7 Attached as Exhibits 19 and 20 are (1) a copy of the settlement statement on that
8 transaction, and (2) a letter agreement as to how monies were disposed. The debtor
9 received no monies as a result of the sale. Rather, it received a 50% participation interest.
10 This participation interest is a portion of the assets which will be utilized to fund the
11 debtors’ Plan payments. Again, the SFA’s disclosures were accurate.

8 **Retention of Professionals**

9 On October 17, 2011, the Bankruptcy Court entered an order authorizing the
10 Debtor to retain Michael W. Carmel, Ltd. as bankruptcy and reorganization counsel. No
11 other professionals have been retained, although it is anticipated special counsel will be
12 retained to represent the Debtor in the Delaware proceedings and any appellate
13 proceedings in Arizona.

14 On January 9, 2012, the Debtor filed an Application to Employ Baird Williams &
15 Greet (“BWG”) as Special Counsel. (DE #58.) BWG was the Debtor’s counsel pre-
16 petition as it related to all claims involving ABC. BWG’s Amended Employment
17 Application will state BWG would represent the Debtor on all litigation going forward
18 involving ABC, including (1) ABC’s claim(s) in the Bankruptcy case; (2) the Debtor’s
19 set-off claim(s) against ABC; and (3) all matters currently pending in ABC’s Chapter 15
20 case in the District of Delaware – including but not limited to any appeal(s). It is
21 anticipated BWG will file the amended application no later than February 16, 2012.

22 Daryl Williams of Baird, Williams & Greer has known Rick Sodja, the principal
23 for RCS Capital Development, for over ten years. Mr. Williams has represented Rick and
24 several of his businesses throughout that time. As with prior representation, there were no
25 written fee agreements, only oral agreements between the firm and Mr. Sodja. Those oral
26 agreements have never been violated by either party. On July 25, 2011, RCS Capital
27 Development paid Baird, Williams & Greer \$575,000. Of that total, RCS paid
28 \$491,314.55 for work done by BWG in representing RCS in various proceedings around
the country, including the Nevada Litigation and the Delaware Chapter 15. The
remaining \$83,685.45 was paid by RCS for work performed on behalf of other entities
owned by Rick Sodja. At the time of the payment, RCS was solvent and able to pay its
creditors in full, as it is today. RCS anticipates retaining Baird, Williams & Greer to
represent its interests in the Chapter 15 case currently before the Bankruptcy Court for the
District of Delaware and to represent its interests in litigating the applicability of setoff in
this case. RCS will file its amended application to employ Baird, Williams & Greer, and
that Firm’s employment has been approved.

26 **Bar Date for Filing Proofs of Claims**

27 On October 18, 2011, the Bankruptcy Court entered an order setting the bar date
28 for filing proofs of claims as **November 30, 2011**. Regardless of whether your claim is
listed on the Debtor’s Bankruptcy Schedules or whether your claim is listed as disputed,
contingent, unliquidated, or unknown, or you disagree with the amount of the listed claim,

1 or whether you are asserting a claim against any alleged assets of the Estate in any
2 adversary proceeding, **YOU MUST HAVE FILED A PROOF OF CLAIM IN THIS**
3 **CASE OR BE FOREVER BARRED FROM RECEIVING A DIVIDENT FROM**
4 **THE ESTATE.**

5 **A copy of the Claims Register for each of the three (3) cases is attached as**
6 **Exhibit 17. The Debtor believes Jinbo, LLC (Claim #4) will have no claim if the Plan**
7 **is confirmed. Additionally, the Krynski Claim (Claim #2) is overstated by at least**
8 **\$1,250,000.00. Accordingly, the anticipated timely filed Allowed Claims in Class 3 A**
9 **should not be greater than \$925,000.00.**

10 The Court has scheduled an initial hearing on the Debtor's Objection to the
11 Krynski claim on March 14, 2012.

12 **Debtor's Assets**

13 The Debtor's Bankruptcy Schedules reflect assets of \$57,038,210.04. The Debtor
14 owns three parcels of property in Nevada, one on North Las Vegas (the "Ann Road
15 Property") and two in Las Vegas (the "Valley View" and "Simmons Properties"). The
16 City of North Las Vegas has a lien for unpaid property taxes and development fees.
17 Under the plan, the Ann Road Property will be sold pursuant to 11 U.S.C. § 363 and the
18 proceeds will be used to pay the City of North Las Vegas. The remainder will be used to
19 pay other Allowed Claims under the Plan. The Valley View and Simmons Properties
20 have liens on them in favor of Hill Crest Bank, which will retain its lien interests in those
21 Properties. Debtor also owns a profit interest in a property located at 2488 East Russell
22 Road (the "Russell Road Property") once the Russell Road Property is sold, Debtor with
23 use its proceeds of approximately \$800,000.00 - \$1,000,000.00 to pay off its general
24 unsecured claims, except the debt owed to ABC Learning Center Limited ("ABC").
25 Debtor's largest asset is a judgment in the approximate amount of \$57,000,000.00 against
26 ABC. Debtor will offset any allowed claim made by ABC with its judgment against
27 ABC. Any monies the Debtor collects on the balance owed from ABC will be used *first*,
28 to satisfy all Class 3 (A) Claims to the extent the sales of property contemplated in the
Plan are insufficient to fully satisfy all Class 3(A) Claims, and *second*, to be distributed to
the holders of Class 5 Interests on a *pro rata* basis.

