

1 James C. Bastian, Jr. - Bar No. 175415
Mark Bradshaw - Bar No. 192540
2 **SHULMAN HODGES & BASTIAN LLP**
26632 Towne Centre Drive, Suite 300
3 Foothill Ranch, California 92610-2808
Telephone: (949) 340-3400
4 Facsimile: (949) 340-3000
Email: jbastian@shbllp.com
5 mbradshaw@shbllp.com

6 Attorneys for Laguna Village Owners' Association, Inc.,
a California non-profit corporation, the Debtor and Debtor in Possession

7
8 **UNITED STATES BANKRUPTCY COURT**
9 **CENTRAL DISTRICT OF CALIFORNIA, SANTA ANA DIVISION**

11 In re
12 **LAGUNA VILLAGE OWNERS'**
ASSOCIATION, INC., a
13 **California non-profit corporation,**
14
15 Debtor.

Case No. 8:10-bk-24033 RK

Chapter 11

**NOTICE OF MOTION AND DEBTOR AND
DEBTOR IN POSSESSION'S MOTION FOR
ORDER:**

- (1) **APPROVING SETTLEMENT AND
COMPROMISE OF DISPUTES WITH
AV BUILDER CORP.; AND**
- (2) **AUTHORIZING SPECIAL
HOMEOWNER ASSESSMENTS TO
FUND THE SETTLEMENT
PAYMENTS TO AV BUILDER CORP.**

**MEMORANDUM OF POINTS AND
AUTHORITIES; AND DECLARATION OF
WILLIAM F. WHALEN IN SUPPORT**

Hearing
Date: January 11, 2011
Time: 10:30 A.M.
Place: Courtroom 5D
Ronald Reagan Federal Building
and United States Courthouse
411 West Fourth Street
Santa Ana, CA 92701

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1 **TO THE HONORABLE ROBERT KWAN, UNITED STATES BANKRUPTCY JUDGE,**
2 **THE OFFICE OF THE UNITED STATES TRUSTEE, AND OTHER PARTIES-IN-**
3 **INTEREST:**

4 **I. NOTICE**

5 **NOTICE IS HEREBY GIVEN** that on **January 11, 2011 at 10:30 A.M.**, Courtroom
6 5D of the above-entitled Court located at the Ronald Reagan Federal Building and United States
7 Courthouse, 411 West Fourth Street, Santa Ana, California 92701, before the Honorable Robert
8 N. Kwan, United States Bankruptcy Judge, Laguna Village Owners' Association, Inc., a
9 California non-profit corporation, the debtor and debtor in possession herein ("Debtor") will
10 bring its Motion \for Order: (1) Approving Settlement and Compromise of Disputes with AV
11 Builder Corp.; and (2) Authorizing Special Homeowner Assessments to Fund the Settlement
12 Payments to AV Builder Corp. ("Motion").

13 Through the Motion, the Debtor requests approval of a settlement with AV Builder Corp.,
14 a California corporation ("AVB") that is consistent with the terms described in a certain Term
15 Sheet a true and copy of which is attached as **Exhibit 1** to the Declaration of William F. Whalen.
16 The Debtor and AVB are working to finalize the actual settlement agreement and ancillary
17 documents and intend to file the final form of settlement documents prior to the hearing on the
18 Motion.

19 In addition, in order to implement the terms of the settlement with AVB and to make
20 certain that the Debtor complies with California law, through the Motion the Debtor further
21 requests that the Court enter an order authorizing a special assessment on the owners of Laguna
22 Village to fund the settlement payments to AVB.

23 As set forth below, the proposed settlement essentially paves the way for a smooth and
24 consensual reorganization as the litigation and disputes with AVB were the primary precipitating
25 events which resulted in the Debtor's chapter 11 case. Further, the expenses to be incurred
26 through continued litigation of the disputes among the parties would most likely exceed any
27 additional benefit that might be achieved. The settlement will also minimize the disruption and
28 expense to the community served by the Debtor and is the best means for AVB to be paid its

1 allowed claim amount. As such, the Debtor believes that the interests of the creditors and the
2 interest of the Debtor's bankruptcy estate ("Estate") would best be served if this Court approves
3 the Motion.

4 The Motion is based upon this Notice of the Motion, the Motion and Memorandum of
5 Points and Authorities in Support thereof, the Declaration of William F. Whalen, the pleadings
6 and files in the Debtor's bankruptcy case, and upon such further oral and documentary evidence
7 as may be presented to the Court in support of the Motion.

8 **NOTICE IS HEREBY FURTHER GIVEN** that any opposition or other responsive
9 paper to the Motion must be filed with the Clerk of the above-entitled Court and a copy served
10 on Shulman Hodges & Bastian LLP to the attention of James C. Bastian, Jr., at the address
11 indicated above and the Office of the United States Trustee, Ronald Reagan Federal Building
12 and United States Courthouse, 411 West Fourth Street, #9041, Santa Ana, California 92701-8000
13 at least **fourteen days** prior to the hearing in the form required by Local Bankruptcy Rule 9013-
14 1(f).

15 **NOTICE IS HEREBY FURTHER GIVEN** that failure to file a timely response may be
16 deemed as consent to the relief requested in the Motion. **SEE, LOCAL BANKRUPTCY**
17 **RULE 9013-1(h).**

18
19
20 Dated: December 20, 2010

SHULMAN HODGES & BASTIAN LLP

21 /s/ James C. Bastian, Jr.

22 _____
23 James C. Bastian, Jr.
24 Attorneys for the Debtor and Debtor in Possession,
25 Laguna Village Owners' Association, Inc., a California non-
26 profit corporation,
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1 **II. MOTION**

2 In support of the Motion, the Debtor respectfully represents as follows:

3 **A. The Disputes with AVB**

4 The Debtor filed for bankruptcy protection of October 1, 2010 (“Petition Date”). Prior
5 to the bankruptcy filing, the Debtor was a party to a lawsuit with AVB which strained the
6 administrative and financial resources of the Debtor. In addition to the normal challenges of
7 operating a homeowners’ association with more than 900 dwellings, this lawsuit was taxing the
8 Debtor’s managerial, operational and financial resources. The Debtor believes that the lawsuit
9 filed against it is without merit, but its belief did not prevent costly and distracting litigation from
10 proceeding against the Debtor prior to the Petition Date nor did it prevent a judgment against the
11 Debtor for approximately \$775,000. In addition, AVB seeks more than \$1.5 million in
12 attorneys’ fees, costs and interest which may be awarded and added to the judgment. The Debtor
13 has filed an appeal of the state court judgment.

