IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 7
LUXEYARD, INC.,	Case No. 14-12170 (LSS)
Alleged Debtor.	Re: Docket No. 64

MEMORANDUM ORDER[1]

This matter is before the Court on a motion to dismiss an involuntary petition. For the reasons set forth below, I find that a bona fide dispute exists regarding Luxeyard Inc.'s liability to one (and perhaps two) of the three Petitioning Creditors with respect to the 2012 Convertible Debentures that form the basis of the Petitioning Creditors' claims. Accordingly, I am dismissing the involuntary petition.

Current/Relevant Procedural Posture[2]

1. An involuntary chapter 7 petition ("Petition")[3] was filed against Luxeyard Inc. ("Alleged Debtor" or "Luxeyard") on September 19, 2014 by Jinsun, LLC ("Jinsun"), Equity Highrise, Inc., Sun Bear, LLC, and Lee Bear I, LLC (the "Original Petitioners").

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[1] The Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 1334 and 157(a) and (b)(1). A motion to dismiss an involuntary petition is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). No party has challenged my ability to enter a final order in this proceeding.

[2] A detailed procedural posture and my previous factual findings are found in *In re Luxeyard, Inc.*, 556 B.R. 627 (Bankr. D. Del. 2016) (the "First Luxeyard Opinion"). Capitalized terms not defined herein have the meanings ascribed to them in the First Luxeyard Opinion.

[3] Involuntary Petition, Sept. 19, 2014, D.I. 1; Chris Clayton's Joinder in the Involuntary Chapter 7 Bankruptcy Petition, Nov. 16, 2015, D.I. 105; Jonathan Camarillo Trust's Joinder in the Involuntary Chapter 7 Bankruptcy Petition, Nov. 16, 2015, D.I. 106.

2. On February 17, 2015, Luxeyard filed its motion to dismiss ("Motion to Dismiss").[4] In the Motion to Dismiss, the Alleged Debtor asserted three bases for dismissing the case:

(i) the Original Petitioners "are not Luxeyard's creditors because the Petitioners' debentures, on which their claims are based, were convertible debentures that were converted to equity in Luxeyard in 2012"

(ii) the Original Petitioners' "purported claims are subject to *bona fide* dispute because (i) their claims are subject to disgorgement in Alattar v. Casey et al., which is pending in Texas State Court (the "Alattar Action") and (ii) the Petitioners claims are subject to recoupment counterclaims by Luxeyard in the Alattar Action" and

(iii) this case was filed in bad faith by the Original Petitioners because they: "(i) filed this third involuntary petition against Luxeyard within two years, orchestrated by entitites controlled by Scott Gann and Kevin Casey; (ii) are using this case, like its predecessors, to interfere with the Alattar Action; (iii) are using this case for non-bankruptcy purposes; (iv) are engaged in a "two party" dispute with Luxeyard; (v) are prosecuting this case using "bad faith" tactics."[5]

3. The Original Petitioners filed an objection to the motion to dismiss (the "Objection")[6] and Luxeyard filed its reply (the "Reply").[7] On July 13, 2015, a hearing was held on the Motion to Dismiss. At that hearing, Luxeyard was unprepared to develop an evidentiary record or present legal argument. After further review of the record post-hearing, I convened a status conference to address scheduling of a further hearing. At the conclusion of the status conference, I directed the parties to: (i) proceed with discovery in preparation for an evidentiary hearing on the Motion to Dismiss, (ii) present to Chambers

[4] Alleged Debtor Luxeyard, Inc.'s Motion to Dismiss the Involuntary Petition, Feb. 17, 2015, D.I. 64.
[5] Motion to Dismiss ¶ 2.
[6] Objection of the Petitioning Creditors to Alleged Debtor Luxeyard, Inc.'s Motion to Dismiss the Involuntary Petition, Mar. 3, 2015, D.I. 67.
[7] Alleged Debtor Luxeyard, Inc.'s Reply to Objection of the Petitioning Creditors to Alleged Debtor Luxeyard, Inc.'s Motion to Dismiss Involuntary Petition, Mar. 10, 2015, D.I. 69.

an agreed upon scheduling order with the trial date open for Chambers to schedule; and, if they desired, (iii) provide an agreed record (*i.e.,* documents) for consideration of the conversion contention as a matter of law.

4. Thereafter, Equity Highrise, Inc., Sun Bear, LLC, and Lee Bear I, LLC resolved their differences with Luxeyard in the Allatar Action, and I entered stipulations permitting each of them to withdraw as petitioning creditors in this bankruptcy proceeding. Within days, of those stipulations, Chris Clayton and the Jonathan Camarillo Trust (together, with Jinsun, the "Petitioning Creditors") joined in the involuntary petition under 11 U.S.C. § 303(c).

5. Luxeyard challenged the joinder of Mr. Clayton and the Jonathan Camarillo Trust and filed a motion to bar their joinder on the basis that the Original Petitioners filed the Petition in bad faith.[8] After an evidentiary hearing, and for the reasons set forth in the First Luxeyard Opinion, I denied Luxeyard's motion to bar joinder.