Pursuant to the Court's Order at the January 30, 2012 hearing, the Debtor is
providing the following information regarding sales of property in the two (2) year time
period preceding the Bankruptcy filing (October 12, 2009 – October 12, 2011).

On March 4, 2010, property located at 7051 Woodlake Commons Loop,
Midlothian, Virginia and Rutland Shire Drive, Richmond Virginia was sold. Attached as
Exhibit 22 is a breakdown of sales proceeds and disposition.

On March 25, 2011, the property located at 2488 East Russell Drive, Las Vegas,
Nevada was sold. Attached as **Exhibit 23** is a breakdown of the sales proceeds and
disposition.

On July 22, 2011, property located at 6980 West Robindale, Las Vegas, Nevada
and 10405 Griffith Park, Las Vegas, Nevada was sold. Attached as **Exhibit 24** is a
breakdown of the sales proceeds and disposition.

The Debtor's Bankruptcy Schedules reflect liabilities of approximately
\$47,169,203.60, the most significant of which is the disputed US\$41,000,000.00 claim of
ABC. With the passage of time, the Debtor's judgment claim(s) against ABC has now
increased to approximately USD\$59,000,000.00. The June 7, 2012 Ruling means the

1 Debtor will now be asserting a claim against ABC, and will pursue all collection remedies
2 available to it.

3 From April, 2010-July, 2011, the Debtor made the following loans to Rick Sodja:

4	• April 23, 2010	\$360.00
5	• July 22, 2010	\$1,350.00
6	• July 23, 2010	\$(1,428.67)
7	• December 31, 2010	\$34,260.41
8	• July 18, 2011	\$26,111.40
9	• July 25, 2011	<u>\$24,357.18</u>
10	Total:	<u>\$85,010.32</u>

11
12
13 As of the filing of this Amended Disclosure Statement, the loans remain
14 outstanding. While they do constitute an asset of the estate, the Debtor currently does not
15 intend to seek collection from Mr. Sodja, as the Plan provides for a full payment to
16 creditors.

17 **Brief Explanation of Chapter 11 Reorganization**

18 The Debtor is being reorganized pursuant to the Plan that is proposed under
19 Chapter 11 of the Bankruptcy Code ("Chapter 11"). Under Chapter 11, a debtor is
20 authorized to reorganize its business for the benefit of itself, its creditors and equity
21 holders. Confirmation of a Plan of Reorganization is the principal objective of a
22 Chapter 11 case.

23 In general, a Chapter 11 Plan of Reorganization (a) divides Claims into
24 separate Classes; (b) specifies the property that each Class is to receive under the Plan;
25 and c) contains other provisions necessary to the reorganization of the Debtor. A
26 Chapter 11 Plan of Reorganization may provide that certain Classes of Claims are either:
27 (i) to be paid in full upon the effective date of the plan; (ii) reinstated; or (iii) their legal,
28 equitable and contractual rights are to remain unchanged by the reorganization or
liquidation effectuated by the plan. These Classes are referred to under the Bankruptcy
Code as unimpaired and, because of such favorable treatment, are deemed to accept the
plan. Accordingly, it is not necessary to solicit votes from the holders of Claims in such
unimpaired Classes. A Chapter 11 plan may also provide that certain Classes will not
receive any distributions of property. Such Classes are deemed to reject the plan.

All other Classes of Claims contain impaired Claims. An impaired Class is generally a Class which will receive something less than their Claim under the plan of reorganization. Before a plan can be confirmed by the Bankruptcy Court, Chapter 11 generally requires that each impaired Class of Claims votes to

1 accept a plan. Acceptances must be received from the holders of Claims constituting
2 at least two-thirds in dollar amount and more than one-half in number of the
3 allowed Claims in each impaired Class of Claims that have voted on the plan.
4 However, even if an impaired Class rejects the plan, the Bankruptcy Court may
5 confirm the plan if certain minimum treatment standards are met with respect to
6 such Class or Classes. This is discussed in this Disclosure Statement under the
7 Section heading “Confirmation Without Acceptance by All Impaired Classes”.
8 Classes that receive nothing are deemed to reject the Plan.