14 AVB was threatening to seize virtually all of the Debtor’s cash and securities and leave it
15 with no funds to pay for necessary operating expenses and repairs. In addition, AVB was
16 threatening to seek the appointment of a receiver and force a special assessment on the owners of
17 Laguna Village which may have been required to be paid as one lump sum. The chronology of
18 significant events involving the lawsuit are as follows:

19 • On or about October 2, 2006, AVB filed an action in the Orange County Superior
20 Court styled AV Builder Corp. v. Laguna Village Owners’ Association, Inc., Case No.
21 06CC10565 (“State Court Action”).

22 • In or about May 2010, on the eve of trial in the State Court Action, the Debtor
23 determined that it owed AVB at least \$593,102.62 and paid this amount to AVB (“Pre-Trial
24 Payment”), thereby reducing Debtor’s exposure to AVB at trial.

25 • On or about July 15, 2010, a Judgment After Jury Verdict was entered in the State
26 Court Action in favor of AVB and against Debtor in the amount of \$775,157.58 plus costs,
27 attorneys’ fees and pre-judgment interest (“Judgment”). The jury’s calculation of the amount of
28

1 the Judgment made it clear that the Judgment would have included the Pre-Trial Payment had it
2 not been made just before trial.

3 • On or about July 26, 2010, AVB filed a form JL-1 with the California Secretary
4 of State, Document No. 107239670893 which AVB asserts created a judgment lien against the
5 Debtor and in favor of AVB (“Judgment Lien”).

6 • On or about July 30, 2010, AVB caused a levy under a Writ of Execution on
7 financial accounts owned by the Debtor and maintained at Merrill Lynch. Pursuant to California
8 Code of Civil Procedure section 697.710, AVB asserts that the levy created an execution lien
9 against the Debtor and in favor of AVB (“Execution Lien”).

10 • On or about August 11, 2010, the Debtor filed its Claim of Exemption with the
11 Orange County Sheriff asserting that all of the property levied upon was exempt under Civil
12 Code section 1366(c) and Code of Civil Procedure sections 700.190(a), 700.160, 700.180(b), (d)
13 and 699.540(b).

14 • AVB asserts that it is owed, among other things, costs of \$28,032.55, attorneys’
15 fees and costs in excess of \$1,058,742.58, and that is entitled to pre- and post-judgment interest
16 in connection with the Judgment. AVB asserts that its gross judgment amount is not less than
17 \$2,175,000.

18 • On or about October 6, 2010, the Debtor filed a notice of appeal of the Judgment.

19 • On October 22, 2010, the Debtor filed a complaint against AVB and Merrill
20 Lynch for avoidance of preferential transfers, for turnover of property of the Estate, and for
21 declaratory relief styled Laguna Village Owners’ Association, Inc. v. AV Builder Corp., et al.,
22 Adversary Case No. 8:10-ap-01499-RK (“Adversary Proceeding”). AVB has previously denied
23 the allegations stated in the Adversary Proceeding, and particularly has asserted that its liens are
24 not avoidable as preferential transfers on various grounds. Further, AVB’s position was that the
25 Debtor was solvent due to, amount other things, the application of California Civil Code section
26 1366. On November 2, 2010, the Debtor filed a Notice of Dismissal of Adversary Proceeding.

27 The foregoing events evidence numerous disputes among the parties including, (1) the
28 extent, priority and validity of the lien asserted by AVB against the Debtor’s assets and the

1 Debtor's ability to avoid some or all of the lien using its avoidance action powers, (2) the
2 Debtor's authority to use cash collateral of AVB, (3) the final amount of the allowed claim of
3 AVB including pre- and post-judgment interest, attorneys' fees and costs, (4) the disposition of
4 the Debtor's appeal of the Judgment, (5) the Debtor's ability to claim an exemption in
5 connection with the Judgment and the liens asserted by AVB, and (6) the impact on homeowners
6 and the Debtor's ability to collect any special assessment from them to pay the Judgment.

7 Rather than litigate these and other issues, with all of the cost and uncertainty association
8 with such litigation, the parties agreed to settle their disputes as summarized below and as set
9 forth in full in the Term Sheet attached as **Exhibit 1** to the Declaration of William F. Whalen..

10 **B. The Settlement and Compromise**

11 The Debtor's counsel and counsel for AVB have discussed the merits of the disputes
12 between them and the parties have exchanged numerous communications and participated in an
13 in-person settlement conference. After completing its investigation, the Debtor has determined
14 that the benefits of litigating all of the issues with AVB are outweighed by the fees and risks
15 associated with such litigation. As such, subject to Court approval, the Debtor and AVB
16 (collectively the "Parties") have reached a settlement of their disputes that is consistent with the
17 terms described in the Term Sheet attached as **Exhibit 1** to the Declaration of William F.
18 Whalen. The Debtor and AVB are working to finalize the actual settlement agreement and
19 ancillary documents and intend to file the final form of settlement documents prior to the hearing
20 on the Motion.

21 The principal terms of the settlement with AVB are as follows (the Debtor is referred to
22 as "LVOA" in the following summary¹):

- 23 1. AVB will be granted an allowed, valid, perfected and unavoidable secured claim in the
24 amount of \$2,000,000 (Allowed Claim).
- 25 2. AVB's Allowed Claim will be secured by a consensual first priority security interest and
26 lien on all real and personal property of LVOA (subject to existing liens and mortgages
27 of lenders to homeowners), including, but not limited to, postpetition accounts receivable,
28 homeowners dues, and all causes of action and claims for relief against third parties.

¹ In the event of any conflict between this summary and the Term Sheet attached as **Exhibit 1** to the
Declaration of William F. Whalen, the Term Sheet shall govern.

