IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

In re:	§	**CHAPTER 11 CASE**
BULLION DIRECT, INC.	§	**CASE NO. 15-10940-TMD**
Debtor.	§	

MOTION BY THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS FOR CONVERSION TO CHAPTER 7

This pleading requests relief that may be adverse to your interests.

If no timely response is filed within 21 days from the date of service, the relief requested herein may be granted without a hearing being held.

A timely filed response is necessary for a hearing to be held.

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

The Official Committee of Unsecured Creditors (the "Committee") of BullionDirect, Inc. (the "Debtor") in the above captioned case (the "Case"), hereby files this *Motion for Conversion to Chapter 7* (the "Motion"). The Committee presents this Motion and respectfully represents the following:

I. INTRODUCTION

1. In many aspects, the Debtor in this Case is like Bernard Madoff's Bernard L. Madoff Investment Securities LLC or Allen Stanford's Stanford Financial Group—a massively fraudulent operation that defrauded a number of ordinary people out of their life savings. While the victims of the Debtor were told that the Debtor held approximately $25 million in assets for their benefit, remaining assets in fact are around $700,000.

2. This Case has been administered, however, in a very different manner than the Stanford and Madoff cases. Unlike the Madoff or Stanford cases, the victims here do not have a

trustee or receiver that is actively pursuing all avenues of recovery and restitution. Instead, they have a Chief Restructuring Officer, who was picked by the Debtor's lawyer, who in turn was picked in 2012 by the Charles "Chad" H. McAllister, the Debtor's former CEO. The CRO has not initiated litigation, and has instead focused on trying to sell assets or find new investors.

3. None of the asset sales that were supposedly engineered by McAllister prior to the Case being filed have materialized in the four months since the commencement of this Case. Discussions have now turned to reorganizing the company with the involvement of McAllister's mother, who provided the Debtor with legal advice about its alleged ability to misuse victim funds, who knew that the Debtor was deeply insolvent, and who did nothing to prevent her son from spending what remained of victim's funds. The Committee, while understandably skeptical, was willing to hear out this proposal. This proposal has not materialized, either.

4. At this juncture, the Committee therefore believes that conversion to chapter 7 is appropriate. Chapter 11 administrative expenses are mounting, administrative insolvency is near, and any hope that existed for reorganizing the Debtor has faded. The victims deserve a trustee who will pursue all options for obtaining justice for the victims of the Debtor, Chad McAllister, and his co-conspirators.

II. JURISDICTION AND VENUE

4. This Court has jurisdiction to consider the Motion pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

5. The statutory predicates for the relief requested herein are §§ 1104(a) and 1112 of title 11 of the United States Code, 11 U.S.C. §§ 101-1532 (as amended, the "Bankruptcy Code").

III. BACKGROUND

6. On July 20, 2015 (the "Petition Date"), the Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The Debtor, under the management of a Chief Restructuring Officer (the "CRO"), continues to manage and operate its business as Debtor-in-possession pursuant to §§ 1107 and 1108 of the Bankruptcy Code. The Committee was appointed on August 20, 2015. No trustee or examiner has been requested or appointed.

7. The Case has not been previously converted from any other chapter of the Bankruptcy Code.

8. The Committee has no resources other than its members and its counsel (none of whom have received any compensation for their work.) Between the Committee's lack of resources and the CRO's preference to focus on matters other than investigation and litigation, the Committee's understanding of the facts surrounding the Case set forth below is largely based upon its reasonable information and belief.

a. Events Prior to the Petition Date

9. Chad McAllister started operating the Debtor as a bullion depository and bullion dealer in 1999 in Austin, Texas. For depository customers/victimes, the Debtor represented that it would hold their gold and other precious metals in safekeeping for their future use. Some of these victims were dealing directly with the Debtor. Some were dealing through self-directed Individual Retirement Accounts.

10. Chad McAllister apparently failed to properly segregate or distinguish between victim assets and assets of the Debtor. He also apparently failed to implement key accounting controls necessary to ascertain whether the Debtor was losing money through its operations. As

a result, the Debtor apparently continuously lost money and funded those losses by spending assets that should have been set aside for victims.

11. By sometime in the 2005-2008 timeframe, at the latest, McAllister realized that a huge deficit existed in the Debtor's balance sheets. For instance, the 2007 tax return for the Debtor listed negative retained earnings (that is, net losses) of $6.5 million dollars at the beginning of the year and $10.9 million by the end of the year.

12. Upon realizing that the Debtor was deeply insolvent, McAllister did not do the honest thing, which would have been to come clean, disclose these losses, and stop taking more money from victims. Instead, McAllister continued to send fraudulent statements to customers stating that the Debtor possessed assets sufficient to repay victims. These fraudulent statements induced victims to advance further funds to the Debtor. McAllister continued to accept, and squander (or steal), these funds. By the time of the Petition Date, it appears that under the management of McAllister, the Debtor had lost more than $24 million of victim funds.