6. I scheduled trial on the Motion to Dismiss for February 22, 2017. In addition to discovery disputes, at the request of the parties, I addressed the scope of the issues to be heard at trial. In an Order issued February 15, 2017, I ordered that the trial would be limited to two issues: "(i) whether the Petitioning Creditors hold claims against Luxeyard, or are equity holders because the convertible debentures which form the basis of their claims have previously been converted to equity and (ii) whether there is a bona fide dispute as to

[8] Alleged Debtor Luxeyard, Inc.'s Motion Barring the Joinder of the Jonathan Camarillo Trust and Chris Clayton as Petitioning Creditors in the Involuntary Petition Pursuant to 11 U.S.C. § 105, Feb. 1, 2016, D.I. 117.

the Petitioning Creditors' claims." I declined Luxeyard's request to entertain any further evidence on the issue of bad faith.[9]

7. On February 22, 2017, I convened the hearing (the "Hearing") on the Motion to Dismiss.[10] While I was prepared to take evidence, it became obvious from a review of Luxeyard's exhibit list and discussion with counsel that Luxeyard's evidence consisted largely, if not completely, of the evidence submitted in its month long trial in the Alattar Action. Luxeyard believed that submission of that evidence in this case was necessary to prove its bona fide dispute contention. After further discussion, I concluded that this evidence was unnecessary. I stated my belief that if the Alattar Action was relevant to the involuntary proceeding and created a defense to liability, the existence of the Alattar Action would lead me to conclude that a bona fide dispute existed for purposes of § 303. I also identified non-bankruptcy legal issues still in dispute, as follows:

- whether, as Luxeyard, maintains, the Alattar Action provides a basis for Luxeyard to avoid payment of the 2012 Convertible Debentures; and if so,

- whether, Luxeyard waived/released the ability to raise the Alattar Action in respect of the 2012 Convertible Debentures in the Confidential Settlement Agreement and Mutual Release between Luxeyard, Jinsun, Casey, Jonathan Camarillo Trust and others.[11]

At the conclusion of the hearing, I permitted additional/updated briefing on these issues. Additionally, I again asked for the documents (and referenced pages therein) to support Luxeyard's theory that the 2012 Convertible Debentures had been converted to equity in

[9] Order Regarding Motion of the Petitioning Creditors to Determine Scope of Remaining Issues for Hearing on Motion to Dismiss, Feb. 15, 2017, D.I. 201.
[10] Motion to Dismiss Hr'g Tr., Feb. 22, 2017, D.I. 204.
[11] Motion to Dismiss, Ex. H, Confidential Settlement Agreement and Mutual Release ("Settlement Agreement").

2012. I specifically directed that I did not need further briefing on the legal issues surrounding conversion of the debentures.[12]

8. On March 10, 2017, the parties filed their supplemental opening briefs,[13] and on April 7, 2017, the parties filed their supplemental responsive briefs.[14] Petitioning Creditors also filed an additional brief on April 20, 2017.[15]

9. In the meantime, the judge presiding over the Allatar Action (Honorable Michael Landrum) made Findings of Fact and Conclusions of Law and entered a Final Judgment in that action. Judge Landrum ordered that Mr. Allatar would "take nothing" against defendants, including Jinsun, the Jonathan Camarillo Trust and Mr. Casey. He also ordered that Luxeyard "shall have and recover judgment" against certain defendants in varying amounts based on their profits from sales of Luxeyard shares, in the aggregate amount of $5,242,222.63 plus interest and costs.[16] The judgment was based on his findings that:

- Mr. Casey owed a fiduciary duty to Luxeyard;
- Mr. Casey was an insider as to Luxeyard in that he owned or controlled substantially more than 10% of its shares at all material times;

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[12] Motion to Dismiss Hr'g Tr. at 63:11–14.

[13] Opening Brief of the Petitioning Creditors Regarding Whether There is A Bona Fide Dispute As to the Petitioning Ceditors' Claims Within the Meaning of 11 U.S.C. § 303(b)(1), Mar. 10, 2017, D.I. 206 ("Petitioning Creditors' Supplemental Opening Brief"); Luxeyard, Inc.'s Memorandum of Law Addressing Questions Raised by the Court at the Hearing on February 22, 2017, Mar. 10, 2017, D.I. 208 ("Luxeyard's Supplemental Opening Brief").

[14] Closing Brief of the Petitioning Creditors Regarding Luxeyard, Inc.'s Motion to Dismiss the Involuntary Petition, Apr. 17, 2017, D.I. 210 ("Petitioning Creditors' Supplemental Closing Brief"); Luxeyard, Inc's Answering Brief in Response to the Petitioning Creditors Regarding Whether There is a Bona Fide Dispute as to the Petitioning Creditors' Claims Within the Meaning of 11 U.S.C. § 303(b)(1), Apr. 7, 2017, D.I. 211 ("Luxeyard's Supplemental Closing Brief").

