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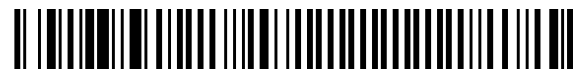
UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: LYONDELL CHEMICAL COMPANY, et al., Debtors.	Case No. 09-10023 (REG) Chapter 11
EDWARD S. WEISFELNER, AS TRUSTEE OF THE LB CREDITOR TRUST,	(Jointly Administered)
Plaintiff, v. MORGAN STANLEY & CO., INCORPORATED, et al., Defendants.	Adv. Pro. No. 10-04609 (REG)

MEMORANDUM OF LAW IN OPPOSITION TO
DEFENDANTS' MOTIONS TO DISMISS THE COMPLAINT



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Plaintiff Edward S. Weisfelner, as Trustee of the LB Creditor Trust (the "**Plaintiff**" or the "**Creditor Trustee**"), respectfully submits this Memorandum of Law in Opposition to Defendants' motions, pursuant to Fed. R. Civ. P. 9(b), 12(b)(1) and 12(b)(6), as incorporated in Fed. R. Bank. P. 7009(b) and 7012(b).[1]

PRELIMINARY STATEMENT[2]

This action has one goal: to recover the just debts of creditors who gave good value and whose valid claims have gone unpaid. These creditors suffered billions of dollars in losses as a result of a transaction—the December 20, 2007 leveraged acquisition of Lyondell by Basell (the "**Merger**")—pursuant to which Defendants received billions of dollars in Merger Consideration. Defendants now appear before the Court expressing misplaced outrage that they are not entitled to keep the entirety of the $5.9 billion that they received as a result of the fraud perpetrated by parties to the Merger. Citing two readily-distinguishable cases from other Circuits that apply Section 546(e) of the Bankruptcy Code to limit a bankruptcy estate fiduciary during a bankruptcy proceeding from asserting certain state law claims under the Code's Section 544(b) avoidance power, Defendants ask this Court to radically expand the coverage of Section 546(e) to apply to a post-confirmation lawsuit brought by a state law plaintiff that is not exercising—indeed, has no power to exercise—any of the Code's avoidance powers.

While Defendants' motions present an important issue of first impression in the Second Circuit, the result they request would cast doubt upon decades of well-settled case law and is utterly unsupported by the legislative history or statutory text at issue here. The legislative

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[1] The Creditor Trustee is filing a single Memorandum of Law in response to all 23 motions to dismiss that have been filed, except for a separate Memorandum of Law that is being filed to respond to one motion to dismiss for lack of *in personam* jurisdiction. Except where otherwise indicated, all references to arguments advanced by Defendants are to the Memorandum of Law submitted by Wilmer Cutler Pickering Hale and Dorr LLP ("**Wilmer Hale**") (the "**Brief**"), in which other moving Defendants have joined.

[2] Except where otherwise noted, all defined terms are as set forth in the Complaint in this action.

history makes clear that the Congressional purpose behind Section 546(e) was to afford the financial markets a partial measure of protection from a trustee (or other bankruptcy fiduciary) invested with the Code's sweeping avoidance powers, not to enact a free-ranging immunity and release that operates to automatically and permanently extinguish legitimate creditor rights upon the filing of a bankruptcy petition. Courts have for decades held that creditors may, after discharge, pursue any of their state law claims that were not prosecuted to conclusion, settled or extinguished by the trustee or debtor-in-possession. Defendants cite the continuing concern of a "ripple effect," but Congress did not, for example, enact a bar on creditor class actions involving the financial markets, or other hypothetical statutory provisions that could more aggressively protect the markets from the possible impact of the successful pursuit of fraudulent transfer claims. Congress chose not even to apply Section 546(e) to Section 548(a)(1)(A) claims, notwithstanding any danger of so-called ripple effects. Defendants are wrong to suggest that the doctrine of preemption provides a platform to experiment with fashioning remedies that more aggressively realize a particular policy goal that they favor.

Moreover, Defendants' analysis of Congressional purpose fails to address the other, more fundamental Congressional purpose behind the avoidance provisions of which Section 546(e) is a part—maximizing creditor recovery—and sets Section 546(e) on a direct collision course with Section 524(e), which provides that third parties are <u>not</u> released by discharge, as well as binding Second Circuit precedent making non-consensual third party releases available only in the most compelling and unusual circumstances, none of which can be claimed to exist here.

In addition, Defendants' overheated rhetoric about how the Creditor Trust provisions in the Court-approved Plan were "contrivances" and "brazen machinations" amounts to no more than an empty complaint that the Plan does not comport with their misguided understanding of

the doctrine of preemption. The Creditor Trust provisions were a material part of a carefully-negotiated settlement of the Committee's objection to the Rule 9019 Motion for approval of settlement, and the provisions were discussed repeatedly in open Court (including at hearings attended by Wilmer Hale) before approval.

Defendants' other arguments fare no better.

Defendants' argument that the encumbrance of substantially all of the assets of the Debtors in order to deliver $12.5 billion to Lyondell shareholders to consummate the Merger somehow did not involve a transfer of property interests of the Debtors to shareholders ignores well-settled collapsing doctrine applicable to leveraged buyouts such as this, ignores black letter law holding that obligors have a property interest in loan proceeds, and fails as a matter of common sense.

Defendants' "standing" argument is based upon the curious and meritless premise that where a defendant may have a potential affirmative defense available to part of an assigned claim, a plaintiff lacks standing to sue. Defendants nevertheless concede that their "standing" argument has no application to approximately $2.4 billion of claims asserted here, and fail to explain what relief they seek at this juncture of the proceedings, and why it is even proper on a motion to dismiss.

Defendants' argument that several financial institutions should be dismissed because they are "mere conduits" for the funds at issue glosses over the fact that many of these financial institutions are alleged to have held shares on their own account, and the Creditor Trustee has offered to dismiss claims asserted against any true "mere conduit" without prejudice and assert claims instead against the beneficial holder, upon such defendant's provision of discovery evidencing such facts.

Finally, Defendants rehash old "intent pleading" arguments cloaked in a new rhetorical gloss that is entirely divorced from the ever-growing record and reality in this case. As the Court is aware from the briefing and March 10, 2011 oral argument on the former Lyondell Directors' and Officers' motion to dismiss the intentional fraud claim asserted by the Trustee of the LB Litigation Trust, the intentional fraudulent transfer claim asserted by the Creditor Trustee here, which is based upon the same record that forms the basis of the detailed factual allegations set forth in the Amended Complaint in *Weisfelner v. Blavatnik, et al. (In re Lyondell)*, (Bankr. S.D.N.Y.), Adv. Pro. No. 09-1375 (REG) (the "***Blavatnik* Action**"),[3] more than adequately states a claim for intentional fraudulent transfer. As explained at the March 10 argument, the detailed allegations of intentional fraud in the *Blavatnik* Action were based on fact discovery taken in Rule 2004 discovery and Phase I of that action, and substantial further discovery taken since the filing of an Amended Complaint in the *Blavatnik* Action has only reinforced the factual underpinnings of the intentional fraudulent transfer claim.[4] Given the compelling factual basis upon which the allegations are based, Defendants' suggestion that the Plaintiff's intentional fraudulent transfer claim is no more than a constructive fraudulent transfer claim masquerading as something it is not is incorrect, as is Defendants' argument that the claim is "implausible." In

[3] Compare, for example, ¶¶ 285-303 of the Complaint in this action to ¶¶ 144-162 in the Amended Complaint in the *Blavatnik* Action.

[4] As the Litigation Trustee's counsel observed during oral argument on March 10, 2011, after the filing of the Amended Complaint in the *Blavatnik* Action on July 23, 2010, more than 2 million additional pages of documents were produced to the Litigation Trustee, including approximately 63,000 pages of documents and 700 pages of handwritten notes produced by Robert Salvin, the former Lyondell Director of Portfolio Planning who, at the direction of CEO and Chairman Dan Smith, prepared the fraudulently inflated Lyondell projections shortly after Blavatnik filed a Schedule 13D on May 11, 2007. *See* Mar. 10, 2011 Hearing Tr. 44:14-45:10; *see* Compl. ¶ 288. The Creditor Trustee is currently preparing an Amended Complaint in this action, which will incorporate such additional fraud allegations based on discovery taken in the *Blavatnik* Action since July 2010.

addition, Defendants' statement that the Merger occurred several years ago is irrelevant; all the claims have been timely asserted, and Defendants do not contend to the contrary.[5]

* * *

While Lyondell CEO and Chairman Dan Smith, Leonard Blavatnik and the others that perpetrated this fraud received substantial personal benefits as a result, it is the Defendants in this action who made away with the vast bulk of the value transferred out of Lyondell upon the Merger. Defendants' attempt to dismiss this case on the pleadings and simply walk away with a multi-billion dollar fraudulent transfer is absurd and unsupported by the law. The motions should be denied.

ALLEGATIONS OF THE COMPLAINT

The well-pled allegations of the Complaint, which must be accepted as true for purposes of this Motion, are set forth below insofar as they bear upon this Motion:[6]

I. The Merger.

The December 20, 2007 acquisition of Lyondell Chemical Company ("**Lyondell**") by Basell AF S.C.A. ("**Basell**"), pursuant to which the shareholders of Lyondell received $12.5 billion as merger consideration, resulted in a severely undercapitalized company that began preparing for bankruptcy less than one year later. Compl. ¶ 1. Lyondell and its major subsidiaries commenced chapter 11 bankruptcy proceedings on January 6, 2009. Compl. ¶ 1. As summarized herein, the Complaint alleges that the Merger as both a constructive and intentional

[5] To be sure, Defendants have been on constructive notice since July 2009 of claims to claw back Merger proceeds from all former Lyondell shareholders, since the Official Committee of Unsecured Creditors (the "**Committee**") on behalf of the Debtors asserted a shareholder clawback claim in a pre-confirmation adversary proceeding initially filed with the Court's approval. Defendants' suggestion that they have acted in reliance on their exchange of shares for cash for over three years, *see* Brief at 2, is therefore not persuasive.

[6] Because of the Court's familiarity with the events relating to the Merger and related transactions, including through the extensive briefing and argument in the *Blavatnik* Action on issues surrounding the pleading of fraudulent intent in connection those events, the Creditor Trustee shall not herein provide an exhaustive recitation of the allegations of the Complaint (all of which are incorporated herein by reference) but instead summarize certain of those allegations here.

fraud on the creditors of Lyondell. Lyondell's senior management, seeing an opportunity to cash-out and realize concrete and personal benefits in the form of hundreds of millions of dollars in change-of-control payments and other consideration, fraudulently reverse-engineered Lyondell earnings projections in order to make it appear that Lyondell's future earnings justified the price they were seeking. Blavatnik, a self-described industrialist and the entities acting under his control engaged in fraudulent misconduct of their own to ensure that the Merger, which they learned was based upon unsupportable earnings projections, closed on terms that would minimize Blavatnik's personal losses upon the financial collapse of the merged companies.

A. Blavatnik's Interest In Lyondell.

By the Spring of 2006, Blavatnik had identified Lyondell as one of several major petrochemicals companies ripe for a leveraged acquisition. Compl. ¶ 240. Beginning on April 24, 2006, Access made initial overtures to purchase Lyondell, which were rejected by Lyondell as too low. Compl. ¶¶ 246-247. Access continued to follow Lyondell and, on May 11, 2007, Blavatnik filed a Schedule 13D disclosing the purchase of 20,990,070 shares of Lyondell as well as his interest in a possible acquisition of the company. Compl. ¶ 270. That same day, Lyondell received a letter sent on behalf of Blavatnik, stating that Blavatnik might acquire over 50% of the outstanding stock of Lyondell. Compl. ¶ 270.

B. Lyondell Reverse-Engineers Projections to Secure Blavatnik's Participation in the Merger

Smith and his inner circle of senior Lyondell management understood that interest in a major petrochemical purchase presented a once-in-a-lifetime opportunity for massive personal gain. Compl. ¶¶ 285-303, 311, 401. Smith responded by directing his inner circle of senior managers, after the filing of Blavatnik's Schedule 13D, to quickly fabricate a set of earnings

projections that would provide Blavatnik with a financial basis for an acquisition of Lyondell. Compl. ¶¶ 287-288, 298-303.

The preparation of new earnings projections involved altering the Lyondell Long-Range Plan ("**LRP**") that was in effect after having been adopted by formal action of the board of directors in December of 2006. Compl. ¶¶ 281-282. Unlike the customary process used to create the LRP, there was no bottom-up, plant-by-plant analysis of earnings for the purposes of the refreshed projections. *Id.* Smith and his inner-circle understood that the refreshed earnings projections contradicted the existing industry outlooks and lacked any credible foundation Compl. ¶ 289. The new projections, added, without any basis whatsoever, almost $2 billion to the EBITDA projections included in Lyondell's then current long range plan. Compl. ¶ 298. Overall, the "refreshed" projections exceeded projections independently developed by Merrill Lynch during 2007 based on industry sources by over $3.4 billion. Compl. ¶ 303.

Smith used these "refreshed" Lyondell earnings projections to induce a blow-out offer for Lyondell, suggesting on June 7, 2007 to Volker Trautz, the CEO of Basell that, if Blavatnik wanted to acquire Lyondell, he had to offer $48 per share. Compl. ¶ 309. Prior to Blavatnik's acquisition of the Toe-Hold Position, Lyondell stock had been trading at $33.07 per share. Compl. ¶ 340. Thus, the $48 per share price represented a 45% premium. Compl. ¶ 340.[7]

Even before the Merger Agreement was reached, Smith understood that he would be leaving Lyondell if Blavatnik acquired Lyondell, and his focus had shifted from guiding the

[7] Defendants appear to argue that the $48 per share offer was actually not a significant premium over the stock's trading price, because in July 2007, Blavatnik offered to purchase Lyondell for $40 per share (and the same day increased the offer to $48 per share), which, according to Defendants, at the time was only 80 cents over the stock's trading price. *See* Brief at 6. Defendants ignore the fact that Lyondell's stock price only began to rise significantly after Blavatnik acquired the Toe Hold Position on May 11, 2007, and Lyondell was put into play as an acquisition target, and therefore, any post-Toe Hold Position share price was already inflated.

future of Lyondell to seizing the once-in-a-lifetime opportunity to obtain an enormous personal fortune. Compl. ¶ 311.

On June 18, 2007, Robert Salvin, among the inner circle involved in creating the "refreshed" earnings projections, provided Lyondell CFO Kevin DeNicola with two new sets of projections called "Today's View" and "Alternate View." Compl. ¶ 288. The "Today's View" and "Alternative View" projections for the period 2007 – 2011 added approximately $1.7 billion and $1.9 billion, respectively, to the EBITDA projections included in the previously approved 2007 LRP. Compl. ¶ 288.

This increase in EBITDA was achieved by projecting refining and petrochemical margins that were entirely unsupported by, and blatantly ignored, the forecasts of industry analysts and, at times, wholly contradicted the previously held views of Lyondell's management. Compl. ¶¶ 285-303. There was simply no basis for Lyondell to expect that its performance during the widely forecasted industry downturn that was already underway in 2007 would deviate positively from the general industry trend. Indeed, as detailed in the Complaint, there were numerous reasons to anticipate that Lyondell was likely to be more severely impacted by the downturn. Compl. ¶¶ 6, 372.

