

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

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In re : Chapter 11  
: Case No. 07-11448 (MG)  
THE 1031 TAX GROUP, LLC, *et al.*, : Substantively Consolidated  
: Debtors.<sup>1</sup> :  
: :  
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**DECLARATION OF GERARD A. MCHALE, JR.  
IN SUPPORT OF MOTION FOR ENTRY OF AN ORDER PURSUANT TO SECTION  
105(a) OF THE BANKRUPTCY CODE AND RULE 9019(a) OF THE FEDERAL RULES  
OF BANKRUPTCY PROCEDURE APPROVING A SETTLEMENT AGREEMENT  
WITH SAN FRANCISCO SERIES OF LOCKTON COMPANIES, LLC.**

**GERARD A. MCHALE, JR.**, pursuant to 28 U.S.C. § 1746, hereby deposes and says  
under penalty of perjury:

1. I submit this declaration in support of the motion (the “Motion”)<sup>2</sup> seeking entry  
of an order pursuant to section 105(a) of title 11 of the United States Code (the “Bankruptcy  
Code”) and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure (the “Bankruptcy  
Rules”) approving a settlement agreement dated as of September 24, 2009 (the “Settlement  
Agreement”), by and among Gerard A. McHale, Jr., Chapter 11 Trustee (the “Chapter 11  
Trustee”) for the 1031 Debtors’ estates, San Francisco Series of Lockton Companies, LLC  
 (“Lockton”), and the Class Representatives. A copy of the Settlement Agreement is attached to  
the Motion as **Exhibit A**.

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<sup>1</sup> The 1031 Tax Group, LLC; 1031 Advance 132 LLC; 1031 Advance, Inc.; 1031 TG Oak Harbor LLC; Atlantic Exchange Company, Inc.; Atlantic Exchange Company LLC; Investment Exchange Group, LLC; National Exchange Accommodators, LLC; National Exchange Services QI, Ltd.; NRC 1031, LLC; Real Estate Exchange Services, Inc.; Rutherford Investment LLC; Security 1031 Services, LLC; Shamrock Holdings Group, LLC; AEC Exchange Company LLC (collectively, the “1031 Debtors” and together with IPofA Shreveport Industrial Park, LLC, collectively, the “Debtors”).

<sup>2</sup> All capitalized terms not otherwise defined herein shall have the meanings given to them in the Motion.

2. I am President of Gerard A. McHale, Jr., P.A., the Liquidation Trustee for the 1031 Debtors Liquidation Trust.

3. The Settlement Agreement represents a comprehensive settlement of claims against Lockton, which were asserted by me in my previous capacity as Chapter 11 Trustee for the 1031 Debtors' estates, and by the plaintiffs (the "Putative Class")<sup>3</sup> in *Hunter, et al. v. Okun, et al.*, Case No. 07-cv-2795-JW (the "Class Action"), pending in the United States District Court for the Northern District of California, San Jose Division (the "District Court"). Pursuant to the proposed settlement, which is subject to approval by both this Court and the District Court, Lockton will make a \$12 million payment, 40 percent of which is allocated to the 1031 Debtors Liquidation Trust and 60 percent of which is allocated to the Putative Class. The settlement provides the funding for additional distributions to the 1031 Debtors Liquidation Trust beneficiaries, most of whom are members of the Putative Class, without the risk and cost that would be incurred litigating the 1031 Debtors Liquidation Trust's and the Putative Class' claims against Lockton.

4. On May 14, 2007 (the "Petition Date"), all but one of the 1031 Debtors filed voluntary petitions for relief under chapter 11, title 11 of the United States Code (the "Bankruptcy Code"). On June 11, 2007, AEC Exchange Company, LLC, one of the 1031 Debtors, also filed a voluntary petition for chapter 11 relief. From their respective filing dates until October 24, 2007, the 1031 Debtors continued in possession of their properties and operated their businesses as debtors-in-possession pursuant to sections 1107(a) and 1108 of the

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<sup>3</sup> The great majority of both the beneficiaries of the 1031 Debtors Liquidation Trust and the members of the Putative Class consist of the exchangers (the "Exchangers") who made exchange deposits with the 1031 Debtors in connection with their exchanges pursuant to Section 1031 of the Internal Revenue Code (a "1031 Exchange").