- 1 3. The Allowed Claim will accrue interest at 8% per annum from December 8, 2010,
2 payable as follows: (a) \$250,000 plus interest will be due within 10 days of the Effective
3 Date of LVOA's plan of reorganization after confirmation by a final and unappealable
4 order, but in no event later than March 31, 2011 (First Payment); (b) \$83,333.33 plus
5 interest (Second Payment) will be due 90 days after the First Payment Date; (c)
6 \$83,333.33 plus interest (Third Payment) will be 30 days after the Second Payment; (d)
7 \$83,333.33 plus interest (Fourth Payment) will be 30 days after the Third Payment; and
8 (e) the balance of the Allowed Claim is the principal sum of \$1,500,000 plus interest
9 from December 8, 2010 at 8% per annum (Remaining Amount). The Remaining Amount
10 will be fully amortized over six years payable monthly with the first payment due 10 days
11 of the Effective Date of LVOA's plan of reorganization after confirmation by a final and
12 unappealable order, but in no event later than April 30, 2011, and each payment due on
13 the same day monthly thereafter for 72 consecutive months until the Remaining Amount
14 plus interest at 8% per annum from December 8, 2010 is paid in full.
- 15 4. AVB will also be paid (as a prepayment on its Allowed Claim) 50% of the net proceeds
16 of any recovery by LVOA against third parties, including former directors, officers,
17 current and former attorneys and any amounts received as the result of any action to
18 avoid the PAO settlement agreement. In order to incentivize LVOA to pay its Allowed
19 Claim earlier, AVB will agree that any principal payment of \$250,000 will reduce the 8%
20 interest rate by 1/8th (i.e., 1.25%) at any time during the term of the plan. As an example,
21 if LVOA were to receive a net settlement of \$500,000 in an action against a third party, it
22 would owe \$250,000 to AVB. After this payment, the new interest rate for the balance of
23 the term of the repayment of AVB's Allowed Claim would be 6.75%. If LVOA chose to
24 pay all of this amount to AVB, it would reduce the interest rate to 5.5% for the balance of
25 the term.
- 26 5. LVOA will agree to immediately stay the appeal and LVOA shall dismiss the appeal with
27 prejudice upon approval of this settlement by a final and unappealable order, but in no
28 event later than March 31, 2011.
6. LVOA and AVB will execute a settlement agreement with mutual general releases
(including any avoiding powers of LVOA) excluding only their duties under this
settlement.
7. LVOA will sign the following loan and security documents (collectively the "Loan
Documents"): (a) promissory note for \$2,000,000 ("Note"); (b) deed of trust ("Deed of
Trust") securing the Note; (c) Security Agreement securing the Note; and (d) Loan
Agreement. LVOA will also consent to the filing of a UCC-1 Financing Statement.
8. The Note will be in a form typically used by AVB's counsel in its collection practice
including containing the following provisions: (a) attorney fee provision; (b) if a payment
is not made within 10 days of the due date, LVOA will be in breach of the Note (Breach);
(c) in the event of a Breach, AVB will provide written notice and LVOA will have 10
days from written notice to cure the Breach by making the required payment and a Late
Charge of \$5,000; (d) if LVOA fails to cure a Breach within 10 days of written notice,
LVOA will be in default of the Note (Default); and (e) in the event of Default, the interest
rate increases to 10% per annum effective on the date of Default, AVB may accelerate
the Note balance and file a lawsuit to recover the full amount due and enforce all of its
rights under the Loan Documents.
9. The Deed of Trust and Security Agreement will provide that AVB has a lien on the
association dues and, in the event of a Default under the Note, after commencing
litigation, AVB may make an ex parte application without notice to obtain appointment
of a Receiver to manage the association including collecting association dues.

- 1 10. AVB will subordinate its claims under the judgment which are not being paid under this
2 settlement (approximately \$250,000 as of November 30th) to all allowed claims of other
3 unsecured creditors and will agree to vote in favor of a plan that contains this settlement,
4 which plan may provide that AVB's subordinated claim is waived effective on
5 confirmation of LVOA's Plan by a final unappealable order.
- 6 11. AVB shall release its judgment lien upon approval of the settlement by a final
7 unappealable order, execution of the Loan Documents and filing and recordation of the
8 UCC-1 financing statement and Deed of Trust.
- 9 12. If LVOA needs to use cash collateral to make immediate health and safety repairs,
10 particularly new roofs on multiple buildings through the association for \$225,000, upon
11 acceptance of this settlement by LVOA, AVB shall stipulate and agree to the immediate
12 use of all but \$500,000 of its cash collateral ("Restricted Funds") for repair of the
13 LVOA's property provided that the funds used are secured by a replacement lien on all of
14 LVOA's real and personal property subject to all existing defenses, priority, validity and
15 avoidance powers. This lien would be superseded by AVB's replacement lien under a
16 plan of reorganization which complies with this Term Sheet if the plan confirmed by a
17 final and unappealable order. AVB agrees that the first \$250,000 payment to AVB
18 described in paragraph 3 above may be made from the Restricted Funds. Upon timely
19 payment of each of the Second Payment, Third Payment and Fourth Payment described
20 in paragraph 3 above in good and valuable funds, the Restricted Funds balance shall be
21 reduced by the amount of such payment(s) such that upon timely payment of the Fourth
22 Payment, the Restricted Funds may be used by LVOA in the ordinary course of business
23 so long as there are no defaults under the Loan Documents.
- 24 13. AVB and LVOA will agree to an immediate stay of all pending motions, discovery and
25 other litigation activities in the bankruptcy case other than drafting a plan of
26 reorganization and disclosure statement.
- 27 14. This Term Sheet shall be replaced by a definitive Settlement Agreement, together with
28 the Loan Documents as exhibits.

18 **C. Good Cause Exists to Approve the Settlement and Compromise**

19 The Debtor believes that good cause exists to approve the proposed settlement based on
20 the following:

- 21 • As an initial matter, the Debtor is not asserting affirmative claims against AVB
22 but rather the disputes involve the amount of any claim AVB has and whether such claim is
23 secured. AVB has already obtained a judgment, a judgment lien, and asserts it is owed more
24 than \$2,175,000 million, plus additional accrued interest at the judgment rate of 10% per annum
25 and attorneys fees and costs. The Debtor has filed an appeal of the Judgment and prepared an
26 adversary complaint to avoid AVB's liens as preferential transfers. A victory for the Debtor
27 would only mean a reduction of the Judgment amount so any fees expended by the Debtor would
28 likely not be recovered. However, the settlement fixes the amount of the claim for AVB well

1 below the amount it believes is due and reduces the interest rate AVB is asserting. Perhaps most
2 importantly, the settlement allows the Debtor to repay the debt to AVB for a period of years
3 rather than to seek an immediate large collection assessment against each homeowner which
4 could trigger defaults. The settlement also allows the Debtor use of cash collateral to pay
5 necessary expenses associated with the maintenance and repair of the facilities in the community.