[15] Motion for Leave to File Supplement Regarding Texas Court Findings, Ex. A, Apr. 20, 2017, D.I. 212.

[16] Letter from Petitioning Creditors' Counsel, Ex. A, Mar. 22, 2017, D.I. 209 (Final Judgment).

- Certain defendants assisted Mr. Casey and others in the commission of a breach of fiduciary duty against Luxeyard;
- Certain defendants participated in a share manipulation scheme with Mr. Casey and others, some of whom are settling parties;
- Certain defendants had actual awareness that the share manipulation scheme was underway and coordinated by Mr. Casey and others;
- Luxeyard was harmed by the share price manipulation scheme organized and operated by Casey with the participation of others;
- Certain defendants profited from the sale of Luxeyard shares;
- Mr. Mireskandari, acting as the principal of Luxeyard and on its behalf, facilitated the financial failure of Luxeyard's business;
- An equitable remedy concerning the share price manipulation scheme is not barred by the unclean hands of Mr. Mireskandari and Luxeyard because their misdeeds did not facilitate or affect the price share manipulation scheme; and
- Disgorgement is a proper equitable remedy and Luxeyard is entitled to recover damages against certain defendants in the amount of profits from sales of Luxeyard shares.[17]

Applicable Standard

10. Section 303(b) of the Bankruptcy Code contains three prerequisites for commencing an involuntary case against a debtor that, like Luxeyard, has at least twelve creditors: (1) there must be three or more petitioning creditors; (2) each petitioning creditor must hold a claim against the debtor that is not contingent as to liability or the subject of a bona fide dispute; and (3) the claims must aggregate at least $15,775 more than the value of

[17] *See generally* Luxeyard's Supplemental Closing Brief, Ex. A (Findings of Fact and Conclusions of Law).

liens on the debtor's property.[18] A court must dismiss a petition if it does not meet these prerequisites.[19]

11. The Bankruptcy Code does not define "bona fide dispute." The Third Circuit has ruled that a bona fide dispute exists "[i]f there is a genuine issue of a material fact that bears upon the debtor's liability, or a meritorious contention as to the application of law to undisputed facts."[20] "Under this standard, the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute as to the validity of debt."[21] The court's objective is to ascertain the existence of a dispute, not to actually resolve the dispute.[22] If a bona fide dispute exists, the Bankruptcy Court is obliged to dismiss the petition, rather than resolve the dispute.[23]

12. The burden is on the petitioning creditor to first establish a prima facie case with respect to the liability and amount of the claims it holds. Once a prima facie case has been established, the burden shifts to the alleged debtor to demonstrate the existence of a bona fide dispute.[24] "[T]he existence of affirmative defenses may suggest that a bona fide dispute exists."[25] The alleged debtor need not prove its affirmative defense; rather the

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[18] 11 U.S.C. § 303(b)(1); *see In re Forever Green Athletic Fields, Inc.*, 804 F.3d 328, 333 (3d Cir. 2015); *In re Diamondhead Casino Corp.*, 540 B.R. 499, 505–06 (Bankr. D. Del. 2015).
[19] *Forever Green Athletic Fields*, 804 F.3d at 334.
[20] *In re Diamondhead Casino Corp.*, No. 15-11647(LSS), 2016 WL 3284674, at *8 (Bankr. D. Del. June 7, 2016) (quotation omitted); *see also B.D.W. Assocs., Inc. v. Busy Beaver Bldg. Ctrs., Inc.*, 865 F.2d 65, 66 (3d Cir. 1989) (quoting *In re Lough*, 57 B.R. 993, 997 (Bankr. E.D. Mich. 1986)).
[21] *Diamondhead Casino*, 2016 WL 3284674 at *8 (quotation omitted); *see also In re AMC Investors, LLC*, 406 B.R. 478, 483–84 (Bankr. D. Del. 2009) (quoting *In re Busick*, 831 F.2d 745, 750 (7th Cir. 1987)).
[22] *See Diamondhead Casino*, 2016 WL 3284674 at *8 (quotation omitted); *see also In re Vortex Fishing Sys., Inc.*, 277 F.3d 1057, 1064 (9th Cir. 2002) ("A bankruptcy court is not asked to evaluate the potential outcome of a dispute, but merely to determine whether there are facts that give rise to a legitimate disagreement over whether money is owed, or, in certain cases, how much.").
[23] *See B.D.W. Assocs.*, 865 F.2d at 66 (quotation omitted).
[24] *See Diamondhead Casino*, 2016 WL 3284674 at *9 (citing *AMC Investors*, 406 B.R. at 484).
[25] *Vortex Fishing*, 277 F.3d at 1067 (citation omitted) (affirming the bankruptcy court's finding of a bona fide dispute because the debtor had presented "sufficient evidence" that it could be entitled to

alleged debtor must demonstrate that its affirmative defense is "colorable" or has "substantial merit."[26]