9 Chapter 11 does not require each holder of a Claim to vote in favor of a plan
10 of reorganization in order for the Bankruptcy Court to confirm the Plan. However, the
11 Bankruptcy Court must find that the Plan meets a number of tests (other than the voting
12 requirements described in this section) before it may confirm, or approve, the Plan. Many
13 of these tests are designed to protect the interests of holders of Claims who do not vote to
14 accept the Plan but who will nonetheless be bound by the Plan’s provisions if it is
15 confirmed by the Bankruptcy Court.

16 **Preserved Claims**

17 The Parties are referred to §8.7 of the Plan for a description of the claims which are
18 being preserved for future prosecution/collection.

19 **Solicitation of Acceptance of the Plan**

20 The Debtor is seeking acceptances of the Plan from holders of Allowed Claims
21 classified in Classes 3 and 4 which are the only Classes entitled to vote under the Plan.
22 Class 1 is deemed to accept the Plan. If the requisite acceptances are received, the Debtor
23 will use the acceptances as evidenced by the Ballots solicited in connection with this
24 Disclosure Statement and the Solicitation Order to seek confirmation of the Plan under
25 Chapter 11.

26 If any impaired Class is determined to have rejected the Plan in accordance with
27 Section 1126 of the Bankruptcy Code, the Debtor may use the provisions of Section
28 1129(b) of the Bankruptcy Code to satisfy the requirements for confirmation of the Plan.

The Debtor believes that its Plan complies with applicable bankruptcy and non-
bankruptcy law. The Debtor believes this Disclosure Statement contains adequate
information for all holders of Impaired Claims to cast an informed vote to accept or reject
the Plan. Furthermore, the Debtor believes the holders of Impaired Claims will obtain a
greater recovery under the Plan than they would otherwise obtain if the Debtor’s assets
were immediately liquidated under Chapter 7 of the Bankruptcy Code.

If the Plan is confirmed by the Bankruptcy Court, each holder of an Impaired
Allowed Claim will receive the same pro-rata consideration as other holders of Claims in
the same Class, whether or not such holder voted to accept the Plan. Moreover, upon
Confirmation, the Plan will bind all Creditors regardless of whether or not such Creditors
voted to accept the Plan.

29 **Classification of Claims and Equity Interests**

30 Section 1123 of the Bankruptcy Code provides that a plan of reorganization must
31 classify Claims against a debtor. Under Section 1122 of the Bankruptcy Code, a plan
32 must classify Claims into Classes that contain substantially similar Claims. The Plan
33 divides the Claims of known Creditors into Classes and sets forth the treatment offered
34 each Class. The Debtor believes it has classified all Claims in compliance with the

1 provision of Section 1122 of the Bankruptcy Code, but it is possible that a Creditor may
2 challenge such classification of Claims and that the Bankruptcy Court may find that a
3 different classification is required for the Plan to be confirmed. If so, the Debtor intends,
4 to the extent permitted by Bankruptcy Code and the provisions of the Plan, to amend or
5 revoke the Plan and file an amended or different Plan that would make modifications to
6 the classification of Claims required by the Bankruptcy Court for confirmation.

7 The Classes under the Plan take into account the differing nature and priority of
8 Claims against the Debtor. Section 101(5) of the Bankruptcy Code defines Claim as a
9 right to payment, whether or not such right is reduced to judgment, liquidated, fixed,
10 contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or
11 unsecured; or a right to an equitable remedy for breach of performance if such breach
12 gives rise to a right to payment whether or not such right to an equitable remedy is
13 reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed,
14 secured or unsecured. A Claim against the Debtor also includes a Claim against the
15 Debtor's property as provided in Section 102(2) of the Bankruptcy Code.

16 For the holder of a Claim to participate in a reorganization plan and receive the
17 treatment offered to the Class in which it is classified, its Claim must be Allowed. Under
18 the Plan, an Allowed Claim is defined as a Claim: (a) proof of which, requests for
19 payment of which, or application for allowance of which, was filed or deemed filed on or
20 before the Bar Date, Administrative Claim Bar Date, or the Professional Fee Bar Date, as
21 applicable, for filing proofs of claim or requests for payment of claims of such type
22 against the Debtor; (b) if no proof of claim is filed, which has been or is ever listed by the
23 Debtor in the Schedules as liquidated in amount and not disputed or contingent; or c) a
24 Claim that is allowed in any contract, instrument, indenture, or other agreement entered
25 into in connection with the Plan and, in any case, a Claim as to which no objection to its
26 allowance has been interposed within the applicable period of limitation fixed by the Plan,
27 the Bankruptcy Code, the Bankruptcy Rules, or the Bankruptcy Court. Any Claim to
28 which an Objection is filed is not an allowed claim until a court of competent jurisdiction
has entered a final, no-appealable order.

Implementation of the Plan

The Debtor shall be responsible for administering and implementing the Plan,
including, but not limited to making Distributions pursuant to the Plan.

Management of the Reorganized Debtor

Subject to the provisions of the Plan, and in accordance with Section 1123(b)(3)(B)
of the Bankruptcy Code, Rick Sodja is the designated representative of the Reorganized
Debtor. Subject to the provisions of the Plan, Mr. Sodja will have the power to take any
and all such actions as are, in his judgment, necessary to fulfill its obligations under the
Plan.