6 • The issues involved are complex and would require substantial time and money to
7 resolve.

8 • The costs of the Estate to litigate the issues will reduce the amount of funds
9 available at the end of this case to pay claims because substantial administrative costs will be
10 incurred. The Debtor estimates that as much as \$500,000, if not more, could be incurred in the
11 appeal, bankruptcy court litigation and then through a new trial if the Debtor is successful on
12 appeal. Approval of the settlement will aid the Debtor in preserving assets of the Estate.

13 • If AVB was to prevail and defeat the Debtor's appeal of the Judgment, the Estate
14 may be liable for additional fees and costs incurred by AVB. The expenses incurred for
15 continued litigation of the disputes would most likely exceed any additional benefit that might be
16 achieved. The settlement the Debtor has reached provides certainty, reduces claims against in
17 the Estate, and provides for means for realistic payment of the debt owing to AVB.

18 In summary, the settlement is based on good business judgment that will benefit the
19 Estate and creditors and therefore approval of the Motion is proper.

20 **D. Authorization to Make a Special Assessment**

21 In order to implement the terms of the settlement with AVB and to make certain that the
22 Debtor complies with California law, the Debtor requires a Court order authorizing a special
23 assessment on the owners of Laguna Village as described below.

24 Regular and special assessments of homeowners' association members are governed
25 largely by California Civil Code section 1366, which provides in part: "Except as provided in
26 this section, the association shall levy regular and special assessments sufficient to perform its
27 obligations under the governing documents and this title." The statute authorizes special
28 assessments to cover emergency situations such as payment of the debt owing to AVB. For

1 example, California Civil Code section 1366(b) recognizes that “an emergency situation is any
2 one of the following: (1) An extraordinary expense required by an order of a court.”

3 In a similar context, Central District Bankruptcy Judge Geraldine Mund noted that
4 Section 1366(b) “allowed the homeowner association to levy an emergency assessment to
5 satisfy an order of the court and that a judgment against the association ‘is, in and of
6 itself, an emergency expense.’ Because a judgment is an order of court, it, ‘by definition,
7 constitutes an extraordinary expense.’” See, In re Oak Park Calabasas Condo. Ass'n, 302
8 B.R. 665, 670 (Bankr. C.D. Cal. 2003). In Oak Park, the homeowners’ association filed a
9 chapter 11 bankruptcy and tried to confirm a plan where its principal creditor, the holder
10 of a state court judgment against the association, would be paid in full over twenty years
11 at the federal interest rate (lower than state interest rate). The Court noted that “When a
12 creditor obtains a large judgment against a homeowner association, unless the parties
13 agree to a payment plan, the judgment creditor may ask the court to appoint a receiver or
14 make some other order in aid of collection.” Id. at 670.

15 In the present case, the Debtor and AVB have agreed upon terms of repayment which,
16 among other things, avoids AVB having to pursue relief from stay, appointment of a receiver,
17 and other actions to collect its judgment which would only increase the expenses of the parties
18 and the ultimate amount of the special assessment. The Debtor’s proposed order approving the
19 Motion will provide for approval of a special assessment on the owners of Laguna Village
20 necessary to cover payments made or to be made to AVB in satisfaction of its claims against the
21 Debtor. This includes the Pre-Trial Payment of \$593,102.62 made to AVB shortly before the
22 trial, the \$500,000 in initial installments described in the settlement agreement, and up to \$1.5
23 million plus interest depending on the date the obligation to AVB is paid in full (i.e., the
24 settlement permits the Debtor to pay early without having to pay all of the unmatured interest).
25 The Debtor believes that the proposed settlement is in the best interest of the Estate, creditors
26 including AVB, and other parties in interest including homeowners. The proposed settlement is
27 also consistent with California law governing special assessments and bankruptcy law which
28 applies it.

1 **III. ARGUMENT**

2 **A. Entry of an Order Approving the Settlement is Proper**

3 The power of the Court to review and approve settlements is expressly recognized in
4 Federal Rule of Bankruptcy Procedure 9019(a), which provides:

5 On motion by the trustee and after notice and a hearing, the court
6 may approve a compromise or settlement. Notice shall be given to
7 creditors, the United States trustee, the debtor, and indenture
8 trustees as provided in Rule 2002 and to any other entity as the
9 court may direct

10 Thus, upon notice to a debtor’s creditors, the United States Trustee, debtors, and
11 indenture trustees, settlement of a claim of the estate is appropriate. The approval of a
12 compromise is a core proceeding under 28 U.S.C. §157(b)(2)(A) and (O). In re Carla Leather,
13 Inc., 50 B.R. 764, 775 (S.D.N.Y. 1985).

14 **B. The Court May Approve a Settlement Which is Fair and Equitable**

15 The purpose of a compromise agreement between a debtor and a creditor is to allow the
16 parties to avoid the expenses and burdens associated with litigation. Martin v. Kale (In re A & C
17 Properties), 784 F.2d 1377, 1380-81 (9th Cir. 1986), cert. denied sub nom, Martin v. Robinson,
18 479 U.S. 854 (1986). The bankruptcy court has great latitude in approving compromise
19 agreements as long as it finds that the compromise is fair and equitable. Id. at 1382; see also,
20 Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610, 620 (9th Cir. 1988).
21 Generally, the benchmark in determining the propriety of a settlement is whether the settlement
22 is in the best interests of the estate and its creditors. In re Energy Cooperative, Inc., 886 F.2d
23 921, 927 (7th Cir. 1989). To be approved, the settlement need not represent the highest possible
24 return to the estate, but merely must fall within the “range of reasonableness.” In re Walsh
25 Construction, Inc., 669 F.2d 1325, 1328 (9th Cir. 1992). In making this determination, the
26 bankruptcy court need not conduct a trial or even a “mini trial” on the merits. Id.