C. <u>Blavatnik and Basell Engage in Fraudulent Misconduct.</u>

Lyondell was not the only party to engage in misconduct. In early July 2007, just prior to execution of the Merger Agreement, Blavatnik's staff at Basell engaged in some manipulation of its own. In particular, Access provided to Merrill multiple "adjusted" Basell earnings forecasts that ignored the forecasted industry downturn and failed to reflect the sharp decrease in earnings that Basell would foreseeably experience. Compl. ¶¶ 318-319. For example, one week before the Merger was agreed to, the projected Basell EBITDA for 2007 was increased from the $1,375 million figure in the existing projections to $1,675 million, and then a few days later abruptly

increased to $1,905 million, 38.5% above the existing projections. Compl. ¶ 318. The 2008 projections were boosted by 25.7% and later years were also boosted significantly. Compl. ¶ 318. As Access knew or should have known, Merrill did not subject these "updated" Basell earnings forecasts to independent analysis. Compl. ¶ 319. These forecasts were then incorporated into the financial case for approval of the Merger. Compl. ¶¶ 320, 336, 417. It may be inferred from these allegations of the manipulation of Basell earnings projections that Blavatnik knew before the Merger Agreement that projected earnings would be insufficient to fund operations and that to adequately capitalize the combined companies, additional capital would be necessary.

Just how capital deficient LBI would be, Blavatnik may not have appreciated until after he had absorbed the implications of the data first disclosed to him on September 11, 2007 in an email from Smith containing emerging results from the third quarter and indicating that Lyondell would likely miss its fourth quarter EBITDA projections by approximately $200 million, or over 20%. Compl. ¶ 359. Access executives were extremely alarmed to discover that the projections used only two months prior to justify the $48 per share price were (and always had been) wildly unrealistic. Compl. ¶ 360.

Upon the revelation that Lyondell's earnings projections had been grossly overstated, Access staff exchanged emails about backing away from the transaction, contacting attorneys and considering its "options," Compl. ¶ 361. Instead, under Blavatnik's direction, Access and Basell opted to move forward and attempt to address the situation by engaging in further manipulation thereby broadening the original fraud. *Id.* ¶¶ 363-364. To avoid the fees and penalties that the banks were entitled to extract upon a failed syndication, Compl. ¶ 363, Access staff set out to "goose" the financials in order to help with the syndication effort. *Id.* ¶¶ 363-367.

They developed further earnings projections that were unsupported by any reasoned analysis and inconsistent with industry forecasts, if not outright fraudulent. Compl. ¶¶ 369-375.

Despite these efforts, the Lead Arrangers' attempts at syndication were a failure, resulting in the implementation of structural and pricing modifications to the financing package that were even more unfavorable to LBI, and still failed to support the syndication effort, as the syndication markets had become understandably wary. Compl. ¶¶ 380-383, 386.

As the likely outcome of the Merger was becoming impossible to ignore, Blavatnik and Access began to further attempt to insulate Blavatnik from as much of the fall-out as possible. Blavatnik had already, in July 2007, refused Merrill's suggestion that he put Access equity into the deal. Compl. ¶ 316. In the midst of the failed syndication efforts, on December 7, 2007, Blavatnik caused Basell to issue its third shareholder distribution of 2007, for €100 million, bringing the total amount of cash taken out of Basell since May 2007 in form of shareholder distributions to €315 million (or approximately $430 million). Compl. ¶ 387. Also, notwithstanding the urging of the lenders for Blavatnik to contribute his profit (in excess of $333 million) on the Toe Hold Position shares as equity, Blavatnik stuck with his insistence that $1.2 billion of Merger Financing be used to buy out the Toe Hold Position. Compl. ¶ 401. In addition to the payment on the Toe Hold Position, Blavatnik, through Nell Limited (his Gibraltar tax vehicle), took an additional $125 million out of LBI in purported "advisory" and "management" fees. Compl. ¶¶ 5, 343, 401. Through these efforts to insulate himself from the fallout, Blavatnik's hedging transactions resulted in removing at least $900 million of needed capital from the overleveraged entity.

D. The Merger Agreement and the Payments to Shareholders.

On December 20, 2007 (the "**Merger Date**"), the Merger closed. Compl. ¶ 396. Pursuant to the Merger Agreement, upon the Merger, all of the issued and outstanding shares of Lyondell stock were converted into the right to receive $48 per share. Compl. ¶ 396. Commitment letters issued by the Financing Parties contemplated the financing of the purchase of 100% of the outstanding capital stock of Lyondell. Compl. ¶¶ 343, 344, 347.

In order to finance the Merger, on December 20, 2007, multiple obligors (the "**Obligors**"), including Lyondell, many of Lyondell's Debtor operating subsidiaries, and LBI (such Debtor obligors, the "**Debtor Obligors**"), entered into debt facilities (the "**Facilities**"), pursuant to which they incurred obligations in the approximate amount of $20.7 billion (the "**Obligations**"). Compl. ¶¶ 12, 397. To secure repayment of the Obligations, the Obligors (including the Debtor Obligors) granted security interests in the form of first and second liens on substantially all of their property to the lenders that provided the Facilities (the "**Lenders**"). Compl. ¶¶ 12, 398-400. The proceeds of these Facilities (the "**Facilities Proceeds**") were used by LyondellBasell to pay the costs of the Merger. Compl. ¶ 401.

Also on December 20, 2007, $12.5 billion of Facilities Proceeds was transferred to former shareholders of Lyondell as payment of the cash due upon the conversion of each share of Lyondell common stock into the right to receive $48 (the "**Merger Consideration**"). Compl. ¶¶ 401 (i), 455.[8]

Immediately following the closing of the Merger, LBI plunged into a liquidity crisis from which it would never emerge. Compl. ¶¶ 10, 394, 417-443, 451. In January 2009, Lyondell

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[8] An additional $7.1 billion in proceeds from the Merger Financing was used to refinance pre-existing debt. *See* Compl. ¶ 401.

finally collapsed under the pressure of the approximately $22 billion of debt created by the Merger, and filed for chapter 11 protection. Compl. ¶¶ 417, 428, 430, 432, 437.

II. Chapter 11, The Adversary Proceeding, Settlement and the Creditor Trust

Lyondell and most of its major operating subsidiaries filed for relief under Chapter 11 of the Bankruptcy Code on January 6, 2009, with additional debtors filing on April 24, 2009 and May 8, 2009. [Case Nos. 09-10023, 09-12518, 09-12519, 09-12956] On July 21, 2009, the Court granted the Official Committee of Unsecured Creditors (the "**Committee**") standing to pursue claims arising out of the Merger. Wissner-Gross Decl., Exh. A at 190:25-191:16.[9] The following day, the Committee initiated the adversary proceeding Official Committee of Unsecured Creditors, on Behalf of The Debtors' Estates v. Citibank, N.A., et al. (the "**Committee Action**"). The Committee Action was bifurcated into two phases, with Phase I consisting of claims against the Financing Party Defendants, certain Access Defendants and certain other parties. [Final Case Management Order – Adv. Pro. Docket No. 124]

On December 4, 2009, the Debtors advised the Bankruptcy Court of a proposed settlement by the Debtors and the Financing Party Defendant (the "**FPDs**") of claims asserted against the FPDs (the "**Original FPD Settlement**"). Wissner-Gross Decl., Exh. B at 17:24-18:24. On the same day, the Bankruptcy Court adjourned the Phase I Trial that was scheduled to commence on December 10, 2009 (Dec. 4, 2009 Tr. 104:18-107:10). On December 11, 2009, the Debtors filed the First Amended Chapter 11 Plan of Reorganization and First Amended Disclosure Statement Accompanying First Amended Joint Chapter 11 Plan of Reorganization reflecting the terms of the Original FPD Settlement. [Docket Nos. 3431, 3432]

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[9] References to exhibits to the accompanying declaration of Sigmund S. Wissner-Gross, dated March 25, 2011 (the "**Wissner-Gross Declaration**") shall be as follows: ("**Wissner-Gross Decl., Exh. __**").

Under the Original FPD Settlement, the settling defendants agreed, among other terms, to provide certain holders of allowed unsecured claims (i) $300 million in cash and (ii) all of the proceeds of future prosecution of claims asserted in the Committee Action against non-settling defendants, to be prosecuted by the LB Litigation Trust, the prosecution of which was to be funded by a $15 million interest free loan to be paid out of first proceeds. [Adv. Pro. Docket No. 284] See First Amended Disclosure Statement III. K. The Original FPD Settlement did not establish the LB Creditor Trust. *Id.*

On December 24, 2009, the Debtors filed the Second Amended Plan of Reorganization and formally sought approval of the Original FPD Settlement by filing a motion pursuant to Bankruptcy Rule 9019 seeking a hearing and Bankruptcy Court approval of the Original FPD Settlement (the "**9019 Motion**"). [Adv. Pro. Docket Nos. 284-288]

On January 29, 2010, the Committee and certain other parties filed objections to the 9019 Motion. [Adv. Pro. Docket Nos. 322, 323, 327, 330] On February 16, 2010, the Debtors, Committee and other parties objecting to the 9019 Motion reached a settlement in principle that would require certain amendments to the Original FPD Settlement, and on that date, the Debtors advised the Bankruptcy Court of such amendments. (Feb. 16, 2010 Tr. 7:11-15:17) Among the amendments to the Original FPD Settlement was an agreement by the Settling Parties to provide an additional $150 million in the form of Class A Shares of the Reorganized Debtors as well as: (i) Assigned Preference Claims, (ii) creation of the LB Creditor Trust, and (iii) conversion of the $15 million interest free loan to a one time grant to the LB Creditor Trust and LB Litigation Trust. Wissner-Gross Decl., Exh. C at 7:21-8:25.

At the February 16, 2010 hearing, the Committee advised the Court of the Debtors' abandonment of claims against the former shareholders of Lyondell. At the hearing, counsel for the Committee stated:

> There are two features of the settlement that I want to make sure Your Honor, as I know you are, are aware of. Over and above the improvement in the settlement amount . . . is what happens to the estate's claims and causes of action against the Lyondell Chemical shareholders.
>
> Those claims are, again to use the vernacular, going to be abandoned by the debtors under its plan of reorganization, abandoned to those creditors that, but for the advent of bankruptcy, would have had the ability to pursue those claims or those shareholders pursuant to state fraudulent conveyance laws.
>
> And if Your Honor tracks the nature of the claims, you'll realize or appreciate the necessity for two of the creditors' trusts that Mr. Golden mentioned. Those claims that will be returned back to creditors, in effect, or abandoned by the estate to those creditors will find their way into a creditor trust.

Id. at 17:23-18:18.

On March 10, 2010, the Debtors, Committee and other settling parties executed an amendment to the Original FPD Settlement (such amended agreement, the "**Final FPD Settlement**"), and the Debtors and Committee filed a joint amendment to the 9019 Motion seeking approval of the Final FPD Settlement. On March 11, 2010, the Court held a hearing on the 9019 Motion. At that hearing, On March 11, 2010, the Bankruptcy Court entered an Order approving the Final FPD Settlement. [Adv. Pro. Docket No. 369]. At that same hearing, counsel for the Committee in describing the settlement stated that "through the mechanism of abandonment, the claims against selling shareholders will be pursued as a matter of State law." Wissner-Gross Decl., Exh. D at 41:23-25.

On March 15, 2010, the Debtors filed their Third Amended Plan of Reorganization (the "Plan"), reflecting the terms of the Final FPD Settlement. [Docket No. 3990] The Plan provides

for the relinquishment by the Debtors of the Creditor Claims and their contribution by creditors to the Creditor Trust:

> On the Effective Date, the Abandoned Claims shall be discontinued by the Debtors without prejudice and the Debtors shall be deemed to have abandoned, pursuant to section 554 of the Bankruptcy Code, any and all right to further pursue the Abandoned Claims. Upon the effectiveness of the aforesaid discontinuance and abandonment, each holder of Allowed 2015 Notes Claims, General Unsecured Claims, and holders of the Deficiency Claims on account of the Senior Secured Claims and Bridge Loan Claims (but excluding the Senior/Bridge Guarantee Claims), shall contribute to the Creditor Trust any and all State Law Avoidance Claims. The Creditor Trust shall be authorized to prosecute the State Law Avoidance Claims that are contributed to the Creditor Trust for the benefit of Creditor Trust Beneficiaries who contribute State Law Avoidance Claims to the Creditor Trust . . . .

Plan § 5.8.[10] The "State Law Avoidance Claims" are defined as follows:

> [A]ny and all claims, rights and causes of action arising under state law against former shareholders of Lyondell Chemical and their respective successors and assigns, (based on the receipt by any such Persons of Merger Consideration, other than claims against those parties that are released by the Debtors hereunder or under the Lender Litigation Settlement.

Plan § 1.1. This relinquishment of the Creditor Claims and their contribution by the Creditor Trust beneficiaries is confirmed in the Confirmation Order:

> As of the Effective Date . . . the Creditor Trust Beneficiaries and Other Distributees (as defined in the Creditor Trust Agreement) shall be deemed to have transferred, assigned, and delivered to the Creditor Trust, without recourse, all of their respective rights, title, and interests in and to the State Law Avoidance Claims free and

[10] The Plan defines "Abandoned Claims" as follows: "'Abandoned Claims' means the claims and causes of action brought on behalf of the Debtors' estates pursuant to section 544 of the Bankruptcy Code against former shareholders of Lyondell Chemical (but solely in their capacity as such) pursuant to Count IV of the complaint in the Committee Litigation, other than (i) claims against Access, Nell Limited, or any of their respective affiliates (as that term is defined in section 101(2) of the Bankruptcy Code, replacing "debtor" with "Access" or "Nell Limited," as applicable, and replacing "corporation" with "entity"), which claims shall continue to be prosecuted as contemplated by the Committee Litigation or the Litigation Trust, (ii) claims against those parties that are released by the Debtors hereunder or under the Lender Litigation Settlement, and (iii) claims against the Directors, Officers, and Subsidiary Directors (as defined in the complaint commencing the Committee Litigation)." Plan § 1.1.

> clear of any and all liens, claims, encumbrances or interests of any kind in such property. Upon the transfer of the initial Creditor Trust Assets to the Creditor Trust, the Creditor Trust shall succeed to all of the Creditor Trust Beneficiaries' and Other Distributees' (as defined in the Creditor Trust Agreement) rights, title and interests in the Creditor Trust Assets and no other entity has any interest, legal, beneficial, or otherwise, in the Creditor Trust or the Creditor Trust Assets as of their assignment and transfer to the Creditor Trust. As of the Effective Date, the Creditor Trustee shall be the duly appointed representative of the Creditor Trust Beneficiaries and Other Distributees (as defined in the Creditor Trust Agreement) with respect to the Creditor Trust Assets, and, as such, the Creditor Trustee shall succeed to all of the rights and powers of the Beneficiaries and Other Distributees with respect to prosecution of the State Law Avoidance Claims.

Confirmation Order ¶ 28.[11]

The ballots of holders of the classes of claims entitled to vote were due on April 15, 2010, and the ballot certification dated April 22, 2010 reported that general unsecured creditors of the Debtors voted overwhelmingly in favor of the Plan, with many classes voting unanimously in favor of the Plan, and all classes voting in favor at a rate exceeding 90%. [Docket No. 4351].[12]

The Plan was confirmed by an order of this Court dated April 23, 2010 and became effective on April 30, 2010. [Docket Nos. 4418, 4468]. Pursuant to the Plan, Edward S. Weisfelner, formerly counsel to the Committee was selected to serve as the Litigation Trustee, the Creditor Trustee, and the Creditor Representative of the LB Litigation Trust and the LB Creditor Trust. [Docket No. 4142].