Distributions

On the Distribution Date, or as soon thereafter as practical, the Debtor shall effect a
Distribution to holders of Allowed Claims that, as of the date of the Distribution, have not
otherwise been paid or satisfied in accordance with the Plan.

Limitations on Members' Liability

1 Subject to applicable law, no Member shall be liable for any act or omission in
2 carrying out the Plan except for such act or omission arising from such Person's gross
negligence, willful fraud or other willful misconduct.

3 **Description of Other Provisions of the Plan**

4 **Executory Contracts**

5 Debtor is not a party to any executory contracts.

6 **Post-Effective Date Distributions**

7 Distributions made after the Effective Date to holders of Claims that are not
8 Allowed Claims as of the Effective Date, but which later become Allowed Claims, shall
9 be deemed to have been made on the Effective Date. Notwithstanding any provision in
10 any contract or other document that may relate to a Claim, all Distributions made pursuant
11 to the Plan shall be made as if paid on the Initial Distribution Date, without the additional
12 accrual of interest, fees or penalties.

11 **Discharge**

12 Except as provided in the Plan or the Confirmation Order, the rights afforded under
13 the Plan and the treatment of Claims under the Plan are in exchange for and in complete
14 satisfaction, discharge, and release of, all Claims including any interest accrued on
15 Administrative Expense Priority Claims and General Unsecured Claims from the Petition
16 Date. Except as provided in the Plan or the Confirmation Order, confirmation of the Plan:
17 (a) discharges the Debtor from all Claims or other debts that arose before the
Confirmation Date, and all debts of the kind specified in Sections 502(g), 502(h) or 502(I)
of the Bankruptcy Code, whether or not: (i) a proof of claim based on such debt is filed or
deemed filed under Section 502 of the Bankruptcy Code; (ii) a Claim based on such debt
is Allowed under Section 502 of the Bankruptcy Code; or (iii) the holder of a Claim based
on such debt has accepted the Plan.

18 **Injunction**

19 Except as provided in the Plan or the Confirmation Order, as of the Confirmation
20 Date, all entities that have held, currently hold or may hold a Claim or Interest or other
21 debt or liability that is discharged are permanently enjoined from taking any of the
22 following actions on account of any such discharged Claims, debts or liabilities:
23 (a) commencing or continuing in any manner any action or other proceeding against the
24 Debtor (including any officer or director acting as a representative of the debtor) or
25 property of the Debtor; (b) enforcing, attaching, collecting or recovering in any manner
26 any judgment, award, decree or order against the Debtor or property of the Debtor;
27 (c) creating, perfecting, or enforcing any lien or encumbrance against the Debtor or
28 property of the Debtor, including; (d) asserting a setoff, right of subrogation or
recoupment of any kind against any debt, liability, or obligation due to the Debtor; and
(e) commencing or continuing any action, in any manner, in any place, that does not
comply with or is inconsistent with the provisions of the Plan or the Bankruptcy Code.

1 **Preservation of Insurance**

2 The Debtor's discharge and release from Claims as provided in the Plan, except as
3 necessary to be consistent with the Plan, do not diminish or impair the enforceability of
any insurance policy that may cover Claims against the Debtor or any other Person.

4 **Section 1146 Exemption**

5 In accordance with Section 1146(c) of the Bankruptcy Code: (a) the distribution,
6 transfer, or exchange of Estate property; (b) the creation, modification, consolidation, or
recording of any deed of trust or other security interest, the securing of additional
7 indebtedness by such means or by other means in furtherance of, or connection with, the
Plan or the Confirmation Order; (c) the making, assignment, modification, or recording of
8 any lease or sublease; or (d) the making, delivery, or recording of a deed or Order, or any
transaction contemplated above, or any transactions arising out of, contemplated by, or in
9 any way related to, the foregoing shall not be subject to any document recording tax,
stamp tax, conveyance fee, intangibles or similar tax, mortgage tax, stamp act or real
10 estate transfer act, mortgage recording tax or other similar tax or governmental assessment
and the appropriate state or local government officials or agents shall be directed to forego
11 the collection of any such tax or assessment and to accept for filing or recordation any of
the foregoing instruments or other documents without payment of any such tax or
12 assessment.

13 **Withholding and Reporting Requirements**

14 In connection with the Plan and all instruments issued in connection with the Plan,
the Debtor shall comply with all withholding and reporting requirements imposed by any
15 federal, state, local or foreign taxing authority, and all Distributions under the Plan remain
subject to any such withholding and reporting requirements. The Debtor shall be
16 authorized to take all actions necessary to comply with such withholding and recording
requirements. Notwithstanding any other provision of the Plan, each holder of an
17 Allowed Claim that has received a Distribution of Cash, shall have sole and exclusive
responsibility for the satisfaction or payment of any tax obligation imposed by any
18 governmental unit, including income, and other tax obligation on account of such
Distribution. For tax purposes, Distributions received in respect of Allowed Claims will
19 be allocated first to the principal amount of such Claims, with any excess allocated to
unpaid accrued interest.