27 In determining the fairness, reasonableness and adequacy of a proposed settlement
28 agreement, the Court must consider the following factors:

- (a) The probability of success in the litigation;
- (b) the difficulties, if any, to be encountered in the matter of collection;
- (c) the

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complexity of the litigation involved, and the expense, inconvenience, and delay necessarily attending it; (d) the paramount interests of the creditors and a proper deference to their reasonable views in the premises.

A & C Properties, 784 F.2d at 1381; Woodson, 839 F.2d at 620. In other words, the Court must weigh certain factors in order to determine whether the compromise is in the best interests of the bankrupt estate. A & C Properties, 784 F.2d at 1382.

Although there may be arguments in support of the Estate’s avoidance claim against AVB and the appeal of the Judgment, the Debtor understands the risks inherent in any litigation. The Debtor would have to litigate the disputes, prevail at trial and perhaps respond to appeals in connection with the Avoidance Action and the Debtor would separately have to litigate the Appeal. The issues involved are complex and would require substantial time and money to resolve. There is no assurance that the Debtor would prevail on all these issues and the statistics regarding the success rate on state court appeals and the timing to complete them are not encouraging for the Debtor’s cause. The Debtor is also sensitive to the fact that it is the homeowners who will have to pay the Judgment and the homeowners have already paid for unbudgeted additional legal expenses as a result of the State Court Action and still the Judgment must be paid. If the Debtor is forced to litigate all issues with AVB the certainty of substantial administrative costs and the possibility of a much larger amount being due to AVB greatly outweigh the proposed settlement. In summary, the settlement is based on good business judgment that will benefit the Estate and therefore approval of the settlement is proper.

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IV. CONCLUSION

WHEREFORE, based upon the foregoing, the Debtor respectfully submits that the proposed settlement is in the best interests of the Estate and creditors and requests that the Court enter an order approving the Motion as follows:

1. Approving the settlement with AVB under the terms and conditions that are consistent with the Term Sheet.
2. Authorizing the Debtor to execute any and all documents in order to carry out the terms of the settlement and compromise, including but not limited to the final settlement agreement and ancillary documents to be filed with the Court which are consistent with and incorporate the terms and provisions described in the Term Sheet .
3. In order to implement the terms of the settlement with AVB and to make certain that the Debtor complies with California law, the Debtor further requests that the Court enter an order authorizing a special assessment on the owners of Laguna Village to fund the settlement payments to AVB pursuant to California Civil Code Section 1366(b)(i).
4. And the Court enter such other and further relief the Court deems just and proper.

Dated: December 20, 2010

Respectfully submitted,
SHULMAN HODGES & BASTIAN LLP

/s/ James C. Bastian, Jr.

James C. Bastian, Jr.
Attorneys for Debtor and Debtor in Possession
Laguna Village Owners' Association, Inc, a
California non-profit corporation

DECLARATION

DECLARATION OF WILLIAM F. WHALEN

I, William F. Whalen, declare:

1. I am the President of Laguna Village Owners’ Association, Inc., a California non-profit corporation, the debtor and debtor-in-possession herein (“Debtor”). I have personal knowledge of the facts set forth herein and could, if called as a witness, competently testify thereto. I am also personally familiar with, and am custodian of, the records of the Debtor as they pertain to the financial records set forth herein. The records of the Debtor are made by agents of the Debtor who report to me and who have a business duty to enter the records of the Debtor accurately and at or near the time of the event which they record.

1. I am familiar with the Debtor’s bankruptcy proceeding and make this Declaration in support of the Debtor’s Motion for Order: (1) Approving Settlement and Compromise of Disputes with AV Builder Corp.; and (2) Authorizing Special Homeowner Assessments to Fund the Settlement Payments to AV Builder Corp. (“Motion”). Unless otherwise noted, capitalized terms herein have the meaning as set forth in the Motion.

2. I have read and I am aware of the contents of the Motion and the accompanying Memorandum of Points and Authorities. The facts stated in the Motion and the Points and Authorities are true to the best of my knowledge.

3. Through the Settlement Motion, the Debtor requests approval of a certain settlement with AVB that is consistent with the terms described in a certain Term Sheet agreement, a true and copy of which is attached hereto as **Exhibit 1**. The Debtor and AVB are working to finalize the actual settlement agreement and ancillary documents and intend to file the final form of settlement documents prior to the hearing on the Motion..

4. In addition, in order to implement the terms of the settlement with AVB and to make certain that the Debtor complies with California law, through the Motion the Debtor further requests that the Court enter an order authorizing a special assessment on the owners of Laguna Village to fund the settlement payments to AVB.

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1 5. Before agreeing to enter into the settlement that is the subject of the Motion, on
2 behalf of the Debtor I consulted with counsel about the risks and benefits of continuing with the
3 litigation. I consulted with Debtor's counsel about the benefits to the Estate which would result
4 from the settlement. For the reasons stated in the Motion and the accompanying Points and
5 Authorities, and based on my experience with the Debtor's business operations, as well as my
6 consultation with Debtor's attorneys, I believe it is in the best interest of the Estate for the Court
7 to approve the settlement with AVB which is the subject of the Motion and to authorize the
8 special homeowners' assessments necessary to fund the settlement payments to AVB consistent
9 with the Term Sheet.

10 I declare under penalty of perjury under the laws of the United States of America that the
11 foregoing is true and correct.

12 Executed at Laguna Hills, California on December 20, 2010.

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15 _____
16 William F. Whalen
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EXHIBIT 1