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[11] In the case of an issue with regard to transferability, the Confirmation Order also provided: "To the extent that any State Law Avoidance Claims cannot be transferred to the Creditor Trust because of a restriction on transferability under applicable law, such Creditor Trust Assets shall be deemed to have been retained by the Beneficiaries and Other Distributees, and the Creditor Trustee shall be deemed to have been designated as a representative of such Beneficiaries and Other Distributees to enforce and pursue such State Law Avoidance Claims on behalf of such Beneficiaries and Other Distributees." Confirmation Order ¶ 28.

[12] Defendants' suggestion that the Creditor Trust provisions in the Plan were a response to a motion filed by BGI, see Brief at 26, is incorrect and misstates the record, because (i) BGI was in fact dropped as a defendant because it adduced evidence indicating that it was merely a conduit and (ii) the Committee and BGI entered into an understanding regarding dismissal prior to the creation of the Creditor Trust provisions in the Plan and based entirely on the conduit issue, not any Section 546(e) issue.

On October 22, 2010, the Creditor Trustee filed this action in New York Supreme Court, New York County, asserting the state law Creditor Claims, which had been contributed to the Creditor Trust under the provisions of the Confirmation Order and Plan. On November 22, 2010, certain Defendants represented by Wilmer Hale removed this action to federal court, and this action was thereafter transferred to this Court. On January 11, 2011, Defendants moved to dismiss this action.

ARGUMENT

I. Section 546(e) Has No Application To The Creditor Claims.

Defendants argue that the Creditor Claims are preempted by Section 546(e) of the Bankruptcy Code and that "the Trustee cannot avoid preemption through the stratagem of abandonment." *See* Brief at 27-34. This argument is without merit and fails for multiple reasons.

First, the Creditor Claims not federal claims, but rather state law claims that are now and always have been the property of the creditors. Section 544(b) vested the trustee (or debtor-in-possession) with temporary standing during the bankruptcy proceedings to pursue the claims, but courts have for decades recognized the right of creditors to pursue, after the trustee's relinquishment of his avoidance powers, any of their state law claims that were not resolved under those avoidance powers. The limitations on the federal avoidance powers set forth in Section 546(e), by their very terms, do not apply here.

Second, the Creditor Claims are not preempted. Defendants are unable to cite a single case in which a Court has held that Section 546(e) preempts claims asserted by a plaintiff who is not exercising the federal avoidance powers pursuant to standing conferred by the Bankruptcy Code. The statutory scheme, case law and legislative history make clear why that is so: the purpose of Congress in enacting Section 546(e) was to afford certain financial markets a measure

of protection from a bankruptcy fiduciary invested with the Code's sweeping avoidance powers, not to enact a permanent statutory release for a particular class of transferees. Indeed, Defendants' position effectively would require the discharge or release of claims against non-debtors, through bankruptcy, in direct contravention of Section 524(e) (expressly providing that non-debtors are not discharged in bankruptcy) and binding case law in this Circuit making non-consensual third party releases available only in the most compelling and unusual circumstances, none of which can be claimed to exist here. Defendants thus ask this Court to effectively negate one Bankruptcy Code provision in favor of another and turn a blind eye to Circuit-level precedent. Moreover, Defendants' focus on the "market-protection" concern both misapprehends the role of a court in a preemption case and ignores entirely the fundamental Congressional purposes underlying the Bankruptcy Code (of which Section 546(e) is but one element), which are to facilitate rehabilitation of the debtor and maximize creditor recovery.

Third, Defendants' position is not advanced by, but in fact is undermined by, their complaints about the Creditor Trust provisions of the Plan and Confirmation Order. The Debtors' relinquishment here of Creditor Claims under the Plan and the creditors' contribution of those claims to the Creditor Trust were a fully-disclosed component of a bargained-for and Court-approved settlement of the Rule 9019 Motion. Defendants fail to identify any purported failing of the Creditor Trust provisions of the Plan other than that the provisions do not accord with their misguided view of the law of preemption. Nor do Defendants offer any legal basis for modifying or revoking the Confirmation Order pursuant to which the Plan and Creditor Trust provisions were approved after notice and hearing.

A. The Creditor Claims are State Law Claims Belonging to the Creditors.

The fact that the Debtors, as debtors in possession, had standing for a period of time to prosecute the Creditor Claims under the federal avoidance pursuant to Section 544(b) provides

no basis for concluding that the claims have been permanently transformed into federal claims subject to federal bankruptcy code provisions such as Section 546(e). To the contrary, the Creditor Claims are state law claims owned by the creditors.

There is no controversy that prior to the commencement of a bankruptcy action, state law provided creditors with the causes of actions asserted here—intentional and constructive fraudulent transfer actions. *See, e.g.*, N.Y. Debt. & Cred. art. 10, §§ 270-81; Texas Bus. & Comm. Code, tit. 3, §§ 24.001-24.013.[13] Following the commencement of a bankruptcy action, Section 544(b) of the Code confers on the bankruptcy trustee (or debtor in possession)[14] standing to prosecute creditors' state law claims on behalf of the debtors' estates as part of his broad avoidance powers:

> [T]he trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim . . . .

11 U.S.C. § 544(b).

For so long as a trustee retains standing to pursue claims under Section 544(b), creditors may not prosecute their fraudulent conveyance claims against non-debtors. Section 362(a)(1) of the Code provides that actions "against the debtor" or "to recover a claim against the debtor" are subject to the automatic stay. Upon the filing of a petition, the fraudulent transfer claims of creditors are subject to the automatic stay of bankruptcy. Under Second Circuit law, the stay is applicable to state law fraudulent transfer claims because these are properly regarded as a third-

[13] Delaware, as Texas, has enacted the Uniform Fraudulent Transfer Act, with each state providing actions for intentional and constructive fraudulent transfer. *See* Del. Comm. & Trade. Code, tit. 6, §§ 1301-12.

[14] For the powers at issue here, the terms "trustee" and "debtor in possession" as used in the Bankruptcy Code are "essentially interchangeable." *In re Cybergenics Corp.*, 226 F.3d 237, 243; *see also* 11 U.S.C. § 1107(a).

party actions "to recover a claim against the debtor" within the meaning of Section 362(a)(1). [15] *In re Colonial Realty Co.*, 980 F.2d at 131 (internal quotation marks omitted).

The case law makes clear that although any recovery resulting from a trustee's prosecution of the creditors' state law claims constitutes property of the debtor's estate, the state law avoidance claims themselves remain at all times the property of the creditors. *See In re Cybergenics Corp.*, 226 F.3d 237, 241-43 (3d Cir. 2002); *In re Saunders*, 101 B.R. 303, 305 (Bankr. N.D. Fl. 1989) ("[t]he fraudulent transfer cause of action itself is not considered property of the estate"); *In re PWS Holding Corp.*, 303 F.3d 308, 314 (3d Cir. 2002) (acknowledging that creditors' state law claims are not property of the debtor's estate); *accord In re Colonial Realty Co.*, 980 F.2d at 131 (approving of the *Saunders* analysis and holding that the FDIC non-bankruptcy fraudulent conveyance claim arising from the debtor's prepetition transfer was not property of the debtors' estate).[16]

As the fraudulent transfer claims of creditors are not estate property but can be prosecuted by an estate representative during bankruptcy, the Section 544(b) avoidance power has been described as a temporary "legal fiction" that "enables a debtor in possession to bring certain causes of action that actually belong to its creditors." *In re Cybergenics Corp.*, 226 F.3d at 241; *see also Zilkha Energy Co. v. Leighton*, 920 F.2d 1520, 1523 (10th Cir. 1990), *aff'd by* 999 F.2d 548 (10th Cir. 1990) ("Congress has fashioned a legal fiction . . . the fiction permits the

[15] The Fifth Circuit has taken a different view as to why the automatic stay applies. In *In re MortgageAmerica Corp.*, 714 F.2d 1266, 1275 (5th Cir.1983), the Fifth Circuit found that the automatic stay applied because property that could be recovered pursuant to state law creditor claims was "property of the estate." The Second Circuit explicitly rejected this view in *In re Colonial Realty Co.*, 980 F.2d at 131.

[16] While there is contrary authority in other jurisdictions, *see, e.g.*, *In re Ontos, Inc.*, 478 F.3d 427, 431 (1st Cir. 2007), the Second Circuit has approved of the analysis in *In re Saunders*, 101 B.R. at 305 . . . *See also In re Colonial*, in which the Court found that "[t]he fraudulent transfer cause of action itself is not considered property of the estate," *id.* at 305, *see In re Colonial Realty Co.*, 980 F.2d at 131, and in any event Defendants concede the point in their Brief: "Congress made clear that 'property of the estate' does not include the trustee's avoiding powers under Section 544, but rather only the property the trustee recovers through the successful exercise of those avoiding powers." Brief at 34.

trustee . . . to assume the guise of a creditor with a judgment against the debtor.”). That is, “[m]uch like a public official has certain powers upon taking office as a means to carry out the functions bestowed by virtue of the office or public trust, the debtor in possession is similarly endowed to bring certain claims on behalf of, and for the benefit of, all creditors.” *In re Cybergenics Corp.*, 226 F.3d at 244; *accord In re Metro. Elec. Mfg. Co.*, 295 B.R. 7, 12 (Bankr. E.D.N.Y. 2003) (citing “public official” analogy).

For so long as a trustee retains standing under Section 544(b), he may, subject to court approval, settle, compromise and/or release certain claims of creditors. *In re PWS Holding Corp.*, 303 F.3d at 309 (holding that debtor-in-possession may choose to extinguish claims he had standing to pursue under Section 544(b) even though the claims are not property of the debtor’s estate).

However, the Bankruptcy Code, which provides only that the trustee “may” avoid the transfers described therein, does not automatically discharge or release claims that have not be compromised or resolved by the trustee. To the contrary, Section 524(e) of the Code provides that the discharge of the debtor in bankruptcy does <u>not</u> discharge the liabilities of non-debtors. 11 U.S.C. § 524(e) (“[D]ischarge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”) As set forth below, *see* p.36, *infra*, under Second Circuit case law, non-debtors may be released from liability pursuant to the Bankruptcy Code only under narrow and compelling circumstances.

Moreover, following the termination of the period in which a trustee has standing to pursue state law creditor claims (whether as a result of plan confirmation and discharge of the debtor, termination due to a trustee’s abandonment of a claim, or otherwise), a creditor may proceed under state law to prosecute claims that have not been settled or extinguished in

bankruptcy.[17] *See Hatchett v. United States*, 330 F.3d 875, 886 (6th Cir. 2003) (the "Code does not extinguish the right of the Government to bring a state law action for fraudulent conveyance after the debtor receives a discharge in bankruptcy"); *Unisys Corp. v. Dataware Prods., Inc.*, 848 F.2d 311, 314 (1st Cir. 1988) (holding that when a trustee abandons his section 544(b) claim, a creditor with the right to sue under state law may pursue the claim); *In re Metro. Elec. Mfg. Co.*, 295 B.R. at 12 (stating that the trustee is the only party who is authorized to bring an action under section 544(b) of the Bankruptcy Code "until he abandons it or otherwise allows the creditors to pursue it independently"); *United States v. Doyle*, 276 F. Supp. 2d 415, 429 (W.D. Pa. 2003) (stating that once bankruptcy proceedings are closed, a creditor may pursue its state law fraudulent transfer claims); *In re Integrated Agri, Inc.*, 313 B.R. 419, 428-29 (Bankr. C.D. Ill. 2004) (creditor may bring fraudulent transfer action on its own behalf after trustee's standing expires); *Klingman v. Levinson*, 158 B.R. 109, 113 (N.D. Ill. 1993) ("The trustee's exclusive right to maintain a fraudulent conveyance cause of action expires and creditors may step in (or resume actions) when the trustee no longer has a viable cause of action."); *Casey Nat. Bank v. Roan*, 668 N.E.2d 608, 612-13 (Ill. App. 1996) ("While the trustee has the exclusive right to pursue fraudulently conveyed assets pursuant to the Code once bankruptcy has been initiated[], the trustee loses that right and creditors may step in once the trustee no longer has a viable cause of action (in this case because the statute of limitations for initiating a cause for fraudulent conveyance had expired as to the trustee)."); *In re Pasian*, No. 94-31563 TEC, Adv. No. 09-3182 TC, 2010 WL 935598, at *2 (Bankr. N.D. Cal. Mar. 15, 2010) (bankruptcy discharge of the debtor not a bar to action against pre-petition transfer of fraudulent transfer made by the debtor,

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[17] As the authorities in this section indicate, "abandonment" of a claim is not the only means for termination of the period in which an estate representative vested with the avoidance powers has exclusive right to pursue the creditor claims. For example, the period may end when an estate voluntarily relinquishes its claims, when the Code's limitations statute expires or when the automatic stay ends. The bankruptcy stay in a Chapter 11 case expires no later than the time at which the debtor is granted a discharge. *See* 11 U.S.C. § 362.

even if the debtor's pre-transfer liability to creditor was discharged in bankruptcy.); *In re Boynewitz*, No. 02-30250 LMW, 2002 WL 33951315, at *2, n.5 (Bankr. D. Conn. Nov. 27, 2002) (observing that a creditor may proceed with its fraudulent transfer claims against a non-debtor once the automatic stay is terminated.).[18]

In sum, at issue here are state law claims owned by the creditors. These claims have not been extinguished, altered or otherwise impaired as result of either the Reorganized Debtors'[19] bankruptcy or the confirmation of the Plan.

B. Section 546(e) Does Not Preempt The Creditors Claims.

Because Section 546(e) does not by its terms have any application to claims pursued outside of bankruptcy, Defendants argue that Section 546(e) preempts the Creditor Claims. *See* Brief at 27-34. But they cite no case in which a court has held that anyone other than an estate representative, acting pursuant to power and authority that has been conferred by the Code, is precluded by Section 546(e) from the pursuit of any claim. In fact, as set forth herein, the sole authority addressing that issue finds that Section 546(e) does not apply to a plaintiff that is not acting as an estate representative. An examination of the statutory scheme, case law and legislative history makes clear why no cases support Defendants' position: the prosecution of state law claims by a creditor who is not a bankruptcy fiduciary and who lacks standing to exercise the federal avoidance powers, after the debtor has reorganized and received a discharge, simply does not conflict with the purposes and objectives of Congress.

1. Preemption Standard

[18] Consistent with such authority, on March 22, 2011, Judge Carey of the Bankruptcy Court in the District of Delaware indicated that it in light of a bankruptcy estate's failure to permit certain state law creditor claims, he would find that "creditors have regained the right, if any, to prosecute their respective" state law claims. Wissner-Gross Decl., Exh. F at 103:14-103:15, *In re Tribune*, 08-13141 (D. Del. Mar. 22, 2011).

[19] Those of the Debtors that were reorganized are referred to hereinafter where as the "**Reorganized Debtors**" where appropriate.

The Supremacy Clause provides that "the Laws of the United States . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. "Despite this sweeping language, courts do not readily assume preemption. To the contrary, in the absence of compelling congressional direction, courts will not infer that Congress has deprived the States of the power to act." *Madeira v. Affordable Hous. Found., Inc.*, 469 F.3d 219, 238 (2d Cir. 2006) (internal quotations omitted) (*citing New York Tel. Co. v. New York State Dep't of Labor*, 440 U.S. 519, 540, 99 S. Ct. 1328, 59 L. Ed. 2d 553 (1979)).

Where, as here, Congress has not explicitly preempted state law in the statutory language, courts have recognized two types of implied preemption: "field preemption," where the scheme of federal regulation is "so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," and "conflict preemption," where "compliance with both federal and state regulations is a physical impossibility" or where state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Gade v. Nat'l Solid Wastes Mgmt. Ass'n*, 505 U.S. 88, 98 (1992) (internal citations omitted).