Application of the Standard

A. The Petitioning Creditors are Creditors for Purposes of the Involuntary Petition

13. From the inception of this case, and throughout the three years since, Luxeyard has taken the position that the Petitioning Creditors are stockholders rather than creditors because the 2012 Convertible Debentures were converted to equity in 2012 under the mandatory conversion feature of the debentures.[27] To support its conversion argument, Luxeyard argued that it had met all the requirements for mandatory conversion, including by filing its form S-1 with the Securities and Exchange Commission on June 15, 2012.[28] Alternatively, Luxeyard argued that it had satisfied Rule 144. In response, Petitioning Creditors contended that the 2012 Convertible Debentures had never converted, because,

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affirmative defenses of impossibility of performance and waiver on petitioning creditor's claim); *see also Lough*, 57 B.R. at 997–98 (finding bona fide disputes with respect to petitioning creditor's claims because while the petitioning creditor had cited numerous cases to support both of its claims, "there is substantial merit (without resolving the issue)" to the alleged debtor's legal and factual arguments against both claims); *In re Tri-Cty. Farm Equip. Co.*, 87 B.R. 667, 671 (D. Kan. 1988) (affirming the bankruptcy court's decision to dismiss the involuntary bankruptcy, finding that the alleged debtor had "colorable defenses" to the petitioning creditor's claim).

[26] *Tri-Cty. Farm Equip.*, 87 B.R. at 671; *Lough*, 57 B.R. at 997–98.

[27] *See* Motion to Dismiss at ¶¶ 22-29; Reply at ¶¶ 2-11; Motion to Dismiss, Ex. F at 4:

> Mandatory Conversion. If at any time prior to the Maturity Date, (a) the shares of Common Stock underlying this Debenture are registered in a registration statement under the Securities Act or the shares of Common Stock underlying this Debenture are available for resale pursuant to Rule 144 or similar rule, without limitation, (b) for a period of ten (10) consecutive trading days the closing bid price for the Company's Common Stock remains at or above $1.00; and (c) the daily volume of the Common Stock during such consecutive ten (10) day period is at least 50,000 shares per day, then all outstanding principal and accrued but unpaid interest under this Debenture shall automatically convert into shares of Common Stock pursuant to the terms of this Article 2 but subject to the limitation provided by subsection (e) above (the "Mandatory Conversion").

[28] Motion to Dismiss at ¶ 28.

among other reasons, the filing of the form S-1 did not register the shares underlying the debentures; they also disagreed with the assertion that Rule 144 had been satisfied.[29]

14. In its Supplemental Opening Brief dated March 10, 2017, Luxeyard did an about face. Luxeyard states that in fact, an S-1 had never been filed with respect to the securities underlying the 2012 Convertible Debentures, and it never mentions Rule 144. Abandoning its previous arguments, Luxeyard now contends that while "[i]t is true that Luxeyard has not filed a registration statement to register the shares of Common Stock underlying the [2012 Convertible] Debentures . . . . Luxeyard is excused from doing so because, given the extent of the fraud practiced by [Mr.] Casey, filing such a registration statement would have resulted in a furtherance of the fraud . . . . [and] would have caused Luxeyard to violate the Securities Act."[30] Luxeyard further maintains, again for the first time in the supplemental briefs, that Luxeyard was excused from filing a registration statement in order for the 2012 Convertible Debentures to mandatorily convert because it could not possibly know the extent of Mr. Casey's beneficial ownership due to Mr. Casey's efforts to conceal his beneficial ownership interests in Luxeyard, and that if Luxeyard had filed a statement with the SEC that did not properly reflect the beneficial ownership interests of Mr. Casey, Luxeyard would have been subjected to potential sanctions with the SEC.[31]

15. I will not entertain this new argument raised by Luxeyard for the first time in its supplemental briefings—three years after the commencement of the case and more than two years after I was prepared to hear and determine the conversion argument. This

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[29] *See* Objection at ¶¶ 29–31.
[30] Luxeyard's Supplemental Opening Brief at 17.
[31] Luxeyard's Supplemental Opening Brief at 17–25.

argument, which raises additional factual issues, simply comes too late.[32] Accordingly, for purposes of the involuntary petition, I conclude that the Petitioning Creditors are creditors.

B. Luxeyard has Demonstrated the Existence of a Bona Fide Dispute with Respect to its Liability on the 2012 Convertible Debentures held by Jinsun and the Jonathan Camarillo Trust

16. Initially, the Petitioning Creditors have met their prima facie case. There is no dispute that each Petitioning Creditor holds a 2012 Convertible Debenture, the debentures are matured and they have not been paid.[33]

17. Luxeyard, however, continues to maintain that it has a defense to payment of the 2012 Convertible Debentures based on the allegations, and now the judgment, in the Allatar Action. Luxeyard argues that it has an illegality defense with respect to Petitioning Creditors' claims on the 2012 Convertible Debentures, and therefore that the 2012 Convertible Debentures are subject to a bona fide dispute.[34] Specifically, Luxeyard alleges

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[32] *Laborers' Int'l Union v. Foster Wheeler Corp.*, 26 F.3d 375, 398 (3d Cir. 1994) ("An issue is waived unless a party raises it in its opening brief."); *In re Catholic Diocese of Wilmington, Inc.*, 437 B.R. 488, 492 (Bankr. D. Del. 2010) (holding that issues raised for the first time in a reply brief are waived); *cf. FMC Corp. v. Am. Cyanamid*, No. 01-0476, 2010 WL 3906904, at *4 (D.N.J. Sept. 29, 2010) (granting summary judgment and refusing to permit State of New Jersey to change its position, when to do so "would serve to completely alter the calculus of the litigation and undermine settlement negotiations that parties engage in with the State."). Moreover, this argument is obviated by the fact that as to certain debenture holders, such as Mr. Clayton, there is no alleged fraud associated with his 2012 Convertible Debentures.