20 **Full and Final Satisfaction and Penalties and Fines**

21 In accordance with the Plan, all payments and all distributions are in full and final
22 satisfaction, settlement, release, and discharge of all Claims and Equity Interests, except
as otherwise provided in the Plan.

23 Except as expressly provided for in the Plan, no distribution shall be made under
24 the Plan on account of, and no Allowed Claim (whether Secured, Unsecured, Priority or
Administrative) shall include any fine, penalty, or exemplary or punitive damages relating
25 to or arising from any default or breach by the debtor, and any claim on account of such
fine, penalty, or exemplary or punitive damages shall be deemed to be disallowed,
26 whether or not an objection is filed to such Claim.

27 **Impaired Classes to Vote**

28 Each holder of a Claim in an impaired Class shall be entitled to vote separately to
accept or reject the Plan unless such holder is deemed to reject the Plan.

1 **Acceptance by Class of Creditors and Holders of Interest**

2 An impaired Class of holders of Claims shall have accepted the Plan if the Plan is
3 accepted by at least two-thirds in dollar amount and more than one-half in number of the
4 Allowed Claims of such Class that have voted to accept or reject the Plan. A class of
5 holders of Claims shall be deemed to accept the Plan in the event that no holder of a
6 Claim within that Class submits a Ballot by the Voting Deadline.

5 **Cramdown**

6 If any impaired Class of Claims entitled to vote does not accept the Plan by the
7 requisite statutory majorities provided in Section 1126(c) or 1126(d) of the Bankruptcy
8 Code as applicable, or if any impaired Class is deemed to have rejected the Plan, the
9 Debtor reserves the right to request that the Bankruptcy Court confirm the Plan under
10 Section 1129(b) of the Bankruptcy Code and to amend the Plan, in accordance with the
11 applicable provisions of the Plan governing amendments or modifications, to the extent
12 necessary to obtain entry of the Confirmation Order.

10 **Disbursement of Funds**

11 Any payment of Cash required to be made under the Plan will be made by check
12 drawn on a domestic bank or by wire transfer from a domestic bank at the election of the
13 Person making such payment. Any payment or distribution required to be made under the
14 Plan on a day other than a Business Day will be made on the next succeeding Business
15 Day, without interest.

16 From and after the Effective Date, the Debtor may litigate to Final Order, propose
17 settlements of, or withdraw objections to, all pending or filed Disputed Claims or
18 Litigation Claims and may settle or compromise any Disputed Claim or Litigation Claim
19 without notice and a hearing and without approval of the Bankruptcy Court.

17 **Retention of Jurisdiction**

18 Notwithstanding the entry of the Confirmation Order and the occurrence of the
19 Effective Date, the Bankruptcy Court retains broad jurisdiction over the Chapter 11 case
20 after the Effective Date, to the extent legally permissible.

20 **Amendment of the Plan**

21 At any time before the Confirmation Date, the Debtor may alter, amend, or modify
22 the Plan under Section 1127(a) of the Bankruptcy Code provided that such alteration,
23 amendment, or modification does not materially or adversely affect the treatment and
24 rights of holders of Claims or Interests under the Plan. After the Confirmation Date and
25 before substantial consummation of the Plan as defined in Section 1101(2) of the
26 Bankruptcy Code, the Debtor may, under Section 1127(b) of the Bankruptcy Code,
27 institute proceedings in the Bankruptcy Court to remedy any defect or omission or
28 reconcile any inconsistencies in the Plan, the Disclosure Statement, or the Confirmation
Order, and such matters as may be necessary to carry out the purposes and effects of the
Plan so long as such proceedings do not materially and adversely affect the treatment of
holders of Allowed Claims under the Plan; provided, however, that prior notice of such
proceedings shall be served in accordance with the Bankruptcy Rules or applicable order
of the Bankruptcy Court.

28 **Revocation or Withdrawal of the Plan**

1 The Debtor reserves the right to revoke or withdraw the Plan at any time before the
2 Confirmation Date. If the Plan is withdrawn or revoked, then the Plan shall be deemed
3 null and void and nothing contained in the Plan shall be deemed a waiver of any Claims
4 by or against the Debtor or any other person in any further proceedings involving the
5 Debtor or an admission of any sort, and the Plan and any transaction contemplated by the
6 Plan shall not be admitted into evidence in any proceeding.

7 **Post-Confirmation Fees**

8 The Debtor will be responsible for the payment of any fees payable to the Office of
9 the United States Trustee for the Debtor after Confirmation, consistent with applicable
10 provisions of the Bankruptcy Code, Bankruptcy Rules, and 28 U.S.C. Section 1930(a)(6).
11 The Debtor plans to seek an order closing the case as soon as it is substantially
12 consummated, without the burden of ongoing fees assessed against all the Reorganized
13 Debtor's expenditures.