Defendants fail to take a clear position on whether it is field or conflict preemption that they claim applies here, but the thrust of their argument—that prosecution of the Creditor Claims would frustrate the Congressional purpose behind Section 546(e), *see* Brief at 29-31—is a classic conflict preemption argument. Moreover, as demonstrated above, insofar as the Bankruptcy Code provisions impose field preemption,[20] it is apparent that (i) the relevant "field" is not as sweeping as Defendants imply and clearly does not extend to cover claims asserted by creditors

[20] *See In re Hechinger Inv. Co.*, 274 B.R. 71, 96 (D. Del. 2002) (noting that field preemption applied although conflict preemption theory was "clearly more applicable"). The Memorandum of Law submitted by Proskauer Rose LLP on behalf of various defendants ("**Proskauer Memo**") takes the position that field preemption should apply. *See* Proskauer Memo at 18.

after discharge, as evidenced by the decades of case law permitting creditors to proceed with any remaining claims following the trustee's completion of the exercise of his federal avoidance powers, *see* Part I-A, *supra,* and (ii) as set forth below, even within the carefully-calibrated scheme enacted by Congress, Section 546(e) simply was not intended to operate as a release of third-party transferees, *see* p.35, *infra*. Because field preemption is inapplicable here and it is not "physically impossible" to prosecute the Creditor Claims without violating the terms of Section 546(e), the conflict preemption analysis turns on whether the prosecution of the Creditor Claims "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." As set forth herein, the prosecution of these claims does not stand as an obstacle to Congressional purpose.

2. Congressional Purpose and Objectives.

Defendants imply that the sole Congressional purpose at issue here is the protection of the "nation's financial markets from the instability caused by the reversal of settled securities transactions," *see* Brief at 29-30, and argue that preemption requires an expansive broadening of the limited application of Section 546(e), so as to preclude the exercise of any rights, within or without bankruptcy proceedings, that would result in the reversal of settled securities transactions. Defendants' analysis of Congressional purpose is incomplete, to say the least. The purpose of Section 546(e) was not to remediate instability in the financial markets at large, independent of bankruptcy, but rather to partially shield those markets from a trustee exercising the federal avoidance powers. Moreover, Section 546(e) is but one element in a series of provisions that have as their Congressional purpose the maximization of creditor recovery.

(a) The Purposes Behind the Bankruptcy Code and Avoidance Provisions

Evaluation of Defendants' conflict preemption argument must begin with consideration of the Congressional purposes behind the Code and the avoidance provisions, of which Section 546(e) is but one element. "[B]olstering creditors' rights is the primary objective of avoidance powers such as section 544(b)." *In re Cybergenics Corp.*, 226 F.3d at 244, n.9. More generally, "the basic policy implications of the Bankruptcy Code emphasize maximization of recovery of estate assets and fairness to all creditors." *In re Greenberg*, 266 B.R. 45, 49 (Bankr. E.D.N.Y. 2001); *see also In re Kingbrook Dev. Corp.*, 261 B.R. 378, 379 (Bankr. W.D.N.Y 2001) ("Among the goals of the bankruptcy process is maximization of distribution to creditors."); *In re Selinky*, 365 B.R. 260, 267 (Bankr. S.D. Fla. 2007) ("The goal of every bankruptcy case should be a discharge of debts and maximizing value for creditors.").[21] In order to realize creditor rights and maximize recovery available to the creditors, Congress invested the bankruptcy trustee with sweeping avoidance powers. This is no ordinary "trustee." The existence of a single unsecured creditor with a triggering cause of action allows the trustee to avoid the entire transfer under Section 544(b), and once avoided under that section a transfer "is avoided in its entirety for the benefit of all creditors, not just to the extent necessary to satisfy the individual creditor actually holding the claim." *Id.* See also *In re PWS Holding Corp.*, 303 F.3d 308, 314 (3d Cir. 2003); *In re Cybergenics Corp.*, 226 F.3d at 243.

(b) <u>The Purpose Behind Section 546(e)</u>

Congress, however, long ago expressed concern that these Code provisions—and the avoidance powers in particular—could potentially contribute to the instability of the financial markets. Section 546(e) was enacted as one of a series of "safe harbor" provisions that except transactions involving counterparties in a protected class of financial contracts from the normal

[21] In addition to the avoidance powers, other provisions of the Code that achieve these objectives include the automatic bankruptcy stay. *See* 11 U.S.C. § 362.

operation of the Code, including the automatic bankruptcy stay and the avoidance powers.[22] As an examination of the text, case law and legislative history indicates, Section 546(e) in particular was enacted to partially insulate financial contract counterparties from the effects of the federal avoidance powers.

As an initial matter, the text of Section 546(e) is itself evidence of the Congressional purpose of limiting the powers under the Bankruptcy Code to reverse certain transactions. *See Cummings v. Dep't of the Navy*, 279 F.3d 1051, 1055 (D.C. Cir. 2002) ("statutory text remains the best evidence of congressional intent."). Section 546(e) provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract . . . commodity contract . . . or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e). By its own terms, Section 546(e) is a limitation only on the trustee: "the trustee may not avoid" certain transactions. 11 U.S.C. § 546(e). In addition, the introductory clause—"[n]otwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title"—links Section 546(e) to the avoidance powers of "the trustee."[23]

[22] Another provision was a limitation upon the bankruptcy stay. *See* H.R. Rep. 97-420 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 583, 583 ("The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market. The amendments will ensure that . . . except as otherwise provided, the stay provisions of the code are not construed to prevent brokers from closing out the open accounts of insolvent customers or brokers. The prompt closing out or liquidation of such open accounts freezes the status quo and minimizes the potentially massive losses and chain reactions that could occur if the market were to move sharply in the wrong direction.").

[23] In addition, the use of the definite article "the" (as opposed to an indefinite article such as "a" or "an") is intended to mean a singular, identifiable person. *See In re Cardelucci,* 285 F.3d 1231, 1234 (9th Cir. 2002); *In re Dow Corning*, 237 B.R. 380, 404 (Bankr. E.D. Mich. 1999); *In re Melenyzer*, 143 B.R. 829, 831 n.2 (W.D. Tex. 1992). And, the Supreme Court's decision in *Hartford Underwriters Ins. Co. v. Union Planters Bank,* 530 U.S. 1, 7-9 (2000), makes clear that "the trustee" can mean only the statutory bankruptcy trustee (or debtor-in-possession). As such, only the bankruptcy trustee, with his otherwise broad powers, is intended to be limited by Section 546(e).

Indeed, the District of Delaware, in a Chapter 7 case in which a liquidating company had been assigned the claims of both a bankruptcy estate and unsecured creditors, found that Section 546(e) simply did not apply to claims brought by the liquidating company in its capacity as assignee of unsecured creditors:

> [T]he Court concludes that if the avoidance action were brought by a trustee or a debtor-in-possession (or the successor to a debtor-in-possession), the avoidance action would be barred by Section 546(e) of the Bankruptcy Code. However, in this case, PHP LLC has not asserted its claims against Movants in the capacity of a trustee or as a successor-in-interest to a trustee or debtor-in-possession. Rather, PHP LLC is bringing the instant claims as a direct assignee of the unsecured creditors. As such, Section 546(e) is not a bar to PHP LLC's claims.

PHP Liquidating v. Robbins, 291 B.R. 603, 607 (D. Del. 2003), *aff'd by* 128 Fed. App'x. 839 (3d Cir. 2005).[24]

Moreover, the placement within the Bankruptcy Code of Section 546(e) (placed in the sub-chapter containing <u>the trustee's</u> avoidance powers), further underscores that the section is not intended to constitute a broad-ranging release of claims against non-debtors.[25] Indeed, the Sixth Circuit has noted regarding a different subsection of Section 546 that "the statute of limitations in § 546 applies only to actions by trustees. . . . As we have discussed, this state law action by the Government for fraudulent conveyance commenced after the discharge of the

[24] Although finding that Section 546(e) would have had no application to the prosecution of the claims by the liquidating company as the assignee of unsecured creditors, the district court concluded that the liquidating company had not been assigned the claims by creditors. *Id.* At 610-611. Rather, under the terms of the Plan, the debtor-in-possession, rather than relinquishing its Section 544(b) standing, assigned claims to the liquidating company. As a result, the liquidating company held such claims as successor to the debtor-in-possession and the creditors had not claims that they were able to assign.. *Id.* On appeal, the Third Circuit affirmed dismissal of the claims, finding that as prosecuted by an assignee of the debtor-inpossession, the claims were defective on the merits. *See In re PHP Healthcare Corp.*, 128 Fed. App'x. 839, 844-47 (3d Cir. 2005).

[25] As discussed *infra*, where, in contrast, Congress intended a provision of the Bankruptcy Code to affect the liability of non-debtors on the claims of other non-debtors, it knew how to do so. Thus, Section 524(g), located in the sub-chapter dealing with the discharge of claims, does specifically provide for the release of non-debtor claims against non-debtors in certain situations. *See* 11 § U.S.C. 524(g). Similarly, Sections 1201 and 1301 (applying only to family farmer/fisherman reorganization and individual rehabilitation cases, respectively) specifically provide for the stay of creditor actions against non-debtors.

bankruptcy and has nothing to do with the rights of the trustee." *Hatchett v. United States*, 330 F.3d 875, 887 (6th Cir. 2003).

Courts and commentators, based upon a review of the legislative history and the text, have consistently recognized the same Congressional purpose and objective—to protect the commodities and securities markets, indeed, but through a partial limitation on the <u>trustee's</u> avoidance powers. Indeed, the very cases cited by Defendants make the point. As the Court explained *In re Hechinger Investment Co.*,

> [W]ith reference to section 546(e), it is clear from the case law and legislative history of that statute that the broad avoidance power given to a trustee in bankruptcy led to the potential risk that the avoidance of a major transfer would have a disruptive effect on settled securities transactions. To address this danger, Congress passed section 546(e) to narrow the trustee's avoidance power under certain circumstances to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions.

274 B.R. at 88 (internal citation omitted).

Indeed, Congress enacted the original precursor to Section 546(e) in response to a proceeding in this District pursuant to which a bankruptcy trustee for a commodities broker, acting pursuant to federal avoidance powers (the statutory predecessor of Section 544(b)) sought to recover a margin payment made to a commodities exchange. *See* S. Rep. 95-989, at *104 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5892 (*citing Seligson v. New York Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975)). The statutory limitation enacted in 1978 was intended to protect margin payments from commodities clearing organizations. *See In re Enron Creditors Recovery Corp.*, 422 B.R. 423, 429 (S.D.N.Y. 2009) ("[t]hen-codified as section 764(c), the safe harbor applied exclusively to margin payments *from* commodities clearing organizations and thus only protected transfers in the ordinary course of business in the market") (internal quotations omitted) (*citing* S. Rep. 95-989 (1978), *as reprinted in* 1978 U.S.C.C.A.N.

5787, 5892; H.R. Rep. 95-595 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6348; H.R. Rep. 97-420 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 583, 583).

In 1982, Congress amended the limitation to extend its scope to include more broadly the securities markets. *See In re Enron Creditors Recovery Corp.*, 422 B.R. at 429 ("Section 764(c) was replaced by three provisions . . . [which] broadened the former safe harbor by extending its scope to include the securities markets. It also expanded the safe harbor's protection beyond the ordinary course of business to include margin and settlement payments to and from brokers, clearing organizations, and financial institutions.") As the court in another case cited by Defendants explained, Section 546(e) was enacted as "an exception to various other Code provisions that allow a trustee or debtor-in-possession to avoid certain transfers. . . ." *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 984 (8th Cir. 2009).

The legislative history also reflects the focus on protecting the commodities and securities from the avoidance powers. For example, the legislative history to the original enactment of the provision in 1978 provides:

> Subsection (c) insulates variation margin payments and other deposits *from the avoiding powers* except to the extent of actual fraud under Section 548(A)(1). This facilitates prepetition transfers and protects the ordinary course of business in the market.

H.R. Rep. 95-595, at *392 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963 (emphasis added).[26] Similarly, the House Report on the 1982 amendment extending the limitation more broadly to the securities markets is reflective of and responsive to the concern about a "ripple effect" through the markets.[27] But that concern, in any event, is addressed through limitations on the

[26] The House and Senate reports are issued in "all caps" format; the text has been converted to ordinary capitalization conventions for ease of reading.

[27] As some courts examining the legislative history of Section 546(e) have observed, the "ripple effect" with which Congress was concerned was actually a specific impact on clearinghouses and brokerages that rely on interlocking guarantees and netting arrangements. In one prominent decision, *Wiebolt Stores v. Schottenstein*, 131 B.R. 655, 663-

trustee's avoidance power, not by enacting a broad immunity (never done, nor contemplated by Congress) that applies without reference to the avoidance power:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature [sic] the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possible threatening [sic] the collapse of the affected market.

H.R. Rep. 97-420, at *1-2 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 583, 583.[28]

Congressional concerns were, however, addressed through limitations on the trustee's avoidance power, not by enacting a broad immunity that applies without reference to the avoidance power:

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65 (N.D. Ill 1991), the court rejected the application of Section 546(e) to the LBO before it on such basis, noting that while the legislative history revealed Congress' concern "that the bankruptcy of one party in the clearance and settlement chain could spread to other parties in that chain" requiring the shareholders of an LBO to return payments they received "poses no significant threat to those in the clearance and settlement chain." *Id*. at 665. Other courts have made similar observations. *See Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846, 850 (10th Cir. 1990) (noting that "[n]either LBOs nor other exceptional transactions were even mentioned in any of the discussions of the securities industry in the reports, debates, and hearings on the bill").

Notably, the Third Circuit in *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l)*, 181 F.3d 505 (3d Cir. 1999) and other courts adopting a broader reading of Section 546(e) have not purported to do so based on a legislative history demonstrating that Congressional concerns regarding a "ripple effect" extended beyond those identified in *Wieboldt* but rather have found that the rules of plain language construction constrained them from relying on the legislative history to support a more narrow reading. Offering as its rationale for finding Section 46(e) applicable to the transactions under consideration in the case before it, the *Resorts* court explained, "[w]hen the language is clear, no further inquiry is necessary unless the plain language leads to an absurd result.") *See also In re Kaiser Steel Corp.*, 952 F.2d 1230, 1237 (10th Cir. 1991) ("[O]ur task is to apply the term 'settlement payment' according to its plain meaning.").

While courts have used the plain meaning doctrine to construe Section 546(e) broadly, it does not logically follow (indeed it would be illogical) that the narrow scope of Congressional concerns, as expressed in the legislative record, should be disregarded in analyzing whether preemption of state law is necessary to prevent Congressional intent in enacting Section 546(e) from being thwarted. Indeed, it is entirely circular to fashion a federal preemption argument regarding Congressional purpose based on a broad application Section 546(e) that has been driven by a "plain language" even while ignoring the legislative record demonstrating a narrower purpose. Thus, while a plain language construction of Section 546(e) may not lead to an "absurd" result, it would be absurd to preempt state law based on a Congressional intent that multiple courts have found does not exist. There is, in sum, no basis for the assertion that preemption is necessary to avoid the "ripple effect" that was the object of Congressional concern in enacting Section 546(e).

[28] Further amendments to the language of the provision do not reflect any change in Congressional purpose or evidence an intent to expand Section 546(e) to apply outside the context of the bankruptcy code. *See, e.g.*, H.R. Rep. 109-648, pt. 1, at *1 (2006) (Financial Netting Improvements Act of 2006 "makes technical changes to . . . update the language to reflect current market and regulatory practices, and help reduce systemic risk in the financial markets by clarifying the treatment of certain financial products in cases of bankruptcy or insolvency.")