Term Sheet

December 8, 2010

TERM SHEET

1. AVB will be granted an allowed, valid, perfected and unavoidable secured claim in the amount of \$2,000,000 (Allowed Claim).
2. AVB's Allowed Claim will be secured by a consensual first priority security interest and lien on all real and personal property of LVOA (subject to existing liens and mortgages of lenders to homeowners), including, but not limited to, postpetition accounts receivable, homeowners dues, and all causes of action and claims for relief against third parties.
3. The Allowed Claim will accrue interest at 8% per annum from December 8, 2010, payable as follows: (a) \$250,000 plus interest will be due within 10 days of the Effective Date of LVOA's plan of reorganization after confirmation by a final and unappealable order, but in no event later than March 31, 2011 (First Payment); (b) \$83,333.33 plus interest (Second Payment) will be due 90 days after the First Payment Date; (c) \$83,333.33 plus interest (Third Payment) will be 30 days after the Second Payment; (d) \$83,333.33 plus interest (Fourth Payment) will be 30 days after the Third Payment; and (e) the balance of the Allowed Claim is the principal sum of \$1,500,000 plus interest from December 8, 2010 at 8% per annum (Remaining Amount). The Remaining Amount will be fully amortized over six years payable monthly with the first payment due 10 days of the Effective Date of LVOA's plan of reorganization after confirmation by a final and unappealable order, but in no event later than April 30, 2011, and each payment due on the same day monthly thereafter for 72 consecutive months until the Remaining Amount plus interest at 8% per annum from December 8, 2010 is paid in full.
4. AVB will also be paid (as a prepayment on its Allowed Claim) 50% of the net proceeds of any recovery by LVOA against third parties, including former directors, officers, current and former attorneys and any amounts received as the result of any action to avoid the PAO settlement agreement. In order to incentivize LVOA to pay its Allowed Claim earlier, AVB will agree that any principal payment of \$250,000 will reduce the 8% interest rate by 1/8th (i.e., 1.25%) at any time during the term of the plan. As an example, if LVOA were to receive a net settlement of \$500,000 in an action against a third party, it would owe \$250,000 to AVB. After this payment, the new interest rate for the balance of the term of the repayment of AVB's Allowed Claim would be 6.75%. If LVOA chose to pay all of this amount to AVB, it would reduce the interest rate to 5.5% for the balance of the term.
5. LVOA will agree to immediately stay the appeal and LVOA shall dismiss the appeal with prejudice upon approval of this settlement by a final and unappealable order, but in no event later than March 31, 2011.
6. LVOA and AVB will execute a settlement agreement with mutual general releases

(including any avoiding powers of LVOA) excluding only their duties under this settlement.

7. LVOA will sign the following loan and security documents (collectively the “Loan Documents”): (a) promissory note for \$2,000,000 (“Note”); (b) deed of trust (“Deed of Trust”) securing the Note; (c) Security Agreement securing the Note; and (d) Loan Agreement. LVOA will also consent to the filing of a UCC-1 Financing Statement.
8. The Note will be in a form typically used by AVB’s counsel in its collection practice including containing the following provisions: (a) attorney fee provision; (b) if a payment is not made within 10 days of the due date, LVOA will be in breach of the Note (Breach); (c) in the event of a Breach, AVB will provide written notice and LVOA will have 10 days from written notice to cure the Breach by making the required payment and a Late Charge of \$5,000; (d) if LVOA fails to cure a Breach within 10 days of written notice, LVOA will be in default of the Note (Default); and (e) in the event of Default, the interest rate increases to 10% per annum effective on the date of Default, AVB may accelerate the Note balance and file a lawsuit to recover the full amount due and enforce all of its rights under the Loan Documents.
9. The Deed of Trust and Security Agreement will provide that AVB has a lien on the association dues and, in the event of a Default under the Note, after commencing litigation, AVB may make an ex parte application without notice to obtain appointment of a Receiver to manage the association including collecting association dues.
10. AVB will subordinate its claims under the judgment which are not being paid under this settlement (approximately \$250,000 as of November 30th) to all allowed claims of other unsecured creditors and will agree to vote in favor of a plan that contains this settlement, which plan may provide that AVB’s subordinated claim is waived effective on confirmation of LVOA’s Plan by a final unappealable order.
11. AVB shall release its judgment lien upon approval of the settlement by a final unappealable order, execution of the Loan Documents and filing and recordation of the UCC-1 financing statement and Deed of Trust.
12. If LVOA needs to use cash collateral to make immediate health and safety repairs, particularly a new roof for \$225,000, upon acceptance of this settlement by LVOA, AVB shall stipulate and agree to the immediate use of all but \$500,000 of its cash collateral (“Restricted Funds”) for repair of the LVOA’s property provided that the funds used are secured by a replacement lien on all of LVOA’s real and personal property subject to all existing defenses, priority, validity and avoidance powers. This lien would be superseded by AVB’s replacement lien under a plan of reorganization which complies with this Term Sheet if the plan confirmed by a final and unappealable order. AVB agrees that the first \$250,000 payment to AVB described in paragraph 3 above may be made from the Restricted Funds. Upon timely payment of each of the Second Payment, Third Payment and Fourth Payment described in paragraph 3 above in good and valuable funds, the

Restricted Funds balance shall be reduced by the amount of such payment(s) such that upon timely payment of the Fourth Payment, the Restricted Funds may be used by LVOA in the ordinary course of business so long as there are no defaults under the Loan Documents.

13. AVB and LVOA will agree to an immediate stay of all pending motions, discovery and other litigation activities in the bankruptcy case other than drafting a plan of reorganization and disclosure statement.
14. This Term Sheet shall be replaced by a definitive Settlement Agreement, together with the Loan Documents as exhibits. After execution, LVOA will immediately file a motion for approval of the Settlement Agreement, including the Loan Documents.

C:\Documents and Settings\Peter L. Duncan\My Documents\Data\Wordperfect\AV Builders-Laguna\Correspondence\Term Sheet 12-08-10.5.wpd

NOTE: When using this form to indicate service of a proposed order, **DO NOT** list any person or entity in Category I. Proposed orders do not generate a NEF because only orders that have been entered are placed on the CM/ECF docket.

