

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re:

TERRAFORM LABS PTE. LTD., et al.,

Debtors.

Case No. 24–10070 (BLS)

Chapter 11 (Jointly Administered)

OBJECTION TO CONFIRMATION OF THE PROPOSED PLAN

Thomas Blanc, a creditor holding a Class 5 claim (Crypto Loss Claims) with a Claim amount of \$418,490.19, hereby submits this objection to the confirmation of the Debtors' proposed liquidation plan for the following reasons:

1. Introduction

I am a holder of a Class 5 claim (Crypto Loss Claims) and object to the proposed plan of liquidation on two grounds:

1. Within Class 5, **UST losses should be prioritized** due to its intended stable nature and different investor expectations.
2. There is no prioritization within Class 5 to ensure that **non-institutional investors are compensated before larger investors and institutional funds**. This lack of prioritization unfairly disadvantages smaller, more vulnerable investors.

2. First Objection: Prioritizing UST Losses Over Luna Losses

A. Nature of the Objection

Class 5, referred to as "Crypto Loss Claims," includes claims against Terraform Labs that arise from specific types of losses related to transactions of any cryptocurrency associated with Terraform Labs, such as TerraUSD (UST), Luna, and other tokens issued on the Terra blockchain.

While both UST and Luna losses should be included in Class 5, **UST losses should receive priority** because UST was marketed as a stablecoin with a fixed value, unlike Luna, which was understood to be a volatile asset within the ecosystem.

B. Reasons for the Objection

1. Nature of Investment and Marketing Misrepresentation:

- **Expectation of Stability:** UST was marketed as a "stablecoin," specifically designed to maintain a one-to-one peg with the U.S. dollar. This promise of stability attracted investors seeking a low-risk investment. Its collapse represents a severe breach of this promise, making UST investors more deserving of compensation.
- **Reliance on Misleading Information:** The SEC's complaint emphasizes that UST holders were misled about the asset's true nature. Since UST investors were induced to invest based on false stability assurances, they have a stronger claim for restitution compared to Luna investors, who knowingly engaged in a speculative investment.
- **Misrepresentation of Stability:** According to the SEC's amended complaint, Terraform Labs and Do Kwon misled investors about UST's stability, particularly after the first de-pegging in May 2021. Terraform Labs intervened to restore the UST peg while falsely claiming the algorithm was responsible. This deception supports prioritizing UST investors for compensation.

2. Risk Profile and Investor Expectations:

- **Higher Risk Assumed by Luna Investors:** Luna was marketed as a speculative asset with high volatility tied to the Terra ecosystem's growth. Luna investors accepted the high-risk nature of their investment. Conversely, UST investors were led to believe they were investing in a stable, low-risk asset. Luna, as a speculative investment, lacked such promises of stability. This difference in risk profiles suggests prioritizing UST investors who suffered losses due to misrepresentation.
- **Total Loss in UST's Value:** UST's collapse directly undermined the Terra ecosystem's stability. The de-pegging of UST triggered this collapse, causing catastrophic losses for UST holders and the broader ecosystem, including Luna. Given the presumed stability of UST, this justifies prioritizing its investors for compensation.

3. Judicial Precedent and Priority in Bankruptcy/Settlement:

Here are some real examples of cases where courts prioritized claims based on fraudulent misrepresentation and the expectations set by investment promoters, giving priority to creditors who were misled. Given UST's marketing as a stable investment, UST investors should be treated similarly to misled creditors, giving them priority in any recovery or settlement.

- **Madoff Investment Scandal (2008)**
 - **Context:** Bernard Madoff's Ponzi scheme, one of the largest financial frauds in history, defrauded investors of billions of dollars. The court-appointed trustee, Irving Picard, sought to recover assets to compensate victims.
 - **Precedent:** The court prioritized returning funds to those who were directly misled by Madoff's fraudulent misrepresentations. Investors who were misled into believing they were investing in legitimate securities, based on Madoff's false representations, were given priority in receiving recovered funds over other creditors.
 - **Reasoning:** Courts often prioritize restitution to victims who were misled or defrauded over other unsecured creditors because these victims relied on

fraudulent statements, which created an expectation of safety or return that was not met.