Bankruptcy Code.<sup>4</sup> By order entered May 22, 2007, the Court authorized the joint administration of the 1031 Debtors' bankruptcy cases. On October 24, 2007, the United States Trustee filed a motion for approval of my appointment as Chapter 11 Trustee. The Court granted the United States Trustee's motion by order dated October 25, 2007.

5. On October 7, 2009, the Bankruptcy Court entered an order (the "Confirmation Order") confirming the Second Amended Chapter 11 Plan (the "Plan") of Reorganization of Gerard A. McHale, Jr., as Chapter 11 Trustee for Each of the 1031 Debtors, and IPofA Shreveport Industrial Park, LLC, which became effective on December 2, 2009 (the "Effective Date"). On the Effective Date, pursuant to the Plan, the 1031 Debtors Liquidation Trust was formed, and Gerard A. McHale, Jr., P.A. ("McHale PA") accepted appointment as Liquidation Trustee for the 1031 Debtors Liquidation Trust.

6. Pursuant to Section 7.6 of the Plan, all of the 1031 Debtors' assets, including the Chapter 11 Trustee's and the 1031 Debtors' rights under the Settlement Agreement and claims against Lockton, vested in the 1031 Debtors Liquidation Trust.

7. The primary creditors of the 1031 Debtors' estates were the Exchangers who are also the members of the Putative Class. Upon consummation of the Plan, the Exchangers received their ratable share of beneficial interests in the 1031 Debtors Liquidation Trust on account of their claims against the 1031 Debtors.

8. On January 20, 2009, I, in my previous capacity as the Chapter 11 Trustee, and the Class Representatives entered into an agreement concerning the prosecution of claims by the Trustee and the Class Representatives (the "Class Action Agreement") which was approved by this Court on May 18, 2009. Among other things, it contains formulas for the sharing of

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<sup>4</sup> On November 15, 2007, IPofA Shreveport Industrial Park, LLC filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code.

recoveries from various causes of action being pursued by the Trustee and the Class Representatives. With respect to Lockton, the Class Action Agreement provides for a formula under which the Class receives 60% of the recoveries and the 1031 Debtors Liquidation Trust receives 40% of the recoveries.

9. Continental Casualty Company, Continental Insurance Company, Federal Insurance Company, and Twin City Insurance Company (the “Crime Insurers”)<sup>5</sup> issued certain commercial crime insurance policies (the “Crime Policies”) under which the 1031 Debtors claimed to be insured, and pursuant to which the Putative Class asserts claims. Certain insurance companies (the “E&O Insurers”) issued certain errors and omissions insurance policies (the “E&O Policies”) under which the 1031 Debtors claimed to be insured. Lockton acted as the insurance broker with respect to certain of the Crime Policies and E&O Policies.

10. Prior to confirmation of the Plan, I (as Chapter 11 Trustee) investigated asserting a claim against Lockton. In addition, the Class Representatives amended their complaint in the Class Action to include claims against Lockton. The claims of the 1031 Debtors’ estates and the Putative Class relate to Lockton’s conduct in (a) advising the 1031 Debtors with respect to the purchase of the commercial crime insurance policies discussed above; and (b) the creation and use of representations made with respect to, among other things, the evidences of insurance (“EOIs”) issued by Lockton in connection with these policies. Lockton denies any liability and contends that it bears no responsibility for the losses because, among other things, the EOIs that

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<sup>5</sup> The Trustee’s claims against the Crime Insurers and the E&O Insurers were resolved pursuant to settlement agreements, under which the 1031 Debtors’ estates received \$23,250,000, collectively, from the Crime Insurers and, collectively, \$4.6 million from the E&O Insurers. These settlements were approved in connection with confirmation of the Plan.