13. McAllister did not act alone in this fraud. He worked with employees, officers, lawyers, accountants, and vendors, among others. Many of these third-parties knew or should have known that the Debtor was acting in a massively fraudulent matter. Unfortunately, nobody blew the whistle in time to stop this criminal enterprise in time to prevent further losses.

14. Examples of people who may have aided and abetted the fraud of McAllister and the Debtor may include McAllister's own mother, Cheryl Huseman, a Texas lawyer who was apparently involved drafting a revised customer agreement in 2012 (the "2012 Customer Agreement"). The 2012 Customer Agreement was, on its face, completely unconscionable. It purportedly had the Debtor's victims agree to "heads you win, tails I lose":

> Notwithstanding the passage of title to Customer, BullionDirect® may use such Products [*i.e.*, gold and other precious metals], in fungible form, held for

> Customer. Customer understands that such usage of the Products in this form may result in gains or losses, which will inure solely to the benefit of BullionDirect®.

Declaration of Dan Bensimon in Support of Debtor's Petition and First Day Motions at ¶ 3, filed July 28, 2015, Docket No. 16.

15. McAllister's mother, who was also a shareholder, apparently knew at this time that BDI had suffered substantial net operating losses and was therefore presumably insolvent. The Debtor's balance sheet from 2010 showed that negative retained earnings (net losses) had increased to $14 million. Yet despite knowing that her son was wasting or stealing innocent victims' retirement savings, Huseman did not disclose this knowledge in time to save victims from millions of dollars of further losses and instead helped McAllister craft an agreement that McAllister and the Debtor now use to try to excuse their fraud.

16. McAllister and the Debtor apparently came close to coming clean and filing bankruptcy in 2012. It appears that at this time the Debtor did still possess funds sufficient to cover at least the claims of the IRA victims in the amount of approximately $6 million. McAllister and the Debtor and its regular counsel even first retained the current bankruptcy counsel for the Debtor in 2012.

17. However, for some reason, the bankruptcy filing was delayed, and the fraud continued, until 2015. In the meantime that remaining $6 million appears to have vanished. It appears that at least some of these funds were used in transactions with McAllister and his personal family trust.

18. McAllister's final act as CEO to the Debtor, apart from awarding himself a $35,000 severance bonus, was to re-hire the Debtor's prior bankruptcy counsel, who then hired the Debtor's current CRO.

b. Events since the Petition Date

19. The Case began on an unfortunate note. The CRO implied that the victims of the Debtor might not in fact have any claims, citing the unconscionable "heads I win, tails you lose" terms of the 2012 Customer Agreement drafted by McAllister and his mother/legal counsel. *Declaration of Dan Bensimon in Support of Debtor's Petition and First Day Motions* at ¶ 3, filed July 28, 2015, Docket No. 16. Every single victim was scheduled as having a "disputed" claim. *Schedules* at pgs. 14-114, filed August 12, 2015, Docket No. 44. The supposed list of the twenty largest creditors in the Case did not list any victims at all, even though dozens of victims have larger claims than the insiders and trade creditors on the first version of the twenty-largest list. *20 Largest Unsecured Creditors List filed by Joseph D. Martinec for Debtor BullionDirect, Inc.*, filed July 20, 2015, Docket No. 2.

20. The CRO expressed hope that assets of the Debtor and its subsidiaries could be monetized. A deal was hoped for in a matter of weeks, as stated at the initial creditors' meeting. However, weeks have turned into months, and until October 2015 no potential purchasers or investors apparently showed serious interest other than leads with entities previously identified by McAllister himself.

21. In October 2015, it appears that McAllister's mother expressed some interest in investing in the Debtor, restarting operations, and regaining some sort of control (and presumably obtaining a release of liability), but more than a month has passed and this interest has never been expressed in any sort of actual, material terms. The Committee naturally has a little skepticism about further delaying this Case based on a potential deal with a person who appears to have aided and abetted, or at least been aware of, the $24 million fraud perpetrated by her son and the Debtor.

22. In the meantime, the CRO has not initiated any litigation. The CRO has stated that he does not have time to "time to do an accounting review", even for larger transfers, and the Committee's inquiry about devoting resources to that basic task was otherwise ignored.

23. The monthly operating reports confirm that the Case is nearing administrative insolvency. Professional fees alone on the Debtor's side alone were close to $160,000 as of the end of September.

24. No restructuring plan has been filed. No draft of a plan has been shared with the Committee. The Debtor's own estimate for the cost of confirming a plan was $35,000, but the Committee believes this will be significantly higher.

25. Committee counsel fees are more than $20,000 and rising because the Debtor has refused to cooperate with the Committee.

26. Reorganization would also require paying the CRO's $150,000 confirmation fee. *Application to Employ Financial Advisor, Unique Strategies Group, Inc.*, filed July 30, 2015, Docket No. 20.