- **Lehman Brothers Holdings Inc. (2008):**
 - **Context:** Following Lehman Brothers' collapse in 2008, it was revealed that the company had engaged in misrepresentations and misleading practices related to the stability and valuation of certain investment products.
 - **Precedent:** In the bankruptcy proceedings, the court approved a settlement framework that gave higher priority to creditors who were misled by the company's misrepresentations about the stability of its financial products.
 - **Reasoning:** The priority was given to misled investors to ensure that they were adequately compensated for their losses, which were incurred based on incorrect or misleading information provided by Lehman Brothers.
- **Enron Corp. (2001):**
 - **Context:** Enron's collapse in 2001 was accompanied by massive accounting fraud and misrepresentation of the company's financial health.
 - **Precedent:** The courts established a priority framework for compensating employees and small creditors who were misled by fraudulent representations about the company's financial status. Employee claims were prioritized because they were directly affected by Enron's misrepresentations and were among the most vulnerable stakeholders.
 - **Reasoning:** The court recognized that employees and smaller creditors had acted based on misleading or fraudulent information and should be compensated first due to their reliance on these misrepresentations.
- **MF Global Holdings Ltd. (2011):**
 - **Context:** MF Global, a brokerage firm, collapsed in 2011 due to excessive risk-taking and failure to properly disclose its financial condition to investors and customers.
 - **Precedent:** The court prioritized claims from customers and investors who were misled by the firm's lack of transparency and misrepresentation of its financial stability. Customers whose funds were improperly commingled and misrepresented were given priority in receiving compensation.
 - **Reasoning:** The court found that the misled customers had a stronger claim for restitution because they had relied on false statements and deceptive practices by MF Global.
- **Purdue Pharma L.P. (2019):**
 - **Context:** Purdue Pharma, the maker of OxyContin, faced thousands of lawsuits alleging that it had misrepresented the risks of addiction associated with its opioid products.
 - **Precedent:** The court approved a bankruptcy plan that prioritized compensation for individual claimants and municipalities that had been directly misled by Purdue's marketing practices over larger governmental entities and institutional investors.
 - **Reasoning:** The court recognized the disproportionate impact of the fraudulent marketing practices on individual victims and local communities, giving them priority over other creditors.

C. Proposed Criteria for Prioritization

- **Sequential Compensation Order:** Fully satisfy UST loss claims before distributing any funds to Luna (and other tokens issued on the Terra blockchain) loss claimants.
- **Tiered Compensation Structure:** Establish a structure where UST holders receive compensation up to a certain amount before Luna (and other tokens issued on the Terra blockchain.) claims are considered.

3. Second Objection: Prioritization of Compensation for the non-institutional investors

A. Nature of the Objection

Compensation for Class 5, which covers "Crypto Loss Claims," will occur through a structured process outlined in the Chapter 11 Plan of Liquidation for Terraform Labs Pte. Ltd. The distribution is supposed to be on a pro-rata basis, meaning the available funds will be divided among the claimants proportionally based on the size of their allowed claims.

Thus, the proposed plan does not prioritize compensation within Class 5, which results in an inequitable distribution of funds. Priority should be given to non-institutional investors over larger institutional investors and hedge funds (such as Foreign Reps of Three Arrows Capital LTD. Crypto Loss claim amount of \$1,322,303,330.08).

B. Reasons for the Objection

1. Vulnerability of non-institutional investors

- **Disproportionate Impact:** non-institutional investors often have limited financial resources, and losing their entire savings in a collapse like that of UST had devastating personal consequences. These investors have faced significant financial hardship, including the inability to cover basic living expenses, pay for education, or secure retirement. Larger investors, including investment funds, generally have diversified portfolios and often have access to various financial safety nets, including insurance, capital reserves, and the ability to hedge against losses.
- **Lack of Resources and Expertise:** non-institutional investors generally lack the financial resources, expertise, and access to sophisticated financial advice that large investors have. They are more likely to be misled by fraudulent claims and less able to assess the risks associated with complex financial products like UST. This makes them more susceptible to the misinformation and deceptive practices alleged in the Terraform Labs case.