14 The Debtor estimates that it will incur no more than \$100,000 in attorneys' fees to
15 implement the Plan, once it is confirmed. These fees would be incurred primarily to
16 represent the debtor on any appeals as well as claims objections.

17 **Conditions to Confirmation and Effective Date**

18 **Conditions to Confirmation.** The following are conditions precedent to
19 confirmation of the Plan:

- 20 • The Bankruptcy Court shall have entered a Final Order approving the
21 Disclosure Statement with respect to the Plan;
- 22 • The Confirmation Order has been entered in form and substance reasonably
23 acceptable to the Debtor and the Creditors' Committee, and contains
24 specific provisions as set forth in the Plan.
- 25 • Conditions to Effectiveness: The following are conditions precedent to the :
26 occurrence of the Effective Date:
 - 27 • The Confirmation Date has occurred;
 - 28 • The Confirmation Order is a Final Order, except that the
Debtor reserves the right to cause the Effective Date to occur
notwithstanding the pendency of an appeal of the
Confirmation Order, under circumstances that would render
moot such an appeal;
 - No request for revocation of the Confirmation Order under
Section 1144 of the Bankruptcy Code has been made, or, if
made, remains pending;

- The Bankruptcy Court, in the Confirmation Order, has approved the retention of jurisdiction provisions of the Plan; and
- All documents necessary to implement the transactions contemplated by the Plan are made in form and substance reasonably acceptable to the Debtor and the Creditors' Committee.
- ***Waiver of Conditions.*** The conditions to confirmation and the Effective Date may be waived in whole or in part by the Debtor at any time without notice, an order of the Bankruptcy Court, or any further action other than proceeding to confirmation and consummation of the Plan.

ACCEPTANCE AND CONFIRMATION OF THE PLAN

The following is a brief summary of the provisions of the Bankruptcy Code relevant to acceptance and confirmation of a plan of reorganization. Holders of Claims are encouraged to review the relevant provisions of the Bankruptcy Code with their own attorneys.

Acceptance of the Plan

This Disclosure Statement is provided in connection with the solicitation of acceptances of the Plan. The Bankruptcy Code defines acceptance of a plan of reorganization by a Class of Claims as acceptance by holders of at least two-thirds (2/3) in dollar amount, and more than one-half (1/2) in number, of the Allowed Claims of that Class that have actually voted or are deemed to have voted to accept or reject a plan. The Bankruptcy Code defines acceptance of a plan of reorganization by a Class of interests as accepted by at least two-thirds in amount of the allowed interests of that Class that have actually voted or are deemed to have voted to accept or reject a plan.

If one or more impaired Classes reject the Plan, the Debtor may, in its discretion, nevertheless seek confirmation of the Plan if the Debtor believes that the requirements of Section 1129(b) of the Bankruptcy Code for Confirmation of the Plan (which are summarized below) will be met, despite the lack of acceptance by all Impaired Classes.

Confirmation

Confirmation Hearing

Section 1128(a) of the Bankruptcy Code requires the Bankruptcy Court, after notice, to hold a hearing on confirmation of a plan. Notice of such hearing is being provided to all known holders of Claims or Interests or their respective representatives along with this Disclosure Statement. The hearing may be adjourned from time to time by the Bankruptcy Court without further notice except for an announcement of the adjourned date made at such hearing or any subsequent adjournment thereof.

Section 1128(b) of the Bankruptcy Code provides that any party-in-interest may object to confirmation of a plan. Any objection to confirmation of the Plan must be in

1 writing, must conform with the Bankruptcy Rules and the Local Rules of the Bankruptcy
2 Court, must set forth the name of the objecting party, the nature and amount of Claims or
3 Equity Interests held or asserted by that party against the Debtor's Estate or property, and
4 the specific basis for the objection. Such objection must be filed with the Bankruptcy
5 Court, with a copy forwarded directly to the chambers of the Honorable Randolph J.
6 Haines, together with a proof of service, and served on all parties and by the date set forth
7 on the notice of the confirmation hearing in accordance with the Local Rules of the
8 Bankruptcy Court.