[33] First Luxeyard Opinion, 556 B.R. at 636 n.68; Motion to Bar Joinder Hr'g Tr. at 101–102, Apr. 13, 2016, D.I. 155; *see In re VitaminSpice*, 472 B.R. 282, 292–93 (Bankr. E.D.Pa. 2012) (holding that a petitioning creditor established a prima facie case by showing the absence of a bona fide dispute as to liability on a loan by presenting the note and documents showing that the petitioner transferred money to the alleged debtor, and the petitioner's testimony that the note was due and unsatisfied); *see also United States v. Davis*, No. 00-1985, 2002 WL 169603, at *1 (6th Cir. 2002) (holding that the lender, in a non-bankruptcy case, established a prima facie case that it was entitled to collect on a promissory note by presenting the promissory note and a certification from an agent of the lender that the defendant had defaulted on the loan).

[34] *See* Reply at ¶ 15 ("The [Petitioning Creditors'] claims are also subject to *bona fide* disputes as Luxeyard claims the [2012 Convertible] Debentures were entered into to further an illegal securities scheme. As such, the [Petitioning Creditors] are not in a position to seek enforcement of the [2012 Convertible] Debentures."); Motion to Dismiss, Ex. J, at ¶¶ 63-64 (footnotes omitted) ("From January through April of 2012, LuxeYard was engaged in private placement funding at $0.30 per

that the 2012 Convertible Debentures were entered into in furtherance of the stock manipulation scheme.[35]

18. Petitioning Creditors argue that the 2012 Convertible Debentures are not subject to an illegality defense because "[p]recedent makes clear that to avoid repayment of amounts it owes under the [2012 Convertible] Debentures, Luxeyard must establish that *enforcing the* [2012 Convertible] *Debentures* would violate law . . . . Said differently, a valid contractual defense of illegality requires a showing that a term or condition of the contract is illegal."[36]

19. Luxeyard, on the other hand, cites decisions for the legal proposition that even if the subject of a contract itself is not illegal, or procured in an illegal fashion, "[p]roper and consistent application of a prime and long-settled public policy closes the doors of our courts to those who sue to collect the rewards of corruption."[37] "[N]o court

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share. Unknown to LuxeYard and legitimate investors, the Defendants and their co-conspirators undertook 'gypsy swaps' in order to continue 'investing' in LuxeYard. Their goal was to have the company continue functioning until their Pump and Dump plan was fully implemented. The Defendants and their co-conspirators sold shares received from the pump and dump scheme at prices ranging from $0.80 to $1.50, and used proceeds to invest in the private placement at a substantially reduced price. In some instances, these investors in convertible debentures were bribed or subsidized by 'free trading stock' in order to invest. They used ill-gotten funds to create the appearance of legitimate investment in LuxeYard. These gypsy swaps also had the effect of causing other, unaffiliated and innocent third-parties to be induced into making private placement investments during this time frame. But these investors had no knowledge of the 'gypsy swap' funding in which the Defendants and their co-conspirators were engaged during the same round of financing."); Motion to Dismiss at ¶ 34 ("Among the relief sought in the Alattar Action is the disgorgement of the Petitioners' profits from their frauds and the proceeds of those profits. The Debentures are proceeds of those profits."); Luxeyard's Supplemental Closing Brief at 7 (The 2012 Convertible Debentures "sales arose from and were financed by an earlier, fraudulent transaction.").

[35] Reply at ¶ 15.

[36] Petitioning Creditors' Supplemental Opening Brief at ¶¶ 12–13 (citing *Hurd v. Hodge*, 334 U.S. 24, 34–35 (1948); *Fields v. Thompson Printing Co.*, 363 F.3d 259, 268–69 (3d Cir. 2004); *Pryor v. Nat'l Collegiate Athletic Ass'n*, 288 F.3d 548, 569–70 (3d Cir. 2002); *Valhal Corp. v. Sullivan Assocs. Inc.*, 44 F.3d 195, 206 (3d Cir. 1995); *Williams v. Allstate Ins. Co.*, 595 F.Supp. 2d 532, 542 (E.D. Pa. 2009); *Shadis v. Beal*, 520 F.Supp. 858, 861 (E.D. Pa. 1981)).