2. Behavioral Economics and Investor Expectations

- **Asymmetry of Information:** non-institutional investors are less likely to have access to the same level of information and analysis as large investors. They often rely on the information provided by the issuers, which in this case was misleading. This asymmetry in information puts non-institutional investors at a disadvantage, warranting priority in compensation.
- **Risk Perception:** non-institutional investors may have invested in UST under the false belief that it was a safe and stable asset, as promoted by Terraform Labs. Large investors, on the other hand, likely understood the inherent risks better and made their investment decisions accordingly. This difference in risk perception and understanding should be considered when determining compensation priorities.

3. Moral and Ethical Considerations

- **Protection of Retail Investors:** Financial regulations, including those enforced by the SEC, often emphasize the protection of retail investors because they are less equipped to recover from significant financial losses. The principle of investor protection suggests that those with the most to lose—and the least ability to recover—should be prioritized in compensation.
- **Public Trust:** Compensating non-institutional investors first can help restore public trust in the financial system. It sends a message that the system protects the interests of ordinary individuals rather than favoring large, well-capitalized institutions. If non-institutional investors are left uncompensated while large investors recover most of their losses, it could undermine trust in the financial system and discourage participation from retail investors in the future.

4. Precedent in Legal Settlements

In many legal settlements, especially in cases involving fraud, courts prioritize the restitution of non-institutional investors over larger, more sophisticated parties. This is because large investors are presumed to have better access to information and the means to mitigate risks. In contrast, non-institutional investors are seen as having been more misled and more vulnerable to the fraudulent actions of the defendants.

· **Madoff Investment Scandal (2008)**

- **Context:** Bernie Madoff perpetrated the largest Ponzi scheme in history, defrauding thousands of investors out of approximately \$65 billion.
- **Legal Precedent:** In the liquidation process, the trustee (Irving Picard) and the Securities Investor Protection Corporation (SIPC) gave priority to small investors. People who invested less than \$1.1 million, the relatively smaller investors, were paid back in full.
- **Reasoning:** They focused on "net losers" — those who had not withdrawn more money than they initially invested — to recover and distribute funds equitably. Smaller investors received compensation first from the funds recovered, while larger investors, especially those who had withdrawn more than they deposited, received less priority.

- **MF Global Bankruptcy (2011)**
 - **Context:** MF Global, a major global commodities brokerage, collapsed after it was discovered that the company had misappropriated client funds totaling about \$1.6 billion.
 - **Legal Precedent:** The bankruptcy trustee, James Giddens, prioritized the return of funds to small retail customers before large institutional creditors.
 - **Reasoning:** This approach aimed to protect individual customers whose losses would have a more substantial impact on their financial situation.
- **WorldCom Scandal (2002)**
 - **Context:** WorldCom, a telecommunications giant, filed for bankruptcy after an \$11 billion accounting fraud was uncovered, one of the largest in U.S. corporate history.
 - **Legal Precedent:** In the subsequent bankruptcy proceedings, smaller claimants and shareholders were often given priority.
 - **Reasoning:** The bankruptcy court aimed to recover as much value as possible for smaller creditors before distributing remaining assets to larger institutional creditors.
- **BitConnect Ponzi Scheme (2018)**
 - **Context:** BitConnect was a cryptocurrency investment platform that was revealed to be a Ponzi scheme, leading to massive losses for investors globally.
 - **Legal Precedent:** In the aftermath, U.S. regulators and courts worked to prioritize smaller, individual investors who had lost funds in the fraudulent scheme.
 - **Reasoning:** Compensation efforts focused on recovering and returning funds to these smaller victims before any large-scale creditors or claimants, recognizing their relatively greater vulnerability and financial impact compared to larger institutions or high-net-worth individuals.
- **Case of Lehman Brothers Holdings Inc. (2008)**
 - **Context:** Lehman Brothers, a major investment bank, filed for Chapter 11 bankruptcy in 2008 during the global financial crisis, marking one of the largest bankruptcies in U.S. history.
 - **Legal Precedent:** The courts established a hierarchy of creditors, giving relative priority to small investors and non-institutional creditors over larger institutional creditors and investors.
 - **Reasoning:** The courts justified this approach by acknowledging the disproportionate impact of losses on smaller individual investors, who lacked the same diversification or protection against losses as large investment funds.
- **Case of Enron Corp. (2001)**
 - **Context:** Enron, once one of the world's largest energy companies, filed for Chapter 11 bankruptcy in 2001 following revelations of massive accounting fraud.
 - **Legal Precedent:** The courts allowed the creation of an "Employee Retention and Compensation Pool" for employees who were also creditors in the bankruptcy proceedings, giving priority to employee claims (often smaller) over those of larger commercial creditors.