> The Bankruptcy Code now expressly provides certain protections to the commodities market to protect against such a 'ripple effect.' One of the market protections presently contained in the bankruptcy code, for example, *prevents a trustee in bankruptcy from avoiding or setting aside*, as a preferential transfer, margin payments made to a commodity broker (*see* 11 U.S.C. Sec. 764(c)).
>
> The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market. *The amendments will ensure that the avoiding powers of a trustee are not construed to permit* margin or settlement payments to be set aside except in cases of fraud and that, except as otherwise provided, the stay provisions of the code are not construed to prevent brokers from closing out the open accounts of insolvent customers or brokers. The prompt closing out or liquidation of such open accounts freezes the status quo and minimizes the potentially massive losses and chain reactions that could occur if the market were to move sharply in the wrong direction. *Id.* (emphasis added).

Id.

Moreover, even within the context of the trustee's avoidance powers, it is significant that the limitation that Congress chose to enact was only partial. For example, Section 546(e) has no application to the federal avoidance power set forth in Section 548(a)(1)(A), which permits avoidance of intentional fraudulent transfers. *See* 11 U.S.C. § 546(e) ("the trustee may not avoid a transfer . . . except under section 548(a)(1)(A) of this title"); *Collier on Bankruptcy* ¶ 546.06[1] (16th ed. 2010) ("The limitations on the trustee's avoiding powers set forth in section 546(e) expressly do not apply to section 548(a)(1)(A) of the Bankruptcy Code, which permits the trustee to avoid transfers made or obligations incurred with the actual intent to hinder, delay or defraud creditors."). This provides further explicit support for the conclusion that the purpose of Congress was to establish a carefully-crafted limitation on the avoidance powers.

Ultimately, there is simply no support whatsoever in the legislative history for Defendants' notion that the purpose of Congress was to create a sweeping substantive immunity

for certain third party transferees, untethered to a trustee's exercise of the avoidance powers and effective even after discharge of the debtor. To the contrary, what the materials show is a Congressional purpose of granting the financial markets a partial measure of protection from a trustee invested with the federal avoidance powers, in the context of a larger purpose of bolstering creditor rights and maximizing recoveries.

3. Federal Law Does Not Preempt State Law Creditor Actions Where the Section 544(b) Avoidance Powers Are Not Being Exercised.

(a) Conflict Preemption Does Not Apply.

The Creditor Claims do not stand as an obstacle to the accomplishment of the Congressional purpose of granting the financial markets a partial measure of protection from the federal avoidance powers, because the Creditor Trustee is not exercising federal avoidance power and lacks any standing to do so.

Defendants cite two cases from other Circuits in support of the proposition that Section 546(e) preempts the Creditor Claims, *Contemporary Industries Corporation*, 564 F.3d at 988 and *In re Hechinger Investment Co.*, 274 B.R. at 88. *See* Brief at 30-31. Neither case supports their argument. In fact, both are consistent with the Creditor Trustee's understanding of Congressional purpose. In each case, the state law claims were brought during bankruptcy by a bankruptcy estate representative that possessed and was concurrently exercising the Section 544(b) avoidance powers under the Code, before any discharge in bankruptcy had been granted to the debtor or the right to prosecute state law claims had been relinquished back to the owners/creditors. *See Contemporary Industries Corporation*, 564 F.3d at 988 and *In re Hechinger Investment Co.*, 274 B.R. at 88. The District Court's holding in *In re Contemporary Industries Corporation*, upheld by the Circuit Court, was that Section 546(e) prohibits "the trustee, debtor-in-possession, or Committee, in this case," from avoiding the transfers. *See In re*

Contemporary Industries Corporation, 2007 WL 5256918, at*6 (D. Neb. June 29, 2007), *aff'd by* 564 F.3d 981. Likewise, the Court in *In re Hechinger* referred only to preemption applying "in bankruptcy." *See In re Hechinger Investment Co.*, 274 B.R. at 97.[29] The holding of preemption in these cases therefore simply blocked a bankruptcy estate representative exercising the avoidance powers during bankruptcy from prosecuting claims assertable under those powers without adhering to the limits in Section 546(e)-i.e., obstructing the Congressional purpose of partially protecting the financial markets from a bankruptcy trustee invested with the federal avoidance powers. That finding has absolutely no application here, where (i) the Creditor Trustee is not exercising the federal avoidance powers and does not even have standing to do so, (ii) the debtors have been reorganized and granted a discharge in bankruptcy, and (iii) the Creditor Claims were explicitly relinquished back to the creditors under the Plan.

Defendants cite no authority whatsoever in support of the proposition that Section 546(e) preempts state law claims asserted by anyone other than the bankruptcy trustee (or other bankruptcy fiduciary deriving its avoidance powers from the federal statute), much less a party doing so after the debtors have reorganized, a discharge in bankruptcy has been granted and the stay no longer applies to creditor claims.[30] Again, that is because Congress's purpose with

[29] Indeed, while the courts in *In re Hechinger* and *In re Contemp. Indus. Corp.* precluded estate representatives from bringing state law claims on the grounds that the claims were preempted, it appears from the face of the decisions in those cases that the courts may have been able to reach the same result without resorting to preemption analysis. Because an estate representative may only assert state law creditor claims under the standing temporarily granted him under Section 544(b), to the extent that the state law claims the estate representatives in *In re Hechinger* and *In re Contemp. Indus. Corp.* purported to assert outside of their Section 544(b) power were properly characterized as creditor claims, they lacked standing to do so.

[30] None of Defendants' other bankruptcy preemption cases even involve the preemptive effect of Section 546(e). *See In re Gen. Motors Corp.*, 407 B.R. 463, 515 (Bankr. S.D.N.Y. 2009), *aff'd by* 430 B.R. 65 (S.D.N.Y. 2010) (state franchise laws preempted by Section 365); *In re Old Carco LLC*, 406 B.R. 180, 199-200 (Bankr. S.D.N.Y. 2009) (state dealer statutes preempted by Section 365); *Astor Holdings v. Roski*, 325 F. Supp. 2d 251, 262-63 (S.D.N.Y. 2003) (state-law claims for bad faith bankruptcy filings preempted, because remedies for misuse of Code are governed exclusively by the Code); *Simmons v. Roundup Funding, LLC*, No. 08 Civ. 6263, 2009 WL 3049586, at *4 (S.D.N.Y. Sept. 23, 2009) (state law claims for filing fraudulent proof of claim preempted), *aff'd in part and vacated in part on other grounds*, 622 F.3d 93 (2d Cir. 2010); *Diamante v. Solomon & Solomon, P.C.*, No. 99 Civ. 1339, 2001 WL 1217226, at *3 (N.D.N.Y. Sept. 18, 2001) (state law claims for violation of discharge injunction

regard to Section 546(e)—partially carving out for protection certain markets from a trustee invested with the federal avoidance powers—is simply not implicated where claims are asserted by a plaintiff that does not even possess those powers. There is therefore no support for the notion that conflict preemption applies here.

(b) Defendants' Expansive Approach to "Preemption" Should Be Rejected.

Moreover, for multiple reasons, the Court should decline Defendants' invitation to use "preemption" as a means to more sweepingly realize their favored purpose—absolute "market protection"—in contravention of the choices that Congress has already made.

First, Defendants assert that "the market-protection policies underlying Section 546(e) are no less at issue today," *see* Brief at 35, but the fact that a policy concern motivating the enactment of Section 546(e) could have motivated Congress to enact other hypothetical provisions that it did not in fact enact—a more aggressive version of Section 546(e) that did not carve out intentional fraud cases under Section 548(a)(1)(A), an amendment to Section 524 that released third party transferees involved in the transactions described in Section 546(e), *see* p.35, *infra*, a free-standing statutory provision outside the Bankruptcy Code that barred creditor class

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preempted); *Bessette v. Avco Fin. Servs.*, 230 F.3d 439, 447 (1st Cir. 2000) (state unjust enrichment claims brought as remedy for abuses involving coercive reaffirmance of discharged debt preempted where alternative federal remedy is available under Section 105 of the Code.); *Perez v. Campbell*, 402 U.S. 637, 649-51 (1971) (discharge provisions in Code preempted state statute suspending drivers license for non-payment of discharged judgment); *Stolz v. Brattleboro Hous. Auth. (In re Stolz)*, 315 F.3d 80, 87, 92-94 (2d Cir. 2002) (Code's bar against bankruptcy-discrimination prohibited enforcement of state-law eviction remedies for non-payment of discharged rent); *E. Equip. & Servs. Corp.*, 236 F.3d 117, 120 (2d Cir. 2001) (state law claims for violation of automatic bankruptcy stay preempted); *MSR Exploration, Ltd. v. Meridian Oil, Inc.*, 74 F.3d 910, 913-16 (9th Cir. 1996) (state law claim that defendants engaged in malicious prosecution in Chapter 11 proceedings preempted). Moreover, those few that concern the avoidance powers (none involve Section 546(e)) all involve a situation where the plaintiff is concurrently exercising the federal avoidance powers. *See Pereira v. United Jersey Bank, N.A.*, 201 B.R. 644, 677 (S.D.N.Y. 1996) (state law setoff actions stayed pending resolution of Trustee's preference claims); *In re Flagstaff Foodservice Corp.*, 56 B.R. 899, 908-09 (Bankr. S.D.N.Y. 1986) (creditor fraud claim to recover goods from debtor preempted by Section 546(c)); *In re Hecht*, 41 B.R. 701, 706 (Bankr. S.D.N.Y. 1984) (state law governing creditor setoff rights preempted by Section 553(b) to the extent of conflict); *Smith v. Am. Founders Fin., Corp.*, 365 B.R. 647, 675-79 (S.D. Tex. 2007) (Section 546(a) limitations period preempted state-law fraudulent-transfer statute of repose).

actions involving securities transaction—should not be used as a license to experiment, under the rubric of "preemption," with various alternative approaches to realizing those policy objectives, at variance with the plain language of Section 546(e). That would be not preemption, but judicial legislation. *See Madeira*, 469 F.3d at 238 (conflict preemption is to be strictly construed); *Wimbush v. Wyeth*, 619 F.3d 632, 643 (6th Cir. 2010) ("Conflict preemption analysis should be narrow and precise, to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role.") (internal citations omitted).[31]

Second, although Defendants focus on certain "market-protection" policies behind Section 546(e), it is clear that Congress was faced, in enacting that section, with striking a balance between competing policy interests, market protection on the one hand and creditor recovery on the other. *See, e.g., QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 738 (W.D. Mich. 2007), *aff'd by* 571 F.3d 545 (6th Cir. 2009), *cert. denied* 130 S Ct. 1141 (2010) (noting the tension between provisions intended to avoid disruption to securities markets and the avoidance provisions of the Bankruptcy Code). Again, Congress carved out intentional fraud cases under Section 548(a)(1)(A), and did not choose to enact a release of these third party transferees, *see* p.35, *infra*. The doctrine of "preemption" should not be used to select, from amongst the multiple policy objectives of Congress here at issue, the policy objective favoring Defendants and then give that particular objective a more aggressive implementation than Congress itself saw fit, to the detriment of the other critical objectives such as protecting the rights of creditors.

[31] Indeed, Defendants fail to specify when, precisely, the concern about even the generic "ripple effect" they describe should lead a court to bar the assertion of a fraudulent transfer claim. For example, if following a trustee's election not to pursue state law claims, a single creditor took up its claim, there would be no ripple effect from that suit. Moreover, where intentionally fraudulent conduct provides a basis for a Section 548(a)(1)(A) claim, a fraudulent transfer action may be asserted despite any ripple effect. Defendants present no guidance as to when the "ripple effect" should require a holding of preemption and when it should not. Fortunately, the institution best suited to make such a policy judgment has already done so: the decision of Congress was only to partially limit the federal avoidance powers, not to wholly limit them or to release third party transferees.

The careful balance that Congress actually chose to strike, enacting a partial limitation upon the federal avoidance powers, must be allowed to stand.

Third, the utter fallacy of Defendants' position is underscored by the collision course on which it sets Section 546(e), on the one hand, and Section 524(e), tenets of statutory interpretation, settled decisional law concerning non-debtor releases, and the terms of the Plan, on the other hand. To begin with, Section 524(e) of the Code provides that third parties are not released from liability by the discharge granted to the debtor. *See* 11 U.S.C. § 524(e). As such, the recipient of a fraudulent transfer is not immunized from the claims of the transferor's defrauded creditors by its transferor's bankruptcy discharge. *See Kathy B. Enters., Inc. v. U.S.*, 779 F.2d 1413, 1415 (9th Cir. 1986) (holding Section 524(e) did not affect creditor's claims against non-debtor recipient of fraudulent transfer); *Rountree v. Nunnery, et al. (In re Rountree)*, No. 01-21480-SCS, Adv. No. 09-07057-SCS, 2011 WL 806193, at *22 (Bankr. E.D. Va. March 2, 2011) (discharge of debtor did not affect liability of debtor's co-defendants in fraudulent transfer action); *In re Boynewicz*, 2002 WL 33951315, at *2 n.5 (noting transferor's bankruptcy proceedings would not extinguish creditor claims against non-debtor recipient of fraudulent transfer); *Power Equities, Inc. v. Altas Telecom Services-USA, Inc.*, No. 3:06-CV-1892-G, 2007 WL 43843, at *2 (N.D. Tex. Jan. 5, 2007) (denying motion to dismiss state law fraudulent conveyance claim of alleged recipient of fraudulent transfer where motion was based on transferor having obtained relief in bankruptcy and concluding, after "thorough analysis," that the law did not support defendants position); *J.P. Castagna v. Castagna*, CV 920523960, 1995 Conn. Super. LEXIS 1097, at *8 (Conn. Super. Ct., April 7, 1995) (holding that, because of the limited scope of Section 524(e), transferor's bankruptcy discharge did not bar creditor's fraudulent transfer action against non-debtor transferee).

Certain limited exceptions to Section 524(e)'s general prohibition are provided by the Code. *See* 11 U.S.C. § 524(g) (providing for limited exception in chapter 11 cases involving asbestos claims); 11 U.S.C. § 524(e) (creating a limited spousal exception for claims related to community property, as contemplated by Section 524(a)(3)); *see also* 11 U.S.C. §§ 1201 and 1301 (providing a stay of actions against certain non-debtors, but only in Chapter 12 and Chapter 13 proceedings, respectively). Where a statute specifically provides for exceptions or limitations to a general prohibition, a court should not readily read into the statute additional, implied exceptions or limitations. *See Andrus v. Glover Constr. Co*., 446 U.S. 608, 616-17 (U.S. 1980) ("Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent."); *Copeland by & Through Copeland v. Toyota Motor Sales U.S.A*., 136 F.3d 1249, 1257 (10th Cir. 1998) (declining to read additional equitable exceptions into statutory subrogation rights); *see also* Norman J. Singer, 2A Sutherland's Statutes and Statutory Construction § 47.11 (5th ed. 1992) (stating that "exceptions are not to be implied. Where there is an express exception, it comprises the only limitation on the operation of the statute and no other exceptions will be implied"). Therefore, it should be presumed that except for non-debtor claims to which the foregoing enumerated exceptions to Section 524(e) are applicable, claims against non-debtors are not discharged or released by the bankruptcy filing or discharge of a debtor.