Lockton provided were accurate. Lockton's defenses also include, but are not limited to, the additional defenses discussed in paragraph 15 below.

11. In order to resolve the competing claims asserted by me and the Putative Class, and the defenses asserted by Lockton, the Class Representatives and I, as Chapter 11 Trustee, and Lockton executed the Settlement Agreement in September of 2009.

12. On May 13, 2010, the District Court entered its Preliminary Approval Order (the "Preliminary Approval Order") of the Settlement Agreement with Lockton. A copy of the Preliminary Approval Order is attached to the Motion as **Exhibit B**. The District Court has scheduled its Fairness Hearing to consider final approval of the Settlement Agreement with Lockton for August 30, 2010 at 9:00 a.m. (Prevailing Pacific Time). Accordingly, McHale PA seeks approval of the Settlement Agreement with Lockton subject to final approval of the agreement by the District Court on August 30<sup>th</sup>.

### **THE PROPOSED SETTLEMENT**

13. The salient terms of the Settlement Agreement are:<sup>6</sup>

- (i) Payment of the Settlement Amount of \$12,000,000 (40 per cent of which is allocated to the 1031 Debtors Liquidation Trust and 60 per cent of which is allocated to the members of the Putative Class).
- (ii) Lockton releases the proofs of claim that it filed against the 1031 Debtors.
- (iii) I, on behalf of myself as Liquidation Trustee and each of the 1031 Debtors and their Estates, and the Class Representatives, on their own behalf and on behalf of the Settlement Class, each fully, finally, and completely releases and waives any and all Claims and defenses against the Lockton Released Parties and the Lockton Insurers relating to or arising out of: any EOI issued to any of the 1031 Debtors, regardless of whether that EOI was or was not transmitted

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<sup>6</sup> The following is a summary of the terms of the Settlement Agreement and does not purport to recite all the terms of the Settlement Agreement in full. Parties are encouraged to read the entire Settlement Agreement, annexed to the Motion as **Exhibit A**.

to, described to, seen by or relied on by any of the Class Representatives or other members of the Settlement Class; any insurance policy issued to any of the 1031 Debtors by any insurance company including any fidelity bond or commercial crime insurance policy, whether primary or excess; the business failure of any of the 1031 Debtors, including their parents, subsidiaries or affiliates, or any of those Entities' failure to complete any section 1031 exchange; the operation or business of the 1031 Debtors, or their parents, subsidiaries or affiliates, or any Entities owned or controlled, directly or indirectly, by Edward H. Okun; Edward H. Okun; the actual or alleged theft of money or property from any of the 1031 Debtors by anyone, including Edward H. Okun, Lara D. Coleman, Richard Simring and Robert D. Field; the investigation, consideration, handling or adjustment of claims made by or on behalf of any of the 1031 Debtors or their Estates or any Exchanger who deposited funds or other property with any of the 1031 Debtors to any insurance company or insurance broker in connection with the actual or alleged theft of property or money from any of the 1031 Debtors; the Class Litigation and any of the events, acts, omissions or conduct alleged therein; any Claims that could have been alleged against any of the Lockton Released Parties (or the Lockton Insurers in their capacity as Lockton Insurers) by the Trustee, the 1031 Debtors or their Estates, the Liquidation Trust or the Liquidation Trustee; any adversary proceeding filed by the Trustee, the Liquidation Trust or the Liquidation Trustee in the Bankruptcy Case, any of the events, acts, omissions or conduct alleged therein, and any matters that could have been alleged therein; and the putative class action styled "*Hunter, et al. v. Citibank, NA., et al.*", Case No. 09-cv-02079-JW (United States District Court for the Northern District of California) ("*Hunter v. Citibank*"), any of the events, acts, omissions or conduct alleged therein, and any matters that could have been alleged therein.

- (iv) Lockton releases all claims and defenses against the Trustee and the Settlement Class relating to the matters described in (iii) above.
- (v) The Settlement Agreement is subject to final approval by both this Court and the District Court.