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is: **26632 Towne Centre Drive, Suite 300, Foothill Ranch, California 92610.**

A true and correct copy of the foregoing document described as **NOTICE OF MOTION AND DEBTOR AND DEBTOR IN POSSESSION'S MOTION FOR ORDER: (1) APPROVING SETTLEMENT AND COMPROMISE OF DISPUTES WITH AV BUILDER CORP.; AND (2) AUTHORIZING SPECIAL HOMEOWNER ASSESSMENTS TO FUND THE SETTLEMENT PAYMENTS TO AV BUILDER CORP.; MEMORANDUM OF POINTS AND AUTHORITIES; AND DECLARATION OF WILLIAM F. WHALEN IN SUPPORT** will be served or was served (a) on the judge in chambers in the form and manner required by LBR 5005-2(d); and (b) in the manner indicated below:

I. TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s) ("LBR"), the foregoing document will be served by the court via NEF and hyperlink to the document. On **December 21, 2010**, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following person(s) are on the Electronic Mail Notice List to receive NEF transmission at the email address(es) indicated below:

- James C Bastian jbastian@shbllp.com
- Mark Bradshaw mbradshaw@shbllp.com
- Franklin J Contreras fcontreras@shbllp.com
- Peter L Duncan peterd@psdslaw.com
- Nancy S Goldenberg nancy.goldenberg@usdoj.gov
- United States Trustee (SA) ustpreion16.sa.ecf@usdoj.gov

Service information continued on attached page

II. SERVED BY U.S. MAIL OR OVERNIGHT MAIL(indicate method for each person or entity served) - On **December 21, 2010**, I served the following person(s) and/or entity(ies) at the last known address(es) in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States Mail, first class, postage prepaid, and/or with an overnight mail service addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Service information continued on attached page

III. SERVED BY PERSONAL DELIVERY, FACSIMILE TRANSMISSION OR EMAIL (indicate method for each person or entity served): Pursuant to Fed. R. Civ. P. 5 and/or controlling LBR, on **December 21, 2010** I served the following person(s) and/or entity(ies) by personal delivery, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on the judge will be completed no later than 24 hours after the document is filed.

Judge's Copy – Via Messenger

U.S. Bankruptcy Court
Hon Robert N. Kwan, U.S. Bankruptcy Judge
411 West Fourth Street Bin Outside Room 5097
Santa Ana, CA 92701

Service information continued on attached page

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

December 21, 2010

Date

Lorre Clapp

Type Name

/s/ Lorre Clapp

Signature

U.S. MAIL SERVICE LIST

DEBTOR

LAGUNA VILLAGE OWNERS'
ASSOCIATION, INC.
WILLIAM WHALEN, PRESIDENT
2330 SANTA VITTORIA DRIVE
LAGUNA HILLS, CA 92653

REQUEST FOR NOTICE - ATTORNEYS FOR AV BUILDER CORP

MILES D GRANT ESQ
MICKEY WALKER ESQ
1331 INDIA ST
SAN DIEGO, CA 92101

SCHEDULE E - NOTICE PURPOSES ONLY

INTERNAL REVENUE SERVICE
PO BOX 21126
PHILADELPHIA, PA 19114

SCHEDULE D

AV BUILDER CORP
ANTONIO V MADUREIRA, AGENT FOR
SERVICE
6373 NANCY RIDGE DRIVE
SAN DIEGO, CA 92121

SCHEDULE F

CALDERON, OLGA YOLANDA
21682 ALDERBROOK
MISSION VIEJO, CA 92692

SCHEDULE F

COWELL, TIMOTHY AND AIMEE
22476 CAMINITO ESTEBAN
LAGUNA HILLS, CA 92653

SCHEDULE F

DELL FINANCIAL SERVICES LLC
ATTN PRESIDENT
C/O RESURGENT CAPITAL SERVICES
AS SERVICING AGENT
JOYCE MONTJOY, BANKRUPTCY
RECOVERY MANAGER
PO BOX 10390
GREENVILLE, SC 29603-0390

SCHEDULE F

GANAHL LUMBER CO
ATTN PRESIDENT
1220 E. BALL RD.
ANAHEIM, CA 92805

SCHEDULE F - ADDITIONAL NOTICE

HOME DEPOT CREDIT SERVICES
ATTN PRESIDENT
PO BOX 9121
DES MOINES, IA 50368-9121

SCHEDULE F

MCC CONSTRUCTION SERVICES
ATTN PRESIDENT
928 ARLEE PLACE
ANAHEIM, CA 92805

INTERESTED PARTY

OFFICE OF THE UNITED STATESTRUSTEE
411 WEST FOURTH STREET SUITE 9041
SANTA ANA, CA 92701

SCHEDULE E - NOTICE PURPOSES ONLY

ORANGE COUNTY
TREASUER-TAX COLLECTOR
ATTN BANKRUPTCY UNIT
PO BOX 1438
SANTA ANA, CA 92702

PROOF OF CLAIM ADDRESS -ADDITIONAL NOTICE

INTERNAL REVENUE SERVICE
MAIL STOP 5503 INSOLVENCY GROUP 7
2400 AVILA RAOD, M/S 5503
LAGUNA NIGUEL, CA 92677

SCHEDULE F

ANTIS ROOFING & WATERPROOFING
ATTN PRESIDENT
48 WATERWORKS WAY
IRVINE, CA 92613

SCHEDULE F

CAPISTRANO LOCK & SAFE
ATTN PRESIDENT
31592 DEL OBISPO SUITE 280
SAN JUAN CAPISTRANO, CA 92675

SCHEDULE F

COX, TROY D
2708 IONE STREET
SACRAMENTO, CA 95821

SCHEDULE F

DOHENY PLUMBING INC
ATTN SANDRA E PRESSWELL, CFO
1311 CALLE AVANZADO
SAN CLEMENTE, CA 92673

SCHEDULE F

HICKEY & PETCHUL LLP
ATTN MANAGING PARTNER
114 PACIFICA SUITE 340
IRVINE, CA 92618

SCHEDULE F

JOHN DEERE LANDSCAPES, INC.
ATTN PRESIDENT
ATTN IRENE HARPER, CREDIT ANALYST
1425 N MCDOWELL BLVD SUITE 125
PETALUMA, CA 94952