[37] *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 469 (1960); *see also Stone v. Freeman*, 298 N.Y. 268, 271 (1948).

should be required to serve as paymaster of the wages of crime" where the money plaintiff sues for the "fruit of an admitted crime."[38] To find otherwise would be to allow a party to "profit by his own fraud, or to take advantage of his own wrong, or to found [a] claim upon his own iniquity, or to acquire property by his own crime."[39] "[C]ourts generally will not enforce an illegal contract based upon 'the elementary principle that one who has himself participated in a violation of law cannot be permitted to assert in a court of justice any right founded upon or growing out of the illegal transaction.'"[40]

20. Given the findings of fact made by Judge Landrum and considering the law cited by the parties, Luxeyard has established that it may have an illegality defense to its liability on the 2012 Convertible Debentures held by Jinsun, whose sole manager and only employee is Mr. Casey.[41] Judge Landrum found that Mr. Casey breached a fiduciary duty owed to Luxeyard, and organized and operated a share manipulation scheme that harmed Luxeyard. He also found equitable remedies appropriate. Further, given the relationship between Mr. Casey and Mr. Camarillo,[42] there may also be a defense to enforcement of the 2012 Convertible Debentures owned by the Jonathan Camarillo Trust.[43]

21. The question becomes, then, whether Luxeyard waived its right to assert defenses to the 2012 Convertible Debentures in the Settlement Agreement. The Petitioning Creditors argue that any defenses Luxeyard may have against their claims on the 2012

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[38] *McConnell*, 7 N.Y.2d at 469 (quoting *Stone*, 298 N.Y. at 271 (1948)).
[39] *Id.* (quoting *Riggs v. Palmer*, 115 N.Y. 506, 511–12 (1889)).
[40] *Sender v. Simon*, 84 F.3d 1299, 1307 (10th Cir. 1996) (quotation omitted); *see Gibbs & Sterrett Mfg. Co. v. Brucker*, 111 U.S. 597, 601 (1884) ("one who has himself participated in a violation of law cannot be permitted to assert in a court of justice any right founded upon or growing out of the illegal transaction").
[41] First Luxeyard Opinion, 556 B.R. at 633.
[42] *Id.* at 636.
[43] To be clear, I am not making any statements or conclusions with respect to the preclusive effect, if any, of the rulings in the Alattar Action on Jinsun or the Jonathan Camarillo Trust.

Convertible Debentures are precluded by the Settlement Agreement. Luxeyard disagrees.

22. The Settlement Agreement is governed by Texas law. The Texas Supreme Court has provided the following guidance in interpreting a contract:

> In construing a written contract, the primary concern of the court is to ascertain the true intentions of the parties as expressed in the instrument. To achieve this objective, we must examine and consider the entire writing in an effort to harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless. No single provision taken alone will be given controlling effect; rather, all the provisions must be considered with reference to the whole instrument. A contract is unambiguous if it can be given a definite or certain legal meaning. On the other hand, if the contract is subject to two or more reasonable interpretations after applying the pertinent rules of construction, the contract is ambiguous, creating a fact issue on the parties' intent.[44]

"Deciding whether a contract is ambiguous is a question of law for the court."[45] A court "may conclude an agreement is ambiguous even if the parties do not plead ambiguity or argue the agreement contains an ambiguity."[46]

23. With respect to releases, the Texas Supreme Court has held that:

> In order to effectively release a claim in Texas, the releasing instrument must 'mention' the claim to be released. Even if the claims exist when the release is executed, any claims not clearly within the subject matter of the release are not discharged. Furthermore, general categorical release clauses are narrowly construed.[47]

24. The Settlement Agreement contains broad releases. As relevant, Luxeyard:

> waive[s], release[s], remise[s], covenant[s] not to sue and forever discharges[s] Casey, Far East Strategies, LLC, Jinsun, LLC, . . . Jonathan Camarillo Trust . . . jointly and severally of and from all manner of action, causes of action,

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[44] *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 229 (Tex. 2003) (citations omitted); *see also McCullough v. Scarbrough, Medlin & Assocs., Inc.*, 435 S.W.3d 871, 888 (Tex. App. 2014) (citations omitted) ("A writing or term is not ambiguous because it lacks clarity or the parties offer different interpretations. But if the language, after applying the relevant rules of contract construction, is susceptible to more than one reasonable interpretation, the contract contains an ambiguity and a fact issue exists as to the parties' intent.").

[45] *J.M. Davidson*, 128 S.W.3d at 229.

[46] *McCullough*, 435 S.W.3d at 888 (citing *Coker v. Coker*, 650 S.W.2d 391, 394 (Tex. 1983)).

[47] *Victoria Bank & Trust Co. v. Brady*, 811 S.W.2d 931, 938 (Tex. 1991) (citations omitted).