6 **Statutory Requirements for Confirmation of the Plan**

7 At the confirmation hearing, the Debtor will request the Bankruptcy Court
8 determine that the Plan satisfies the requirements of Section 1129 of the Bankruptcy
9 Code. If the Bankruptcy Court so determines, the Bankruptcy Court will enter an order
10 confirming the Plan. The applicable requirements of Section 1129 of the Bankruptcy
11 Code are as follows:

- 10 • The Plan must comply with the applicable provisions of the Bankruptcy
11 Code;
- 12 • The Debtor must have complied with the applicable provisions of the
13 Bankruptcy Code;
- 14 • The Plan must have been proposed in good faith and not by any means
15 forbidden by law;
- 16 • Any payment made or promised to be made by the Debtor under the Plan for
17 services or for costs and expenses in, or in connection with, the Chapter 11
18 Case, or in connection with the Plan, must have been disclosed to the
19 Bankruptcy Court, and any such payment made before Confirmation of the
20 Plan must be reasonable, or if such payment is to be fixed after
21 Confirmation of the Plan, such payment must be subject to the approval of
22 the Bankruptcy as reasonable;
- 23 • The Debtor must have disclosed the identity and affiliates of any individual
24 proposed to serve, after Confirmation of the Plan, as a director, officer, or
25 voting trustee of the Debtors under the Plan. Moreover, the appointment to,
26 or continuance in, such office of such individual, must be consistent with the
27 interests of holders of Claims and with public policy, and the Debtor must
28 have disclosed the identity of any insider that the Debtor will employ or
retain, and the nature of any compensation for such insider;
- Best Interests of Creditors Test: With respect to each Class of Impaired
Claims, either each holder of a Claim of such Class must have accepted the
Plan, or must receive or retain under the Plan on account of such Claim,
property of a value, as of the Effective Date of the Plan, that is not less than
the amount such holder would receive or retain if the Debtor was liquidated
on such date under Chapter 7 of the Bankruptcy Code. In a Chapter 7

1 liquidation, creditors and interest holders of a debtor are paid from available
2 assets generally in the following order, with no lower Class receiving any
3 payments until all amounts due to senior Classes have either been paid in
4 full or payment in full is provided for: (i) first to secured creditors (to the
5 extent of the value of their collateral); (ii) next the Chapter 7 trustee's and
6 his attorney's fees and expenses, and other liquidation costs; (iii) next to
7 priority creditors; (iv) next to unsecured creditors; (v) next to debt expressly
8 subordinated by its terms or by order of the Bankruptcy Court; and (vi) last
9 to holders of equity interests. The Debtor's best estimates of values of
10 assets and liabilities are set forth herein. The Debtor has attached a
11 Liquidation Analysis which it believes satisfies the best Interests of
12 Creditors test.

- 13 • Each Class of Claims must have either accepted the Plan or not be Impaired
14 under the Plan;
- 15 • Except to the extent that the holder of a particular Claim has
16 agreed to a different treatment of such Claim, the Plan provides
17 that Allowed Administrative and Priority Claims (other than
18 Allowed Priority Tax Claims) will be paid in full on the Effective
19 Date and that Allowed Priority Tax Claims will receive on
20 account of such Claim's deferred Cash payment, over a period not
21 exceeding six years after the date of assessment of such Claim, of
22 a value, as of the Effective Date, equal to the Allowed amount of
23 such Claim; and
- 24 • At least one Impaired Class of Claim must have accepted
25 the Plan, determined without including any acceptance of
26 the Plan by any insider holding a Claim of such Class.

27 **Confirmation Without Acceptance by All Impaired Claims**

28 Section 1129(b) of the Bankruptcy Code allows a Bankruptcy Court to confirm a
plan, even if such plan has not been accepted by all impaired Classes entitled to vote on
such plan, provided that such plan has been accepted by at least one Impaired Class. If
any Impaired Classes reject or are deemed to have rejected the Plan, the Debtor reserves
its right to seek the application of the requirements set forth in Section 1129(b) of the
Bankruptcy Code for Confirmation of the Plan despite the lack of acceptance by all
Impaired Classes.

Section 1129(b) of the Bankruptcy Code provides that notwithstanding the failure
of an Impaired Class to accept a plan of reorganization, the plan must be confirmed, on
request of the plan proponent (in a procedure commonly known as **Cramdown**), so long
as the plan does not discriminate unfairly and is fair and equitable with respect to each
Class of Impaired Claims or Interests that has not accepted the plan.

1 The condition that a plan be fair and equitable with respect to a rejecting Class of
2 Secured Claims includes the requirements that (a) the holders of such Secured Claims
3 retain the liens securing such Claims to the extent of the allowed amount of the Claims,
4 whether the property subject to the liens is retained by the debtor or transferred to another
5 entity under the plan, and (b) each holder of a Secured Claim in the Class receives
6 deferred cash payments totaling at least the allowed amount of such Claim with a present
7 value, as of the effective date of the plan, at least equivalent to the value of the secured
8 claimant's interest in the debtor's property subject to the liens.

9 The condition that a plan be fair and equitable with respect to a rejecting Class of
10 Unsecured Claims or a rejecting Class of Interests includes the requirement that either
11 (a) such Class receive or retain under the plan property of a value as of the effective date
12 of the plan equal to the allowed amount of such Claim or Interest, as the case may be, or
13 (b) if the Class does not receive such amount, no Class junior to the non-accepting Class
14 will receive a payment distribution under the plan.