SCHEDULE F

MAGEE, JOHN
23416 CAMINITO BASILIO
LAGUNA HILLS, CA 92653

REQUEST FOR NOTICE - ATTORNEYS FOR AV BUILDER CORP

PETER L DUNCAN ESQ
PYLE SIMS DUNCAN & STEVENSON
401 B STREET SUITE 1500
SAN DIEGO, CA 92101-4238

SCHEDULE E - NOTICE PURPOSES ONLY

CALIFORNIA FRANCHISE TAX BOARD
ATTN BANKRUPTCY
PO BOX 2952
SACRAMENTO, CA 95812

SCHEDULE E - NOTICE PURPOSES ONLY

EMPLOYMENT DEVELOP DEPART
BANKRUPTCY GROUP MIC 92E
PO BOX 826880
SACRAMENTO, CA 94280-0001

SCHEDULE F

ARROWHEAD
ATTN PRESIDENT
#215 6661 DIXIE HWY SUITE 4
LOUISVILLE, KY 40258

SCHEDULE F

CHASE MERRITT FUND II
22224 CAMINITO MESCALERO
LAGUNA HILLS, CA 92653

SCHEDULE F

CUNNINGHAM DOORS AND WINDOWS, INC.
ATTN PRESIDENT
1940 E EDINGER AVENUE
SANTA ANA, CA 92705

SCHEDULE F

FICCADENTI & WAGGONER
CONSULTING STRUCTURAL ENGINEERS,
INC.
ATTN PRESIDENT
16969 VON KARMEN SUITE 240
IRVINE, CA 92606

SCHEDULE F

HOME DEPOT CREDIT SERVICES
ATTN PRESIDENT
DEPT 32-2505773246
PO BOX 6031
THE LAKES, NV 88901-6031

SCHEDULE F

LAW OFFICES OF MARY E. LYNCH
MARY E. LYNCH, ESQ.
2030 MAIN STREET 13TH FLOOR
IRVINE, CA 92614

SCHEDULE F

PAYNE PEST MANAGEMENT
ATTN PRESIDENT
8831 RESEARCH DR SUITE 200
IRVINE, CA 92618

SCHEDULE F

QUALITY CARE TERMITES CONTROL, INC.
ATTN PRESIDENT
26072 MERIT CIRCLE SUITE 126
LAGUNA HILLS, CA 92653

SCHEDULE F

SOLO TERMITES CONTROL
ATTN PRESIDENT
23392 MODERO RD SUITE H
MISSION VIEJO, CA 92691

PROOF OF CLAIM FILED

CITIBANK SOUTH DAKOTA NA
ATTN BANKRUPTCY UNIT
DBA
4740 121ST ST
URBANDALE, IA 50323

SCHEDULE G - NOTICE PURPOSES ONLY

BARRERA AND COMPANY INC
ATTN PRESIDENT
2207 GARNET AVENUE SUITE H
SAN DIEGO, CA 92109

SCHEDULE G - NOTICE PURPOSES ONLY

COMMUNITY COMPLIANCE SERVICES
LLC
ATTN MANAGING MEMBER
7071 WARNER AVE F780
HUNTINGTON BEACH, CA 92647

SCHEDULE F AND G

MARCO POLO POOL & SPA INC
ATTN PRESIDENT
15641 PRODUCT LANE #A-4
HUNTINGTON BEACH, CA 92649

SCHEDULE G - NOTICE PURPOSES ONLY

TOPS SOFTWARE LLC
ATTN MANAGING MEMBER
364C CHRISTOPHER AVENUE
GAITHERSBURG, MD 20879

RETURNED MAIL

SEE PROOF OF CLAIM ADDRESS

SCHEDULE F

DELL FINANCIAL SERVICES
ATTN PRESIDENT
ONE DELL WAY
PS2DF-17
ROUND ROCK, TX 78682

SCHEDULE F

THEODORE R HOWARD - MEDIATOR
2677 N MAIN STREET SUITE 800
SANTA ANA, CA 92705

SCHEDULE F

US BANK NATIONAL ASSOCIATION
22522 CAMINIO ESTEBAN
LAGUNA HILLS, CA 92653

SCHEDULE F

MS. KATHLEEN REED
23456 CAMINITO SALADO
LAGUNA HILLS, CA 92653

SCHEDULE F AND G

CALICO BUILDING SERVICES INC
ATTN PRESIDENT
15550-C ROCKFIELD BLVD
IRVINE, CA 92618

SCHEDULE G - NOTICE PURPOSES ONLY

ENTRE-MANURE LLC
ATTN MANAGING MEMBER
24481 ALTA VISTA DRIVE SUITE 2
DANA POINT, CA 92629

SCHEDULE G - NOTICE PURPOSES ONLY

SKYLINE SECURITY MANAGEMENT INC
ATTN PRESIDENT
9027 FLORENCE AVENUE
DOWNEY, CA 90240

SCHEDULE G - NOTICE PURPOSES ONLY

PACIFIC AIR QUALITY TESTING
ATTN PRESIDENT
2628 O'BRIEN PLACE
ESCONDIDO, CA 92027

**RETURNED 10/10/2010, UNDELIVERABLE/
10/15/2010, RETURNED MAIL RECEIVED
WITH FORWARDING INFORMATION**

SCHEDULE F

JOY, THOMAS
C/O FOUNDATION ESCROW
2020 CAMINO DE RIO #306
SAN DIEGO, CA 92108

SCHEDULE F

THE BEE MAN
ATTN PRESIDENT
25652 TALADRO CIRCLE SUITE G
MISSION VIEJO, CA 92691

SCHEDULE F

JOY, THOMAS
C/O FOUNDATION ESCROW
3131 CAMINO DEL RIO N STE 900
SAN DIEGO, CA 92108

SCHEDULE F AND G

AIR QUALITY SPECIALISTS
ATTN PRESIDENT
22501 CHASE SUITE 8307
ALISO VIEJO, CA 92656

SCHEDULE G - NOTICE PURPOSES ONLY

COAST LANDSCAPE A CALIFORNIA
CORPORATION
ATTN MICHAEL DUNN LANDSCAPE
SERVICES DIRECTOR
1418 NORTH HUNDLEY STREET
ANAHEIM, CA 92806

SCHEDULE G - NOTICE PURPOSES ONLY

INLAND DESERT SECURITY &
COMMUNICATIONS
DBA PROFESSIONAL ANSWERING SERVICES
ATTN PRESIDENT
300 S SYCAMORE AVENUE
RIALTO, CA 92376

SCHEDULE F AND G

PATROL ONE
ATTN BILL BANCROFT, PRESIDENT
PO BOX 5487
ORANGE, CA 92863-5487

**RETURNED 10/12/10, UNDELIVERABLE;
TELEPHONE CALL FROM CAROL AT OC
TITLE 10/25/2010 ADVISING THAT THIS IS
NOT WELLS FARGO AND REQUESTED
THAT THIS BE REMOVED FROM THE
MAILING LIST.**

SCHEDULE F

WELLS FARGO BANK
2411 W LA PALMA AVE
BUILDING #1 SUITE 300
ANAHEIM, CA 92801