> suits, debts, dues, sums of money, accounts, invoices, bills of lading, reckonings, bonds, bills, covenants, contracts, **controversies**, agreements, promises, damages, expenses, claims, attorneys' fees and demands whatsoever, **existing on, or at any time prior to the date hereof,** in law, in equity, or otherwise, whether now known or unknown, **including** economic loss or expense of any type, lost income or compensation, punitive damages, attorneys fees, costs, interest, penalties, sanctions and consequential damages or any other type of damages of any nature whatsoever, whether based on tort, subrogation, contract, quasi-contract, unjust enrichment, detrimental reliance, any type of statute or regulation, **or any other theory of recovery** or responsibility or any other claim or cause of action of any type which Plaintiffs and their respective agents . . . **had, have or may ever have** upon or by reason of any fact, matter, cause or thing whatsoever, including, but not limited to, all claims that were asserted or could have been asserted in connection with **the acquisition or disposition by the Defendants of any Company securities, the reverse merger or exchange agreement by and between LY Retail, Mierskandari, Al Attar and the Company, as described in the Company's 8-K filed with the Securities and Exchange Commission ("SEC") on November 15, 2011,** or in connection with the Dispute and the facts, circumstances, **allegations and controversies related or giving rise thereto.**[48]

"Dispute" is defined as the lawsuit brought by Luxeyard, LY Retail and Mr. Miresdandari against certain defendants, including Mr. Casey, Jinsun and Jonathan Camarillo Trust in the United States District Court for the Southern District of Texas, Civil Action No. 04:12-CV-2480, which are allegations related to the pump and dump scheme.

25. Casey's and Jinsun's release of Luxeyard is not entirely parallel.[49] And, significantly, notwithstanding the settlement of the Dispute, Jinsun and the Jonathan

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[48] Settlement Agreement ¶ 22 (emphasis added). Luxeyard also covenants "not to, in any manner whatsoever, sue the Defendants in any court or tribunal or bring any action, lawsuit or cause of action (whether by way of direct action, counterclaim, cross claim or interpleader) against the Defendants in any manner whatsoever based upon any matter directly or indirectly related to the Dispute." *Id.* at ¶ 24.

[49] "Casey, Far East Strategies, LLC, Jinsun, LLC, [and] Jonathan Camarillo Trust . . . do hereby waive, release, remise, covenant not to sue, and forever discharge, the Company, LY Retail and Mireskandari, jointly and severally, of and from all manner of action, causes of action, suits, debts, dues, sums of money, accounts, invoices, bills of lading, reckonings, bonds, bills, covenants, contracts, controversies, agreements, promises, damages, expenses, claims, attorneys' fees and demands whatsoever, existing on or at any time prior to the date hereof, in law or equity, or otherwise, whether now known or unknown . . . whether based on tort, subrogation, contract, quasi-

Camarillo Trust retained their Luxeyard securities, including the 2012 Convertible Debentures.[50] Further, Luxeyard obligates itself to maintain certain public information and file certain reports and other documents required by the Securities Act and the Exchange Act, as well as to furnish to Mr. Casey, Jinsun and the Jonathan Camarillo Trust written statements of compliance with the federal securities laws, and "other information as may be reasonably requested by" them.[51]

26. Read in its entirety, the Settlement Agreement could provide for a release of Luxeyard's defenses to the 2012 Convertible Debentures. Given the breadth of the release, the stated intention to settle all matters relating to the Dispute,[52] and the specific release

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contract, unjust enrichment, detrimental reliance, any type of statute or regulation, or any other theory of recovery or responsibility or any other claim or cause of action of any type, which they had or have, by reason of any fact, matter, cause that were asserted or could have been asserted in connection with the Dispute and the facts, circumstances, allegations and controversies related or giving rise thereto." Settlement Agreement ¶ 23.

[50] *Id.* ("Nothing contained in the foregoing shall be deemed a release of the Company's obligations pursuant to the November 2011 Equity Offering, the December 2011 Equity Offering, the April 2012 Convertible Debentures, the May 2012 Equity Offering or the Certificates (as defined in paragraph 25 below).").

[51] Settlement Agreement ¶ 26 ("So long as any of the Defendants hold any securities of the Company, the Company shall:

a. make and keep available adequate current public information, as those terms are understood and defined in Rule 144 promulgated under the Securities Act of 1933;
b. use commercially reasonable efforts to file with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act (at any time after the Company has become subject to such reporting requirements); and
c. furnish to any Defendants, so long as the Defendant owns any of the Company's securities as set forth above, forthwith upon request (i) to the extent accurate, a written statement by the Company that it has complied with and are current in the reporting requirements of the Securities Act and the Exchange Act (at any time after the Company has become subject to such reporting requirements) and (ii) such other information as may be reasonably requested by any Defendant.")

[52] Settlement Agreement at 2 ("WHEREAS, the Plaintiffs (as defined below) and Defendants (as defined below) desire to resolve fully and finally all of the matters **relating to** the Dispute without further litigation and to release all potential claims of each Party herein that relate to the Dispute, including all claims and potential counterclaims and cross actions, by performing the acts and promises described in this Agreement.") (emphasis added); *Id.* at ¶ 35 ("Full Satisfaction. The Parties understand and agree that the Settlement Proceeds and other considerations herein are in full

language, which includes all claims that were asserted or could have been asserted in connection with "the acquisition or disposition by the Defendants of any Company securities" and the "facts, circumstances, allegations and controversies related or giving rise" to the Dispute, it is certainly plausible that Luxeyard released defenses based on illegality with respect to the acquisition of the 2012 Convertible Debentures.