14. I submit that the Settlement Agreement should be approved. As Chapter 11 Trustee, I decided to assert claims against Lockton relating to its conduct as insurance broker with respect to the Crime Policies and the E&O Policies. Among other matters, I had decided to

assert that the EOIs were misleading in that they stated or suggested that the coverage was in the nature of a fidelity bond rather than ordinary insurance when, in fact, the Crime Policies and E & O Policies were not bonds but were, indeed, ordinary insurance. As such, they were subject to numerous requirements for obtaining coverage as well as numerous exclusions from coverage. Based on this, I had decided to assert, among other things, that Lockton had caused the 1031 Debtors to have inadequate insurance and was liable to the extent the policies failed to provide full coverage for the losses. I also had decided to assert that Lockton failed to advise properly with respect to the terms and conditions of the policies.

15. In addition to vigorously denying these allegations, Lockton asserted (among other defenses) that the EOIs that Lockton provided were accurate, that there was no causation between any alleged error or allegedly misleading statement in the EOIs it issued and any damage the 1031 Debtors may have suffered, and that Lockton fully and properly performed whatever obligations it may have owed to the 1031 Debtors. Lockton also asserted that my claims would be barred by the *in pari delicto* doctrine and the *Wagoner* standing doctrine. Although I disagree with these defenses, I recognize that the 1031 Debtors Liquidation Trust would face substantial risk at trial on these issues and Lockton's other defenses.

16. Both I (as Chapter 11 Trustee) and the Putative Class have expended substantial amounts of time and resources investigating claims against Lockton. However, for the 1031 Debtors Liquidation Trust to commence an action, discovery and preparing for a trial would require further fact and legal development pursuant to formal discovery. There would be substantial issues relating to Lockton's defenses. Meanwhile, at a potential trial, both parties would incur extensive costs in preparing numerous witnesses and experts and conducting an evidentiary trial. The resolution contemplated by the Settlement Agreement will avoid lengthy

and expensive litigation between the 1031 Debtors Liquidation Trust and Lockton. The Class Representatives have reached the same conclusion, and determined that the settlement, which has received preliminary approval from the District Court, is prudent and appropriate.

17. My professionals and I have evaluated the relative merits of the case that could be brought against Lockton, as well as other factors which concern the evaluation of the settlement. I believe that any ensuing litigation against Lockton would encounter significant evidentiary and substantive difficulties and the outcome cannot be predicted. The result of the litigation is uncertain, and the 1031 Debtors Liquidation Trust would be assuming substantial risk in litigating the case against the Lockton. Indeed, the fact that, under the Class Action Agreement, the Class receives a greater share of the recovery is a result of the belief that the Class possesses stronger claims against Lockton than the 1031 Debtors Liquidation Trust.

18. Another factor supporting the settlement is the fact that it is a global resolution of the 1031 Debtors Liquidation Trust's and the Class Representatives' potentially competing claims against Lockton, and the recovery will go to the Exchangers who make up the bulk of the 1031 Debtors Liquidation Trust beneficiaries as well as the members of the Putative Class.

19. This leads to the next consideration supporting the Settlement Agreement, *i.e.*, that litigation would be very fact-intensive and accordingly protracted and expensive. Each side could easily expend a significant sum – particularly when the cost of experts is included. Approval of the settlement avoids the incurrence of these expenses, as well as frees up the time and resources of the 1031 Debtors Liquidation Trust and the Class Representatives and their respective professionals, to focus on remaining litigation claims.

20. The following factors weigh in favor of the Settlement Agreement:

- a. In light of the risk of taking the matter to trial, I submit that the benefits of the settlement outweigh the risk, expense and delay of trial;
- b. In the event the settlement is not approved, there is a prospect of a complex and protracted litigation;
- c. Although it cannot be known yet how the trust beneficiaries will react to the settlement, I submit that it is likely that the trust beneficiaries will either generally support, or not object to, the proposed settlement;
- d. I submit that the proposed benefits to be received in the amount of \$12,000,000 represent a material benefit to the Exchangers;
- e. The nature and breadth of the mutual releases contemplated in the Settlement Agreement are reasonable and consistent with settlements of this type.
- f. The Class Representatives, as the other primary parties in interest asserting claims against Lockton, not only support, but are parties to the settlement.
- g. All parties to the settlement are represented by competent and experienced counsel.
- h. The Settlement Agreement was the result of protracted arms-length bargaining, and was not the product of any fraud or collusion.