- **Reasoning:** This approach was adopted to protect the interests of vulnerable creditors (employees who lost their jobs and benefits), recognizing their greater economic dependence compared to institutional creditors.
- **Case of Washington Mutual, Inc. (2008)**
 - **Context:** Washington Mutual (WaMu), once the largest savings and loan association in the U.S., filed for Chapter 11 bankruptcy in 2008 after its banking subsidiary was seized by U.S. regulators.
 - **Legal Precedent:** The proposed reorganization plan established a priority of compensation for smaller creditors and individual unsecured creditors over large institutional creditors.
 - **Reasoning:** The court concluded that this prioritization was fair, considering the social and financial impact on individual creditors with limited resources to absorb losses, unlike more diversified institutional creditors.
- **Case of Purdue Pharma L.P. (2019)**
 - **Context:** Purdue Pharma, the manufacturer of the opioid OxyContin, filed for Chapter 11 bankruptcy in 2019 to address claims related to the opioid crisis.
 - **Legal Precedent:** The bankruptcy court approved a distribution of funds prioritizing certain municipalities and individual victims over large government entities or investors.
 - **Reasoning:** The court recognized the disproportionate impact on local communities and direct victims, compared to entities with more substantial resources.
- **Case of Nortel Networks Corporation (2009)**
 - **Context:** Nortel, a major telecommunications company, filed for bankruptcy in 2009.
 - **Legal Precedent:** As part of Nortel's liquidation, a settlement was reached to give priority to smaller creditors, notably former employees and pension beneficiaries, before larger commercial creditors.
 - **Reasoning:** The court found it necessary to protect the most vulnerable creditors due to their increased reliance on pension payments and severance pay, which were essential for their livelihood.

By presenting these arguments, it becomes clear that prioritizing non-institutional investors for compensation is not only fair and just but also aligns with legal precedents, regulatory objectives, and ethical considerations.

C. Proposal for Modification

- I propose that the plan explicitly prioritize compensation for non-institutional investors in Class 5 before distributing any remaining funds to larger investors or institutional entities.
- Establishing a clear threshold for non-institutional investors and a distribution hierarchy would ensure that the most vulnerable creditors are protected and treated fairly. That could be done once data on the distribution of losses among UST investors will be known.

4. Public Commitment to small UST Holders

Terraform Labs, through their Twitter account and other public channels, made a public commitment to prioritize compensating UST holders using the funds from the **Luna Foundation Guard (LFG)**.

- On May 16th, 2022: “The Foundation is looking to use its remaining assets to compensate remaining users of \$UST, smallest holders first.” (https://x.com/LFG_org/status/1526126719874109440)
- On October 7th, 2022: “Our goal remains to distribute LFG’s remaining assets to small \$UST holders. We will not stop advocating for our ability to follow through on these initial plans.” (https://x.com/LFG_org/status/1578420774951452672)

Although this compensation has yet to materialize, their statement must be taken into consideration.

5. Conclusion

For the reasons stated above, I respectfully request that the Court modify the proposed plan of liquidation to:

- Within Class 5, prioritize UST losses over Luna (and other tokens issued on the Terra blockchain) losses. The key points revolve around the nature of the investment, the misrepresentations made by Terraform Labs, and the legal principles surrounding fraudulent misrepresentation and breach of obligations.
- Within Class 5, compensating the non-institutional investors before larger, institutional creditors. Establishing a priority framework would better align the plan with the principles of fairness, equity, and justice as mandated under the Bankruptcy Code.

Those modifications will align with the specific assurances made by Terraform Labs.

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Respectfully submitted,

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