27. These administrative claims—more than $160,000 for estate professionals, $35,000 for confirmation, $20,000 for Committee counsel, and $150,000 for the CRO's exit fee—put the price for confirmation of a chapter 11 plan at more than $365,000, which does not seem reasonably likely.

28. For these reasons, and out of a desire to have the same level of representation provided to victims of other massively fraudulent schemes, the Committee asks that the Court convert the Case to chapter 7.[1]

[1] The Committee considered seeking appointment of a chapter 7 panel trustee as a chapter 11 trustee, thereby giving that trustee the discretion to convert to chapter 7. However, the chapter 7 trustee can of course seek reconversion to chapter 11 if the trustee believes that chapter 11 is preferable under § 706(b) of the Bankruptcy Code.

IV. ARGUMENT

29. Section 1112(b) of the Bankruptcy Code provides that the Case may be converted to chapter 7 for "cause." 11 U.S.C. § 1112(b). As provided by the plain language of § 1112(b)(1), the interests of creditors and the estate are paramount. "The charge to the bankruptcy judge under § 1112, then, is to evaluate each debtor's viability and rate of progress in light of "the best interest of creditors and the estate.'" *In re Timbers of Inwood Forest Assocs., Ltd.*, 808 F.2d 363, 372 (5th Cir. 1987).

30. The Bankruptcy Code provides some examples of cause for conversion, such as "continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation." 11 U.S.C. § 1112(a)(4)(A). This cause plainly exists here—the chapter 11 estate has no income and ever-rising administrative claims. There is no readily apparent reasonable likelihood of rehabilitation—no sales of assets have occurred, no plan has been circulated, and the best option according to the Debtor seems to involve some sort of investment by a person who, at best, apparently stood by and did nothing while the Debtor and her son McAllister stole or squandered the remaining funds of the victims, including $6 million that was supposed to be held for individual retirement accounts. The Committee does not believe that this option is viable and it may not be realistic to expect other creditors to support such a proposal, if it ever actually materializes.

31. Further, conversion to chapter 7 and appointment of a trustee is clearly in the best interests of creditors. The victims and other creditors deserve a trustee who will investigate estate causes of action and look at all potential sources for recovery and restitution. As the Court knows, there are many potential sources of recovery here:

- McAllister, who would likely take the Fifth Amendment if deposed according to his criminal defense counsel, is clearly liable for breach of fiduciary duties

himself. He also seems to have a family trust that may have been the transferee of assets from the Debtor.

- Numerous insiders and business partners seem to have known about this fraud and aided and abetted it.

- It could be argued that most of the transfers made by McAllister and the Debtor were done with actual fraudulent intent. *See, e.g., Christian Bros. High Sch. Endowment v. Bayou No Leverage Fund, LLC (In re Bayou Group, LLC),* 439 B.R. 284, 307 (S.D.N.Y. 2010) ("Even if the Ponzi scheme presumption were not applicable, the guilty pleas of the Bayou principals combined with the Lenhart Report — which confirms the existence of the fraud scheme […] — provides overwhelming evidence of actual fraudulent intent.")

- Recipients of intentionally fraudulent transfers who knew or should have known that the Debtor was perpetrating a fraud do not have a good faith defense. *See, e.g.,* 11 U.S.C. § 550(b) (requiring good faith as an element for a transferee defense).

- In addition, otherwise innocent recipients of constructively fraudulent transfers may not have provided sufficient value to avoid liability. *Seem e.g., Janvey v. Golf Channel, Inc.,* 792 F.3d 539, 547 (5th Cir. 2015) (asking the Texas Supreme Court to determine whether "value" for fraudulent transfer purposes should be is measured "from a creditor's viewpoint").

Conversion would permit these claims to be properly investigated and pursued by a trustee for the benefit of creditors and the estate.

32. This trustee will also be able to retain brokers or advisors to sell any assets of value. It is unclear what, if any, material opportunities for asset sales will be lost through conversion to chapter 7. Indeed, the trustee will have the option to re-convert if that is in the best interest of creditors. Weighing the negligible or non-existent costs of conversion—plus the clear benefits of conversion—against the $365,000+ cost of chapter 11, the interests of the creditors and the estate seem to be better served by conversion.

V. NOTICE

33. This Motion is being mailed to the parties on the Master Service List pursuant to the *Agreed Order Granting Debtor's Emergency Motion for Order Limiting Notice and Implementing Certain Notice Procedures*, entered August 7, 2015, Docket No. 36.

WHEREFORE, the Committee respectfully request that the Court enter an order converting the Case to chapter 7 and granting such other relief as is just and proper.

Respectfully submitted,

/s/ Jesse T. Moore
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Counsel to the Official Committee of Unsecured Creditors

Certificate of Service

I hereby certify that on November 16, 2015 I caused this Motion to be served to the attached Master Service List by U.S. mail first class, postage pre-paid.

/s/ Jesse T. Moore
Jesse T. Moore