Recognizing that the outstanding exposure of certain non-debtors for liabilities related to a discharged debtor can interfere with the successful reorganization of corporate debtors, bankruptcy courts will consider and allow third party releases to be incorporated in a plan even where none of Sections 524(a)(3), 524(g), 1201 or 1301 are applicable – but only in the most compelling and unusual circumstances. As explained by the Second Circuit in *Deutsche Bank*

AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.), 416 F.3d 136, 141 (2d Cir. 2005), a non-debtor release in a plan of reorganization is improper absent the finding that "truly unusual circumstances render the release terms important to success of the plan . . . ." *See also In re Motors Liquidation Co.*, No. 09-50026 (REG), 2011 Bankr. LEXIS 684, *64-65 (Bankr. S.D.N.Y. Mar. 7, 2011) (where circumstances identified by Second Circuit are not present, "third-party releases can't be found to be appropriate."); *In re Adelphia Communs. Corp.*, 368 B.R. 140, 266 (Bankr. S.D.N.Y. 2007) (Gerber, J.), *aff'd by* 544 F.3d 420 (2d Cir. 2008) (noting "increasingly stringent" standards for a bankruptcy court's exercise of its powers to approve third party releases).[32] Furthermore, inquiry into the need for such releases should focus on whether the estate received substantial consideration (financial and non-financial) from the releasee;[33] the enjoined claims were "channeled" to a settlement fund rather than extinguished; the enjoined claims would indirectly impact the debtor's reorganization by way of indemnity or contribution; the plan otherwise provided for the full payment of the

[32] Other Circuits are in accord or impose even higher barriers to plan-created third-party releases. *See Applewood Chair Co. v. Three Rivers Planning & Dev. Dist. (In re Applewood Chair Co.)*, 203 F.3d 914, 918-19 (5th Cir. 2000) (reiterating that third party releases were "beyond the statutory grant of the Code" and declining to extend prior ruling, where third party release was allowed to stand under principles of res judicata); *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000) (third party releases only permissible when supported by "fairness, necessity to the reorganization, and specific factual findings to support these conclusions"). *But see Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995), *cert. denied*, 517 U.S. 1243 (1996) (holding that, without exception, "[Section] 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors.") (citation omitted); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592, 600 (10th Cir. 1990), *op. modified on other grounds sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991) (holding that third party releases violate Section 524(e)). *See also Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195, 2207 (2009) (noting that Congress specifically provided for third party releases in asbestos cases through Section 524(g), but declining, under principles of res judicata, to consider the propriety of a third party release granted outside of that context).

[33] But, it should be noted that the "consideration" provided must be more than what is simply compromised in the normal "give and take" plan negotiation process. *See In re Adelphia Communs. Corp.*, 368 B.R. at 268-69 ("The 'give-ups' that parties made were of rights to recover that were subject to fair debate. In the case of creditors, even those that are Settling Parties, they were merely striking the kinds of deals with respect to their shares of the pie that chapter 11 contemplates. I don't doubt that in this case the Settling Parties engaged, as the Plan Proponents argue, in 'tireless efforts' to come together to work out a global compromise aimed at resolving these cases. But that's not unique. It's something creditors have to do in every chapter 11 case, at the risk of destroying themselves (or their recoveries in the case) with their own quests for incremental recoveries."); *Cartalemi v. Karta Corp. (In re Karta Corp.)*, 342 B.R. 45, 55 (S.D.N.Y. 2006) ("[T]he mere fact of financial contribution by a non-debtor cannot be enough to trigger the right to a *Metromedia/Drexel* release.").

enjoined claims; and/or there is an identity of interest, *see In re Adelphia Communs. Corp*., 368 B.R. at 267. Significant to a court's consideration of a proposed plan-provided third party release is creditor support of the plan in which the provisions are set forth. *Metromedia*, 416 F. 3d at 142; *see also In re Charter Communs.*, 419 B.R. 221, 259 (Bankr. S.D.N.Y. 2009) (creditors approved release). Moreover, a court's approval of third party releases must be supported by detailed findings and evidence. *See Metromedia*, 416 F.3d at 143.

Here, the Plan unambiguously did not contemplate a release of the Defendants; instead, the Plan provided that control over the Creditor Claims would be relinquished, and the creditors in turn would contribute them to the Creditor Trust. *See* Plan, § 5.8. Moreover, the releases Defendants (via their preemption argument) would, *post hac*, foist onto these proceedings satisfy none of the requirements for permissible third party releases. Rather than creditor support for a release of the Creditor Claims, there was overwhelming support for the Plan, which specifically provided the Creditor Claims would be pursued against the Defendants.[34] Defendants have not provided financial and/or non-financial consideration warranting a release of the Creditor Claims. And, there is no identity of interest between Defendants and the Debtors. Moreover, if Defendants are, *arguendo*, successful, the claims would be extinguished completely, while creditors receive less then full recovery on their claims. Finally, there were no findings or evidence presented at the confirmation hearing to support a release of the Creditor Claims under the Plan (that the record would be devoid in this respect is not surprising in that the Plan contemplates the pursuit, rather than release, of the Creditor Claims).

[34] The provisions in the Plan providing for the creation of the Creditors Trust followed a contested Rule 9019 proceeding wherein the Committee objected to the proposed settlement of claims asserted by the Committee under its *STN* authority against certain financing party defendants. The Creditor Trust provisions were not included in the Second Amended Plan of Reorganization. But, the provisions were intentionally added to, and a critical part of, the Plan subsequently presented to the Court. And their inclusion in the Settlement and the Plan confirmed by this Court was a necessary component to the ultimate resolution of LBI's chapter 11 proceedings.

Stated simply, the release of the Creditor Claims (through the subterfuge of "preemption") would be contrary to the provisions of the Bankruptcy Code, binding precedent and the unambiguous provisions of the Plan approved by this Court. Moreover, the "preemption" Defendants seek here would forcibly engraft onto the Plan (and indeed, make part of every bankruptcy proceeding (under any chapter of the Bankruptcy Code) in which third party creditors possess their own avoidance claims against non-debtor parties to financial contracts) a sweeping discharge of liability not contemplated by Congress. Such a result cannot be countenanced, and absent Congressional legislation, providing the result Defendants seek is impermissible.

* * *

Ultimately, notwithstanding Defendants' policy arguments, the fundamental fact is that the purpose of Congress was not to extinguish all state law fraudulent transfer claims concerning the matters described in Section 546(e) upon the filing of a bankruptcy petition. The purpose of Congress was to limit the federal avoidance powers. The federal avoidance powers are not at issue in this action, which asserted creditor state law claims in a Complaint filed initially in New York State Supreme Court. The claims are not preempted.

C. Defendants' Complaints About the Plan and Confirmation Order Are Without Effect.

Finally, Defendants complain that the Plan and Confirmation Order entered by this Court, pursuant to which the Debtors relinquished their right to pursue the Creditor Claims and the creditor trust beneficiaries were "deemed to have transferred, assigned, and delivered to the Creditor Trust, without recourse, all of their respective rights, title, and interests in and to the [Creditor Claims]," *see* April 23, 2010 Order ¶ 28; *see also* Plan Section 5.8(b), was in relevant part a "contrivance" intended to "circumvent the Bankruptcy Code," and a "brazen machination

seeking to evade Congress's will." Brief at 2, 26. Defendants appear to articulate two concrete arguments (aside from the preemption argument addressed above): (i) the Creditor Trustee cannot satisfy Section 554(a), governing the "abandonment" of property of the estate and (ii) the fact that a former counsel to the Committee was appointed trustee of the Creditors' Trust thwarts Congressional intent. These arguments are meritless.

First, there is no question of the propriety of the Debtors' relinquishment of the Creditor Claims. The Creditor Claims could only have been released by the Plan with court approval, and they were not. The Debtors' discontinuance of the state law avoidance claims being prosecuted by the Committee was a critical part of a carefully-negotiated settlement of the Debtors' 9019 Motion.[35] This settlement was then incorporated in the Plan. *See* April 23, 2010 Order. The Confirmation Order was entered and became effective after notice and hearing among the stakeholders and became effective, *inter alia*, when no appeal was filed. Defendants fail to provide any legal authority whatsoever in support of vacating the Confirmation Order. *See* Fed. R. Civ. P. 60; *c.f.* 11 U.S.C. § 1127 (modification of plan by proponent); *In re Rickel & Assocs., Inc.*, 260 B.R. 673, 677 (Bankr. S.D.N.Y. 2001) (post-confirmation modification of a plan may occur only before the plan is substantially consummated); *Resolution Trust Corp. v. Best Prods. Co.*, 177 B.R. 791, 802 (S.D.N.Y. 1995), *aff'd by* 68 F.3d 26 (2d Cir. 1995) (plan may be modified only where circumstances warrant and would not be modified where plan was consummated and provision was integral to Plan). Their complaints about the Order are therefore without effect.

[35] The Court observed in the context of the Rule 9019 Motion that the Debtors' "exit from bankruptcy has been forestalled by monstrous inter-creditor disputes which have come close to exceeding if they did not, in fact, exceed those I encountered in the Chapter 11 cases of Adelphia Communications Corporation described at 368 B.R. 140, Chapter 11 case that I then described as among the most challenging and contentious in bankruptcy history." Mar. 11, 2010 Hearing Tr. 131:3-11.

Second, Defendants' characterizations of the Creditors Trust as an illegitimate "contrivance" are empty rhetoric. *See* Brief at 2, 23, 33-34. As set forth above, Courts have for decades recognized the right of a bankruptcy trustee to elect not to pursue a claim, as well as the viability of a state law action following such election; the point is not controversial. *See* Part I, *supra*. The claims at issue were never the property of the Debtors' estate, *see* Part I, *supra*, and the Debtors did not as a technical matter need to satisfy the "abandonment of property" elements set forth in Section 554(a). All that was required for the Creditor Claims to be pursued post-confirmation was for them not to be extinguished or released by the Plan. *See* Plan, Section 5.8(b).[36]

Third, the appointment of a former Committee counsel as Trustee of the Creditors Trust does not undermine in any respect Congressional intent. Throughout much of their brief, through deliberately sloppy use of the term "Trustee," Defendants seek to obscure the fact that the Creditors Trust, the LB Litigation Trust and the Committee are entirely different entities created at different times with different roles and powers.[37] They acknowledge the different entities, however, insofar as necessary to insinuate that the appointment of a former Committee counsel as trustee of the Creditor Trust defeats Congressional intent. *See* Brief at 26 (complaining that the claims were "transferred right back to the Trustee . . . who simply switched

[36] The Plan provides, in relevant part, that the Creditor Claims "shall be discontinued by the Debtors without prejudice and the Debtors shall be deemed to have abandoned, pursuant to Section 554 of the Bankruptcy Code, any and all right to further pursue the [Creditor Claims]." *See* Plan § 5.7(b), 5.8(b). For the reasons set forth above, the reference to Section 554 is arguably superfluous and the Debtors' clear statement of relinquishment of the right to pursue the claims is sufficient without recourse to an examination of the elements of Section 554(a). To the extent that compliance with Section 554 were somehow relevant, however, it would have been satisfied here as it was reasonable to conclude that the Debtors found the prosecution of the claims "burdensome to the estate" or of inconsequential value and benefit to the estate." *See* 11 U.S.C. § 554(a). Again, however, the point is moot as the relinquishment has already occurred and Defendants provide no authority for the notion that the Plan should be re-opened or the Order vacated.

[37] For example, through ambiguous use of the term "Trustee", Defendants nonsensically contend that the Creditors Trustee made certain allegations in the Committee Action and that under the Creditors Trustee's "own theory of the case" certain Lenders were not defrauded. *See* Brief at 48.

hats from Committee counsel to Trustee of the Creditor Trust").[38] Aside from the use of dismissive characterizations, however, Defendants present no basis for their assertion that the appointment of former Committee counsel as Creditor Trustee subverts Congressional intent in any respect.

* * *

Ultimately, all of Defendants' unseemly and misplaced rhetoric about "contrivances," "brazen machinations," and "stratagems" are based upon the premise that Section 546(e) preempts these claims. As set forth above, that premise is false. Defendants' complaints therefore amount to no more than misplaced rhetoric. Section 546(e) does not preempt these claims and there was nothing improper about the Plan.

D. Section 546(e) Does Not Cover Transfers of the Nature At Issue Here.

Because Section 546(e) does not preempt the Creditor Claims, there is no need for the Court to address the question of whether its language concerns the types of transfers here at issue and the Court need not even reach the issue, briefed at length by Defendants, whether Section 546(e) even applies to the transfer at issue here. Since federal preemption does not apply, Section 546(e) is simply irrelevant and is not available as a statutory defense.

While Section 546(e) has no application to state law avoidance claims, if, *arguendo*, it did, the Creditor Trustee submits that the Court should find that Section 546(e) does not apply to the transfers here because, for the reasons set forth in the Litigation Trustee's papers in opposition to various defendants' motions for summary judgment in the Committee Action, the payments were neither "settlement payments" nor payments "in connection with a securities contract" and were not made by or to a financial institution. *See* Committee Opp. to D&O

[38] Defendants state that "the creditors were not given any right under the Plan to retain the claim for themselves." Brief at 26. But the creditors had notice and multiple opportunities to object and no creditor objected to the Plan.

Summary Judgment Motion at 6-25 [Adv. Pro. Docket No. 224]; Committee Opp. to Financing Party Defendants' Motion to Dismiss at 10-16 [Adv. Pro. Docket No. 130]; Committee Opp. to Nell Motion for Summary Judgment at 12-31 [Adv. Pro. Docket No. 226].[39]

II. <u>The Complaint Alleges Transfers of Property of the Debtors to Defendants.</u>

Defendants incorrectly argue that Plaintiff's fraudulent conveyance claims "fail as a matter of law" because they seek to avoid transfers of funds that "merely passed through the Debtors from the Lenders to the beneficial holders of the Lyondell stock and never became property of any Debtor."[40] Brief at 35-38. Defendants attempt to shoehorn the facts of this case into completely inapt "trust property," "mere conduit" and "earmarking" cases. The Defendants' argument rests on the following facially erroneous assumption, quoted at page 41 of Defendants' brief: "In short, the transfers of cash from the Lenders through the Paying Agent to the Lyondell shareholders did not involve the Debtors' own, pre-existing assets and hence did not cause any injury to the Debtors' creditors." In fact, the transfers at issue directly "involved" the "Debtors' own pre-existing assets" which were pledged as collateral for the Lenders' loans, the proceeds of which were distributed to shareholders, thereby financially disabling the Debtors and inflicting injury directly on the Debtors' creditors, whose claims, as a consequence, could not be paid.

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[39] Since the Litigation Trustee's briefs were filed, courts in this District have issued decisions in *In re Enron Creditors Recovery Corp.*, 422 B.R. 423, (S.D.N.Y. 2009) and *In re Refco*, No. 07 MDL 1902 GEL, 2009 WL 7242548, *adopted by* 07 MDL No. 1902 (JSR) 2010 WL 5129072 (S.D.N.Y. Jan. 12, 2010), that adopt broad readings of the term "settlement payments." The transactions at issue in those cases were different than that here, a transfer between a corporation and its shareholders in the context of an LBO. *See In re Enron Creditors Recovery Corp.*, 422 B.R. 423 (redemption and retirement of debt instruments); *In re Refco*, 2009 WL 7242548 (tender offer for shares of a separate corporate entity that were alleged to be of "little or no value"). The Second Circuit has not yet ruled upon the issue and the Creditor Trustee submits, should the Court find it necessary to reach the issue—which it should not—that the Court adopt the position advanced by the Litigation Trustee for the reasons set forth in his papers, or defer a decision pending a potential ruling on the issue by the Second Circuit in the appeal of the Enron decision, *In re Enron Creditors Recovery Corp.*, No. 09-5122-bk (2d Cir.). The appeal is fully briefed and oral argument was held on November 3, 2010.