21. For the foregoing reasons, I respectfully submit that the Settlement Agreement represents a fair and equitable compromise, a sound exercise of my business judgment and a decision that is in the best interest of the beneficiaries of the 1031 Debtors Liquidation Trust. Moreover, the Settlement Agreement is well above the lowest point on the range of reasonableness. Accordingly, I respectfully submit that the Court should approve the compromise of claims as embodied in the Settlement Agreement.

22. Section 3.2 of the Agreement requires that the Lockton Released Parties and Lockton Insurers be provided with injunctive relief as favorable as the injunctive relief granted to other parties settling with the 1031 Debtors' estates, including the Plan Funding Parties.

23. Accordingly, the proposed order includes a limited injunction similar to the limited injunction previously approved by this Court in the settlement with Cordell Funding LLLP and its affiliates pursuant to the Order dated December 1, 2008 and pursuant to the Orders approving the Plan Funding Party Settlements. Such injunction is limited to claims that are based upon or derivative of any claim or cause of action that could have been asserted by, or injury to, the 1031 Debtor's estates.

24. Furthermore, the proposed order includes provisions that, among other things, bar non-settling Defendants<sup>7</sup> from asserting against the Lockton Released Parties or the Lockton Insurers claims for contribution or indemnity (or any other Claim against the Lockton Released Parties of the Lockton Insurers where the injury to the Defendant is the Defendant's liability to the Plaintiff or costs and fees in connection with asserted liability to Plaintiff) arising out of claims or allegations asserted by the 1031 Debtors Liquidation Trust (the "Contribution Bar"). The Court previously provided the same or similar protection to each of the Plan Funding Parties in connection with approval of the Plan Funding Party Settlement Agreements. The Contribution Bar provides that the 1031 Debtors Liquidation Trust's recovery against any Defendants shall be reduced by the settling Defendant's equitable and proportionate share of any joint and several liability, or such greater amount, if any, as may be required under applicable law, as will be determined later by the court in the allocation of recoverable costs and damages incurred by the Plaintiff. The Contribution Bar also bars Lockton from asserting against any person claims for contribution or indemnity arising out of claims or allegations by Plaintiff, subject to certain exceptions.

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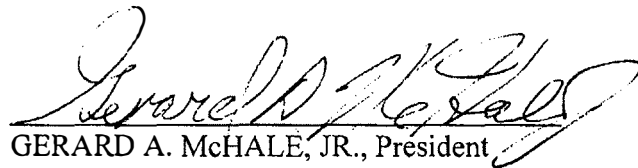
<sup>7</sup> The Agreement defines: (a) "Defendant" as any party now or hereafter named as a defendant in any action brought by the Chapter 11 Trustee or the 1031 Debtors Liquidation Trust or any party who settles with the Chapter 11 Trustee or the 1031 Debtors Liquidation Trust without being named in a complaint, counterclaim or cross-claim, and (b) the term "Plaintiff" as the Chapter 11 Trustee and/or the 1031 Debtors Liquidation Trust.

25. Here, the Contribution Bar and injunctive relief are necessary and appropriate, and Lockton conditioned the Agreement on the issuance of an order providing for this relief.

26. It is respectfully submitted that the Court should issue the proposed order, including the Contribution Bar and injunctive relief provided therein.

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

Dated: Fort Myers, Florida  
August 6, 2010



GERARD A. McHALE, JR., President  
of Gerard A. McHale, Jr., P.A., the Liquidation Trustee  
for the 1031 Debtors Liquidation Trust