15 CERTAIN INCOME TAX CONSEQUENCES

16 **SUBSTANTIAL UNCERTAINTY EXISTS WITH RESPECT TO THE TAX
17 CONSEQUENCES OF THE PLAN. NO RULINGS HAVE BEEN REQUESTED
18 FROM THE INTERNAL REVENUE SERVICE WITH RESPECT TO ANY OF
19 THE TAX ASPECTS OF THE PLAN. THE TAX CONSEQUENCES OF THE
20 PLAN ARE COMPLEX AND, IN MANY AREAS, UNCERTAIN. THEREFORE,
21 EACH HOLDER OF A CLAIM IS STRONGLY URGED TO CONSULT HIS OWN
22 TAX ADVISOR REGARDING SUCH FEDERAL, STATE, LOCAL AND OTHER
23 TAX CONSEQUENCES.**

24 RISK FACTORS

25 In this section, the Debtor has attempted to identify the potential material risks of
26 the Plan. **CREDITORS SHOULD CONSIDER CAREFULLY THE FOLLOWING
27 FACTORS, IN ADDITION TO THE OTHER INFORMATION CONTAINED IN
28 THIS DISCLOSURE STATEMENT, BEFORE SUBMITTING A VOTE TO
ACCEPT OR REJECT THE PLAN.**

Fluctuations in the Value of Debtor's Business

29 The current value assigned to the Debtor's assets is uncertain, may not remain
30 constant, and may decline over time due to a variety of factors including a downturn in the
31 general economy of the United States or the economics of the potential customers of the
32 Debtor. A disruption or continued downturn in the economy could make it more difficult,
33 or impossible, for the Debtor's product to be sold at a favorable price. In addition, the
34 projections on which these valuations are based could also prove to be incorrect. It is
35 important to remember that the value assigned to a business is in many cases difficult to
36 predict and involve uncertainty.

Risk of Non-Confirmation of the Plan

37 Although the Debtor believes the Plan will satisfy all requirements necessary for
38 confirmation by the Court, there can be no assurance that the Court will reach the same
39 conclusion. Amendments to the Plan may also be required by the Court for confirmation,
40 and these amendments could adversely affect the Creditors' rights to receive distributions
41 under the Plan. Any amendment may also necessitate the re-solicitation of votes. If the
42 Plan is not confirmed, a fire sale (i.e., immediate liquidation) of the Debtor's assets may
43 occur. While a fire sale of the Debtor's assets would likely yield less than the value of the

1 business as a going concern in accordance with the Plan, the range of estimated recoveries
2 in either case is subject to variation based upon market conditions and other factors that
are beyond the Debtor's control.

3 The Plan is premised in large part on the Debtor being successful in its position on
4 (1) the set-off of the ABC claim, and (2) the constructive trust theory. If the Debtor is
5 unsuccessful on these issues, it is most likely the Plan, as currently proposed, may not be
successful and the Debtor will then analyze how best to proceed – either with an
Amended Plan, or a possible conversion to Chapter 7.

6 **ALTERNATIVES TO THE PLAN**

7 If the Plan is not timely confirmed, the most likely alternative is either (1) a sale of
8 the debtor's assets, or (2) a Chapter 7 liquidation proceeding. A sale is fraught with a
9 multitude of issues, such as the lease of where the debtor currently conducts its operations,
10 and the lease of a substantial amount of the debtor's equipment. In a Chapter 7
11 liquidation proceeding, a Chapter 7 trustee would be appointed by the Bankruptcy Court
12 to oversee the liquidation of the Debtor's assets. Such trustee would be entitled to retain a
13 new set of professionals, including lawyers and accountants, to review and analyze all of
the Claims and the Debtor's assets. In addition, the Chapter 7 trustee would be entitled to
request a fee equal to 3% of all distributions made to the Creditors. The Debtor believes
that the conversion to a Chapter 7 liquidation proceeding and the appointment of a new
trustee and new estate professionals would substantially increase professional fees and
result in further delays and a reduction in distributions. A copy of the Liquidation
Analysis is attached as **Exhibit 18**.

14 The Debtor has explored various alternative scenarios, including the scenarios
15 described above, and believes the Plan enables the holders of Claims to realize the
16 maximum recovery under the circumstances. The Debtor believes the Plan is the best
plan that can be proposed and serve the best interests of the Debtor and other parties-in-
interest.

17 **RECOMMENDATION AND CONCLUSION**

18 The Debtor has analyzed different scenarios and believes the Plan will provide the
19 opportunity for the Debtor. In this manner the business will move forward and create
20 value. Any alternative other than confirmation of the Plan could result in extensive delays
21 and increased administrative expenses resulting in potentially less successful emergence
22 from bankruptcy and ultimately liquidation. Accordingly, the Debtor recommends
confirmation of the Plan and urges all holders of Impaired Claims to vote to accept the
Plan and to indicate acceptance by returning their Ballots so as to be received by no later
than the Voting Deadline.

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