[40] Even though Plaintiff asserts claims arising exclusively under state law, Defendants' arguments draw primarily on bankruptcy law. *See* Def. Motion at pp. 35-42. The Creditor Trustee reserves all rights to further address any similar arguments the Defendants may make under state law.

Under either New York law or Texas fraudulent transfer and conveyance law, the Complaint in fact adequately states claims for both constructive and intentional fraudulent conveyance.[41] Under New York state law, although constructive and intentional fraudulent transfers have different elements, both causes of action require the plaintiff to establish a "conveyance" made by a debtor. *See* N.Y. Debtor & Creditor Law, §§ 273-276. A "conveyance" is defined as including "every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or incumbrance [*sic*]." *Id.* at § 270. Similar to New York law, Texas state law requires (for both constructive and intentional fraudulent transfer claims) that the plaintiff establish that a transfer by the debtor has occurred. *See* Texas Uniform Fraudulent Transfer Act, Tex. Bus. & Com. Code § 24.001, *et. seq.* The word "transfer" is defined as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." *Id.* at § 24.002(12). "Asset" is in turn defined as "property of a debtor," and "property" is defined as "anything that may be the subject of ownership." *Id.* at § 24.002(2), (10).

Here, under either New York or Texas law, the Complaint has alleged a "conveyance" or "transfer" by a debtor. The allegations of the Complaint include that the Debtors were the legal borrowers under the Facilities, that their substantial assets were pledged to secure the borrowings under those Facilities and that the property transferred was the proceeds of these borrowings.

[41] Although Plaintiff believes that either Texas law or New York law applies, it submits that, under the New York choice of law rules that govern here, because there are no material differences in the basic legal standards on this point, the Court need not decide, at this juncture, between the two. *See Dibbern v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.)*, 325 B.R. 89, 108 (Bankr. S.D.N.Y. 2005), *aff'd in part and rev'd in part on other grounds*, 331 B.R. 93 (S.D.N.Y. 2005) (holding that New York choice-of-law rules apply to state law claims); *Wells v. Shearson Lehman/American Express, Inc.*, 72 N.Y.2d 11, 18, 526 N.E.2d 8, 12, 530 N.Y.S.2d 517, 521 (N.Y. 1988) (where same result would be reached under laws in two different jurisdictions, need not apply conflict of law principles to choose between them).

Compl. at ¶¶ 12, 398-400, 401. As discussed below, these allegations, together with other allegations in the Complaint negating any possible inference that third parties, rather than the Debtors, were responsible for and controlled the property transferred in the Shareholder Transfers, are more than sufficient to plead the property interest of Debtors for the purposes of the claims asserted.

Defendants' argument that the Debtors had no property interest in the Merger Consideration rests entirely on the existence in the Credit Agreement of a "use of proceeds" provision pursuant to which the borrowers under the Credit Agreement committed to use the Facilities Proceeds "solely to finance the Transaction." Brief at 39-40, citing Credit Agreement 5.19 (the "**Use of Proceeds Provision**"). It is on the basis of the Use of Proceeds Provision, and this contractual provision alone, that Defendants argue that the Complaint may be dismissed for failure to allege that property of any of the Debtors was transferred to the Shareholders. Brief at 39-40 (arguing that "the Lyondell Debtors did not have discretion" to use the Facilities Proceeds, citing the Use of Proceeds Provision). According to Defendants, based on the Use of Proceeds Provision, none of the Debtors had "control" or "discretion" over the proceeds. Defendants argue, in essence, that the Use of Proceeds Provision divested the Debtors of any property interest in the proceeds of the Facilities. Moreover, it is apparently Defendants' contention that, based on the Use of Proceeds Provision, the Facilities Proceeds can only be deemed to constitute the property of the Lenders themselves since, according to Defendants, the Lenders controlled the disposition of the Facilities Proceeds. Brief at 40. However, this conclusion, although the logical extension of Defendants arguments, is not explicitly stated. Assuming, *arguendo*, that the Court may consider the terms of the Credit Agreement on this motion to dismiss, the Use of Proceeds Provision is hardly dispositive of the Defendants' contention that none of the Debtors

had a property interest in the $12.5 billion of loan proceeds drawn under the Facilities to pay Lyondell shareholders. *See* Compl. at ¶¶ 12, 397, 401 (alleging that the Shareholder Transfers were funded from the Facilities). Not surprisingly, Defendants disregard all relevant authority (discussed below) in making this argument, citing instead to an abundance of authority—most of it of no or only marginal relevance—as purportedly supporting their position.

More importantly, although they cite many cases, Defendants do not cite a single case involving the application of fraudulent transfer law to leveraged transactions, such as the one at issue here.[42] Yet, as Defendants are well aware, courts, including those of this Circuit and this District, routinely use collapsing to analyze transactions such as the LBO at issue in this case. As demonstrated below, many courts in considering leveraged transactions have treated the transfer of the proceeds of loans leveraged against the target's assets as transfers of property of the target and collapsing doctrine entirely refutes Defendants' argument that no property is transferred by a debtor that is the target of a leveraged acquisition, such as the Merger at issue in this case. Brief at 42.

A. Under a Collapsing Analysis, the Target Has a Property <u>Interest in Proceeds Borrowed Against its Assets.</u>

Although collapsing has a variety of implications, the consequence that is relevant to (and disposes of) Defendants' motion is the collapsing of the two basic value transferring transactions

[42] The absence of relevant authority from Defendants brief is not because it does not exist or because Defendants are not fully aware of it. As this Court is aware, in the *Blavatnik Action*, a separate litigation trust established pursuant to Lyondell's plan of reorganization, is pursuing estate claims arising under the Bankruptcy Code against Lyondell's directors, officers, and other insiders that received compensation pursuant to the Merger. Defendants in that case also made arguments directed to the supposed insufficiency of the plaintiff's fraudulent conveyance claims and urged the Court to conclude certain transfers were technically transfers by certain Basell entities. Plaintiff in the *Blavatnik* Action argued in opposition that the collapsing doctrine applied, such that the Court should conclude that the payments constituted transfers of Lyondell's interest in property. Defendants here have in fact cited the opposition brief filed by the plaintiff in the *Blavatnik* Action in their Memorandum of Law, *see* Brief. at 40 n.23. Yet, despite the fact that the sufficiency of the pleadings in this case cannot be property assessed without taking collapsing doctrine into account, Defendants have willfully chosen to ignore this body of law. Accordingly, to the extent that, on reply, Defendants raise new arguments based on collapsing theory, Plaintiff reserves the right to respond to such new arguments in a surreply.

that generally define an LBO: (i) the transfer of the value of the debtor's assets to financing parties in the form of liens securing acquisition financing, and (ii) the transfer to stockholders of the proceeds of these secured financings. Upon collapsing, these two transfers are treated as a method of withdrawing the equity that exists in the debtor's property, transferring it beyond the reach of the debtor's unsecured creditors, and replacing it with debt. *See, e.g., Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 646 (3d Cir. 1991) ("The effect of an LBO is that a corporation's shareholders are replaced by secured creditors. Put simply, stockholders' equity is supplanted by corporate debt."); *FDIC v. Conte*, 204 A.D.2d 845, 846, 612 N.Y.S.2d 261, 262 (N.Y. App. Div. 3d Dep't 1994) (noting that transfer of loan proceeds derived from debtor's mortgage financing "appears to have been a contrivance designed to withdraw some of the equity from the [debtors'] home and place it beyond the reach of their creditors"). Collapsing is routinely used in the analysis of LBOs as fraudulent transfers and, as has been observed by the Second Circuit, "finds its most frequent application to lenders who have financed leveraged buyouts of companies that subsequently become insolvent," *HBE Leasing Corp. v. Frank*, 48 F.3d 623 (2d Cir. 1995). However, while collapsing is perhaps more frequently used to explain why a target has not received reasonably equivalent value in exchange for the secured obligations it has incurred to finance the acquisition of its stock by an acquirer, as the cases describe below demonstrate, collapsing is no less applicable to an analysis of the transfer of the proceeds of acquisition financing to shareholders.

Defendants' argument that the estates of the Debtors were not diminished by the transfer of the Facilities Proceeds to shareholders "because the Debtors would not have received the funds in the first place," Brief at 42, disingenuously ignores that the Facilities Proceeds represented the value of Lyondell, which having been pledged to the Lenders, was, following the

Merger, no longer available to satisfy the claims of unsecured creditors. Again and again, courts have applied collapsing to leveraged buyouts and concluded that the transfer of a company's equity to its shareholders through its incurrence of liens on its property constitutes a transfer of the company's interest in property.

Thus, for example, in *Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488, 503 (N.D. Ill. 1988), *on recons. in part, on other grounds*, 1989 WL 18112 (N.D. Ill. 1989), the buyer formed a corporation (WSI) solely for the purpose of acquiring the target. WSI borrowed the necessary funds through the grant of liens on the assets of the target (Wieboldt, the debtor). *Id.* Upon receipt of Wieboldt shares, WSI directly transferred to the tendering shareholders the price for their shares, using borrowed funds. Wieboldt never received or controlled the borrowed funds, nor was it formally or technically the transferor. The court found that, for the purpose of both plaintiffs' actual and constructive fraudulent transfer claims for recovery of shareholder payments, "the controlling and insider shareholders of Wieboldt [were] *direct transferees of Wieboldt property.*"[43] *Id.*

Similarly, in *In re Norstan Apparel Shops, Inc.*, 367 B.R. 68 (Bankr. E.D.N.Y. 2007), Norstan (the target/debtor) granted liens on its assets to lenders, and the lenders transferred loan proceeds directly to the debtor's shareholders. *Id.* at 73. The complaint also alleged that the defendants received the sale proceeds from the LBO and that Norstan did not receive anything in exchange for the encumbrance of all of its previously unencumbered assets. Although the court did not engage in an analysis of the target/debtor's property interest in the payments made to the

[43] The Plaintiff notes that, due to application of a collapsing standard that is slightly different than that applicable in the Second Circuit, the *Wieboldt* court refused to collapse payments made to some shareholders. However, in the Second Circuit, the plaintiff need only show a transferee's "actual or constructive knowledge of the entire scheme that renders her exchange with the debtor fraudulent." *HBE Leasing Corp.* 48 F.3d at 635. The Defendants have not contended (nor could they) that the Second Circuit's standard for collapsing is not met here on a motion to dismiss standard.

defendants, the former shareholders of the debtor, by denying the defendants' motion to dismiss the fraudulent transfer claim asserted on behalf of the debtor, the court implicitly held the transfer to the debtor's shareholders of the proceeds of the LBO financing was a transfer by the debtor of its property.[44]

Another case reflecting the same approach is *OODC, LLC v. Majestic Mgmt.*, 321 B.R. 128 (Bankr. Del. 2005). In *Majestic Management*, the targets (referred to in the opinion as the "**Selling Companies**") granted liens on their assets to the lenders and the lenders transferred loan proceeds to the Selling Companies, which then conveyed them to the Selling Companies' shareholders. *Id.* at 134. Pursuant to the LBO, another entity (the debtor) assumed certain liabilities of the Selling Companies. *Id.* at 133. The defendants in that case (including shareholders)[45] moved to dismiss, making a similar argument to the Defendants' "the Debtors would not have received the funds in the first place" argument here, and contending that the complaint should have been dismissed because "the ultimate effect of undoing the transaction is to put the Debtor back where it began: with nothing." *See id.* at 139. The court rejected the defendants' argument, explaining that, "[t]he effect of collapsing theory is to look at the series of transactions as a whole," and that undoing the transaction would "leave the Selling Companies and their creditors where they began, with all their assets and without the secured debt." *Id.* The court further explained that, from the perspective of unsecured creditors of the Selling

[44] Other courts, like *Norstand*, while not expressly addressing the property interest question, have implicitly also recognized the ability of a debtor, upon a failed LBO, to disgorge loan proceeds transferred to shareholders. For example, in *Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Group (In re Hechinger Inv. Co. of Del., Inc.)*, 274 B.R. 71, 75 (D. Del. 2002) debtors sought the avoidance of shareholder payments made in connection with a reverse triangular merger. The court recognized both that "the vast majority of courts now agree that extending fraudulent conveyance provisions to LBO transactions is proper" and that the defendants in fact did "not dispute that the [plaintiff] has pled a prima facie case for fraudulent transfer. As discussed *supra*, the *Hechinger* court found that the claims against the shareholders, which were asserted by a bankruptcy committee vested with the standing under the Code, were precluded by Section 546(e).

[45] *See*, *e.g.*, Defendant Larry D. Large's Motion to Dismiss, or Alternatively, Motion for More Definite Statement, *Roesner v. Majestic Mgmt., Inc.*, 321 B.R. 128 (Bankr. Del. 2005) (Adv. Pro. No. 03-58583).

Companies (which creditors then became unsecured creditors of the debtor), the effect of the transaction was "to transfer assets of the Selling Companies to the [d]ebtor and to impose $40 million additional secured debt on the enterprise." *Id.* The court held that because the trustee had alleged facts that, if true, justified the collapsing of all of the transactions, the trustee had stated causes of action against *all* of the defendants, including the shareholders that received transfers from the non-debtor selling companies. *Id.* at 145.

Another case in the asset sale LBO context, *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787 (7th Cir. 2009), further demonstrates the principle that the surviving company in an LBO has causes of action against shareholders, notwithstanding that the payments to shareholders were funded with loans. In *Boyer*, the funds used to make payments to stockholders were obtained by the debtor's borrowing against the assets acquired from the target–borrowing that resulted in the debtor becoming undercapitalized and ultimately filing for bankruptcy. The court collapsed the transactions pursuant to which the target had been acquired and affirmed the judgment ordering the payments to shareholders be disgorged. *Id.* at 798. In finding that even the portion of the payment to shareholders that was technically paid by the pre-merger target was avoidable, the *Boyer* court found it compelling that the payment essentially "drained [the operation] of cash--all unbeknownst to the corporation's present and future unsecured creditors." *Id.* at 796.

In yet another LBO case, *Crowthers McCall Pattern, Inc. v. Lewis*, 129 B.R. 992 (S.D.N.Y. 1991) (Lasker, J.), the target/debtor (Crowthers) granted liens on its assets to lenders, who then transferred loan proceeds to the buyer's merger subsidiary, which in turn transferred proceeds to shareholders. *Id.* at 1001. The Court, in considering a breach of fiduciary action against directors that approved an LBO, concluded that, upon collapsing,

payments made to shareholders by the merger subsidiary could be characterized as, in substance, having been made by the debtor, where the payments were funded with the $35 million in debt assumed by the debtor. *See id.* (quoting *Wieboldt* for proposition that "the effect of the payment of cash from HCFS [the lender which financed the tender offer] to the shareholders was to transfer Wieboldt assets to Wieboldt shareholders").

Here, just as in *Wieboldt*, *Norstan*, *Majestic Management*, *Boyer* and *Crowthers*, the Debtors granted liens on their assets, the proceeds of which were ultimately received by shareholders of the target. This series of transfers resulted in the Debtors transferring an interest in their property to the Defendants. In each of these cases, the transfers to the shareholders were treated as transfers of property of the debtor – in each case the entity whose assets had been encumbered.