27. But, Luxeyard points to two things running in its favor. First, Luxeyard stresses that the word "defense" appears nowhere in the Settlement Agreement. Second, Luxeyard contends that ¶ 25 specifically provides that the settlement agreement does not alter its "rights" with respect to its outstanding securities,[53] which includes the right to raise defenses to any payment obligations.[54]

28. The Texas Court of Appeals has ruled on a similar scenario. In *Port-Neches*, the trial court found that a party to a settlement agreement related to a construction contact that released certain affirmative claims but retained "all causes of action for retainage withheld under the contract" had released affirmative defenses related to the retainage.[55] The Texas Court of Appeals reversed and ruled that because the releasor "did not expressly waive its defenses to the claim that was expressly excluded from the settlement agreement, as a matter of law those defenses were not waived by the settlement agreement."[56]

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satisfaction of all claims and causes of action arising out of and relating to the Dispute, and that no Plaintiff will receive further sums of money from any defendants or any of their respective agents . . . arising out of or relating to the Dispute.").

[53] Settlement Agreement ¶ 25 ("This Agreement does not alter or effect any of the rights, liabilities or obligations of the Company to the Defendants, if any, pursuant to the November 2011 Equity Offering, the December 2011 Equity Offering, the April 2012 Convertible Debentures, the May 2012 Equity or the Certificates.").

[54] Reply at ¶ 15; Luxeyard's Supplemental Opening Brief at 4–5.

[55] *Port-Neches Groves Indep. Sch. Dist. v. Pyramid Constructors, L.L.P.*, 281 S.W.3d 142, 151 (Tex. App. 2009).

[56] *Id.*; *see Nixon v. Cascade Health Servs., Inc.*, 205 Or. App. 232, 240–243 (2006) ("[A]s a matter of plain meaning, defendant's position that the release agreement *unambiguously precludes* plaintiff from

29. *Port-Neches* is only one decision from one appellate court in Texas.[57] It may be distinguishable both on the language of the settlement agreement and the nature of what was retained – i.e. a cause of action versus an obligation. But, for purposes of raising a bona fide dispute, I cannot ignore this decision. I find that the Settlement Agreement is susceptible to more than one reasonable interpretation and therefore ambiguous with respect to whether Luxeyard released defenses with respect to its liability on the 2012 Convertible Debentures. Therefore, Luxeyard has raised a bona fide dispute.[58]

Conclusion

30. Luxeyard has demonstrated a bona fide dispute with respect to its liability to Jinsun and perhaps to the Jonathan Camarillo Trust on the 2012 Convertible Debentures. As such, the number of individual creditors whose debts are not subject to a bona fide dispute is not sufficient to meet the requirements of 303(b).

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raising a negligence defense is unfounded. 'Claim' does not mean 'defense'—and, if defendant had wanted to explicitly preclude the assertion of 'defenses,' it presumably could have done so. If anything, the text unambiguously does *not* preclude plaintiff from asserting a negligence *defense*."); *Wenger v. Ziegler*, 424 Pa. 268, 270–71 (1967) (emphasis added) (footnote omitted) (holding that a settlement of a trespass action that purported to release appellee "from all claims, demands, damages actions, causes of action, or suits at law or in equity, of whatsoever kind or nature" did not preclude the appellant from asserting a defense against a judgment; "[a]n examination of the written release reveals that the parties obviously contemplated only the surrender by appellant of his right to pursue a cause of action by complaint or counterclaim, and not of his right to defend an action brought by appellee against him .... *It is inconceivable to us that a release otherwise silent may be construed so as to deprive only one party of rights arising from a given transaction.*"); *Schultz v. Nationwide Ins. Co.*, 25 Pa. D. & C.3d 257, 263 (Pa. Com. Pl. 1982) (citation omitted) ("[T]he right to a defense survives a release unless the instrument expressly states to the contrary.").

[57] The parties did not cite me to any Texas Supreme Court decision on waiver of defenses.

[58] *In re Aminian*, No. 07-12957, 2008 WL 793574, at *4 (Bankr. S.D.N.Y. Mar. 25, 2008) (finding that a guaranty which forms the basis for the petitioning creditors' claims is ambiguous, thus creating a bona fide dispute, and holding that "[h]aving identified a bona fide dispute the Court is not required to resolve it in the context of a controverted involuntary petition."); *In re Nargassans*, 103 B.R. 446, 450–51 (Bankr. S.D.N.Y. 1989) (finding that a bona fide dispute exists as to contractual liability where the contract was ambiguous and therefore the petitioning creditors' claims were ineligible under § 303(b)).

WHEREFORE, for the reasons set forth above, **IT IS HEREBY ORDERED** that the Motion to Dismiss is **GRANTED**.

Dated: October 24, 2017

LAURIE SELBER SILVERSTEIN
UNITED STATES BANKRUPTCY JUDGE