Defendants argue that Plaintiff is attempting to "have it both ways" and is precluded from asserting any property interest in the Facilities Proceeds, because the Committee argued that the Debtors ultimately obtained no actual economic benefits from the Facilities Proceeds. *See* Brief at 41. This argument apparently refers to another application of the collapsing doctrine, whereby a debtor that incurs an obligation in exchange for loan proceeds may argue that it did not receive reasonably equivalent value, notwithstanding its receipt of loan proceeds, if the loan proceeds were immediately conveyed to another party in a second related transaction for no value. *See HBE Leasing Corp.*, 48 F.3d at 635. The finding, however, that the immediate conveyance of the borrowed funds results in the obligation being potentially avoidable as a constructively fraudulent conveyance, does not preclude the avoidance of the subsequent conveyance as against the transferee as either constructively or actually fraudulent. *See Boyer*, 587 F.3d at 797 (affirming avoidance of obligations and disgorgement of payments to shareholders, holding that

the combined remedies would not result in a windfall); *see also Norstan*, 367 B.R. at 84 (considering claims against shareholders for disgorgement of payments received in LBO, even after lenders had already settled with plaintiff on claims for avoidance of obligations, and holding that shareholder defendants would not be subject to risk of incurring double, multiple or otherwise inconsistent obligations). Rather, each leg of the collapsed transaction is viewed from the perspective of the creditors of the debtor. *OODC,* 321 B.R at 139.

Indeed, in *HBE Leasing*, the leading case on this collapsing doctrine in the Second Circuit, the court held that a debtor has alternative remedies against both the party holding the debtor's obligation and the party that received the loan proceeds of that obligation. *See id.* at 640 (discussing avoidable payments to attorneys and noting that "[i]f the Petitioners establish on remand that the transfer to the Attorneys was fraudulent, they may recover this property from [the lender] or (if it is shown that the Attorneys had actual or constructive knowledge of the fraudulent scheme) from the Attorneys"). Although an unjustified double recovery would result if a plaintiff could both fully avoid its obligations and fully recover its transfers of the loan proceeds to third parties, that will not occur here. *Id.* (noting that, based on principles of joint and several liability, if mortgage were voided, judgment against transferees receiving loan proceeds must be reduced by an equivalent amount); *see also Boyer*, 587 F.3d at 797; *Norstan*, 367 B.R. at 84. The case cited above are consistent with the observation by Barry Zaretsky, the court-appointed examiner in *In re Revco D.S. Inc.*, that, although the plaintiff "is not entitled to a double recovery," it "could recover partially from the [lenders] and partially from the selling shareholders as long as the recovery does not exceed a single satisfaction." *In re Revco D.S., Inc.*, 118 B.R. 468, 477 (Bankr. N.D. Ohio 1990).

Thus, Defendants are incorrect when they argue that the creditors the Plaintiff represents have already been compensated for the harm done to them in the Merger. General unsecured creditors of the Debtors received $450 million in consideration of their claims against the Lenders, leaving billions of dollars of claims unsatisfied. The case law is clear that a plaintiff may pursue both claims simultaneously and where, as here, obligations have effectively only been partially avoided, a plaintiff may pursue judgment for the remainder from other defendants. *See id.*; *see also Norstan*, 367 B.R. at 84 (considering claims against shareholders, after plaintiff settled with banks).

B. Even Apart From Collapsing Analysis, the Complaint Sufficiently Alleges the Property Interests of the Debtors in the Merger Financing Proceeds.

(a) Legal Borrowers, Not Lenders Are the Presumed Owners of the Facilities Proceeds

The Complaint alleges that multiple Debtors were borrowers under the Merger Facilities. It further alleges that the proceeds of the Merger Facilities were used to make payment to the stockholders of Lyondell. For the purposes of a motion to dismiss, such allegations are sufficient to plead that the Debtors transferred an interest in property to the Lyondell stockholders. This is so because a borrower is presumed to have a property interest in the proceeds of its borrowings. *See Smyth v. Kaufman*, 114 F.2d 40, 43 (2d Cir. 1940) (concluding that loan proceeds were debtor's property, regardless of whether they passed through the debtor); *Smith v. Boyer*, 966 F.2d 1527, 1533(7th Cir. 1992) ("[T]ransfers by a debtor of borrowed funds constitute transfers of the debtor's property."); *Bash v. Sun Trust Banks, Inc. (In re Ohio Bus. Machs.),* Case No. 06-8005, 2007 Bankr. LEXIS 133, *18 (B.A.P. 6th Cir. Jan. 25, 2007), *aff'd* 2008 U.S. App. LEXIS 17100 (6th Cir. 2008) (concluding that "[b]ecause the transfer to the [defendant] was made with funds that had been loaned to [the debtor], there was a transfer of property of the debtor.").

(b) Case Law Emphasizes that Control

is an Inherently Factual Inquiry

Although Defendants urge dismissal on the pleadings based on their assertion that the Debtors had no control over the Facilities Proceeds, courts undertaking a control analysis to determine a debtor's interest in property emphasize that such analyses are fact intensive. Application of the control test requires courts to "look beyond the particular transfers in question to the entire circumstance of the transactions." *Nordberg v. Sanchez (In re Chase & Sanborn Corp.)*, 813 F.2d 1177, 1181-82 (11th Cir. 1987) (where transfer was part of a complex scheme instigated by the sole stockholder of an indirect parent of the debtor to make a transfer to a non-creditor, finding that the debtor, lacked a property interest in funds that were flowed through its account). Moreover, control analysis "requires courts to step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable." *Kapita v. Espirito Santo Bank (In re Bankest Capital Corp.)*, 374 B.R. 333, 342 (Bankr. S.D. Fla. 2007), cited by Defendants (quoting *Nordberg v. Sanchez (In re Chase & Sanborn Corp.),* 848 F.2d 1198, 1178-82 (11th Cir. 1988). Such analyses are not confined to or necessarily determined by the terms of debt instruments and credit agreements.

As noted in *(In re Bankest Capital Corp.*, a court will examine the power to designate who will receive funds and the power to disburse the funds to that party. Beyond such inquiries, courts analyzing control over property will also examine whose interests are "primarily served by the challenged transaction." *Id*. at 339. And, [w]here the transaction primarily serves the interests of the debtor, courts generally find a transfer of "property of the debtor." *Id.* (citing cases). Not surprisingly, most cases requiring a control analysis are not decided on the pleadings, but on full factual record . *See Tolz v. Barnett Bank (In re Safe-T-Brake)*, 162 B.R. 359, 353(Bankr. S.D. Fla 1993) (observing that control issue was "inherently fact based" and explaining that the determination in that issue required an evidentiary hearing in connection with

cross motions for summary judgment). Thus, for example, in *In re Eerie World Entertainment, LLC*, Case No. 00-13708 (ALG), 2006 WL 1288578 (Bankr. S.D.N.Y. April 28, 2006) (cited by Defendants), Judge Gropper denied the motion for summary judgment of an alleged transferee of a fraudulent conveyance where the funds had been deposited with the debtor for the purpose of being channeled through the debtor for payment to the defendants. Assuming, without deciding, that an "earmarking" defense could be asserted to a fraudulent transfer action, the court found that an affidavit of the party who had deposited the funds to be funneled through the corporation left "a fair justifiable issue as to control."

Those cases cited by Defendants in which control issues were decided on the pleadings do not involve facts remotely analogous to those present here. For example, Defendants cite to *In re Refco Secs. Litig.*, Case No. 07-MDL-1902 (GEL), 2009 WL 7242548, at *15 (S.D.N.Y. Nov. 13, 2009), a Special Master recommendation, in which the Special Master addressed the issue of whether the debtor, Suffolk Funds ("**Suffolk**"), was a mere conduit of loans made to it by Refco, the proceeds of loans which had then been transferred to certain defendants. The complaint alleged that Suffolk's sole purpose as a corporate entity was to purchase shares of an investment fund using the loan supplied by Refco, that Suffolk was prohibited from engaging in any other business, that Suffolk's principal asset was a letter of credit allowing it to draw upon the loan from Refco and that the sole permitted uses of funds loaned to it was for the purchase of shares of a specified investment adviser. Based on these allegations as well as other facts indicating that Suffolk was nothing but a "paper intermediary," the Special Master recommended that the plaintiff be required to replead.[46] Brief at 39 n.22. Obviously since Lyondell, LBI and

[46] The plaintiff did replead, as Defendants note, with success (although only as to the property interest issue; the complaint was dismissed on other grounds). Specifically, the plaintiff subsequently alleged that Suffolk's principals "coerced" or "blackmailed" Refco into providing the loan. *See Miller v. PF Saleco LLC (In re Refco)*, No. 09 Civ. 2866 (S.D.N.Y. Aug. 26, 2010) (Report and Recommendation of Special Master), at 16), *adopted*, 2010 WL

many of the other Debtors in this case were at all relevant times, real substantial businesses (and not "paper intermediaries" being used as vehicles in transaction animated by the interests of others)[47] the Special Master's recommendations regarding Suffolk's claim are manifestly irrelevant to the viability of the Complaint. Indeed, the only fair construction of the Complaint is that the transaction was primarily animated by the interests of the Debtors' respective managements and stockholders, not those of the Lenders. The Debtors controlled their own assets and chose to grant liens on those assets in order to enable the Merger; the Lenders would not have funded the Merger had the Debtors not made the decision to allow the use of their assets to obtain the Facilities Proceeds.

Defendants' myopic focus on the Use of Proceeds Provision as supposedly dispositive of the issue of identity of the parties who had control over Facilities Proceeds fails to consider, as is required for application of control analysis, the entire circumstance of the transactions and the interests of the Debtors in the transactions. *See 3V Capital Master Fund Ltd. v. Official Comm. of Unsecured Creditors of TOUSA, Inc. (In re TOUSA, Inc.)*, Case No. 10-60017, at *85 (S.D. Fla. Feb. 11, 2011) (the "**TOUSA District Court Opinion**") 2011 U.S. Dist. LEXIS 14019, at *88, (reversing trial court where court failed to consider "entire circumstances of the transactions," which demonstrated that primary borrower, rather than subsidiary guarantors, had property interest in funds).[48] The mere fact that the Debtors contractually committed with the

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5158115, at *1 (S.D.N.Y Dec. 14, 2010). Defendants' observation that "in contrast," this case does not involve allegations of coercion or blackmail, Brief at 39, no. 22, is beside the point; far more significant, this case does not involve debtors that are paper intermediaries.

[47] Defendants themselves recognize elsewhere in their brief that Lyondell and Basell were not mere "fictitious or dummy companies," and indeed implicitly acknowledge that Lyondell and Basell at one point had control over the cash proceeds ultimately paid to the Defendants. *See* Brief at p. 59 (contending that "[t]here was . . . no use of fictitious or dummy companies in the Merger" and that "neither Lyondell nor Basell *retained* any control over the cash proceeds paid to the Defendants after the Merger closed") (emphasis added).

[48] Overturning the decision of the bankruptcy court in *Official Comm. of Unsecured Creditors of TOUSA, Inc. v. Citicorp N. Am., Inc. (In re TOUSA, Inc.)*, 422 B.R. 783 (Bankr. S.D. Fla. 2009), the District Court found that

Lenders to the use of the Facilities Proceeds "solely to finance the Transaction," Credit Agreement § 5.19, does not change that fact that the Debtors chose enter into "the Transaction" and all that was contemplated thereby (including the Shareholder Transfers in the amount of over $12 billion) in the first instance. Nor does such contractual commitment change the fact that "the Transaction" was primarily animated by the interests of the Debtors, not of the Lenders.[49] At all relevant times, the Debtors controlled the disposition of their own assets. Exercising this control, they chose to enter into the Credit Agreement and to grant liens to the Lenders in order to obtain the Facilities Proceeds. Accordingly, Defendants' assertions that the Debtors did not control the Shareholder Transfers must be rejected.

C. Cases Involving the "Trust Fund" and "Earmarking" Doctrines Are Irrelevant.

The trust fund and earmarking doctrines invoked by Defendants are irrelevant.

1. Trust Fund Cases are Irrelevant to the Sufficiency of the Complaint.

Citing to *Begier v. I.R.S.*, 496 U.S. 53, 59 (1990) and Section 541(d) of the Bankruptcy Code, Defendants invoke the "trust fund" doctrine pursuant to which property held by the debtor at the commencement of the bankruptcy case may not be deemed to be property of the debtor to

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certain subsidiaries did not have control over, and therefore did not have a property interest in the proceeds of borrowings secured by their assets. *TOUSA District Court Opinion*, 2011 U.S. Dist. LEXIS 14019, at *88. The court found that the proceeds were the property of the corporate parent. *Id.* ("the property involved did belong to someone, *i.e.*, [the corporate parent], who, as the primary borrower, was the only party with actual authority under the New Loan documents to control the loan proceeds' distribution"). Although the district court recognized that the relevant credit facilities contained provisions describing the use of the proceeds, no consideration was given by the district court to the notion advanced by the Defendants here -- that *none* of the borrowers had an interest in the proceeds of the borrowings. *Id.* (noting that documentation of New Loans "specif[ied] that proceeds were to be used in satisfying the Transeastern Settlement"). Highlighting the fact-intensive nature of the inquiry, the District Court quoted from hearing testimony by an officer of the corporate parent that it was a "corporate decision" to use the proceeds to pay the Transeastern Settlement and further noted that the New Loan proceeds were not used to pay any debt of the subsidiaries. *Id.* at *88-89. *Tousa*, which did not involve an LBO, did not address the property interests of an entity in funds borrowed against its own assets to redeem or acquire stock form shareholders.

[49] For this reason, Defendants are incorrect that the Plaintiff is required to that the Debtors coerced the Lenders into providing the Facilities. *See* Brief at 39 n.22. The Debtors' property interest in the Facilities Proceeds arises from their interest in its assets that were pledged to fund the Facilities Proceeds, not from any coercion of another entity.

the extent that such property is being held by the debtor for another party. However, in each of these cases, the debtor's sole claim to the subject funds was that those funds had at some point been "held" by or titled to the debtor. Thus, in *Begier*, the Supreme Court rejected an argument that funds in the debtor's account, but which the debtor held in trust for the Internal Revenue Service, were property of the estate. Similarly, in *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 277 F.3d 838 (6th Cir. 2002), the Sixth Circuit held that funds held by the debtor pursuant to an express trust for clients were not property of the estate. *Id.* at 851.[50] Here, however, the issue is not whether property "held" by the Debtors is, notwithstanding such fact, the property of some other party based on such other party's equitable or legal rights to that property. As discussed *supra*, the Debtors' property interest in the Facilities Proceeds used to make the Shareholder Transfers is not based solely on the Debtors having held Facilities Proceeds in a particular account, but because the Facilities Proceeds were obtained through the leveraging of the Debtors' assets for the purposes of transfers purposefully made to complete transactions in which the Debtors chose to participate. The "trust fund" cases are beside the point.

While Defendants argue that these and other cases have a "common theme" that the debtor is a "pass through or mere conduit where the debtor lacks discretion regarding how it may use the property at issue," *see* Brief at 37, the fact that a "common theme" is discernable in

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[50] *See also City of Springfield v. Ostrander (In re Lan Tamers, Inc.)*, 329 F.3d 204, 210 (1st Cir. 2003) (where federal funding program required that firm funded by program was to receive funds by conduit through debtor, debtor lacked property interest in funds); *In re Joliet-Will Cnty. Cmty. Action Agency*, 847 F.2d 430, 432-33 (7th Cir. 1988) (court concluded that grants made to debtor as custodian were not property of debtor's estate); *Dzikowski v. NASD Regulation, Inc. (In re Scanlon)* 239 F.3d 1195, 1198 (11th Cir. 2001) (funds held by debtor in escrow account for benefit of third party not property of estate); *T&B Scottdale Contractors, Inc. v. United States*, 866 F.2d 1372 (11th Cir. 1989) (court concluded that funds in a checking account, opened in a subcontractor's name, but through which the contractor would write checks, were property of the subcontractor's estate); *In re Chase & Sanborn Corp.*, 813 F.2d at 1182 (debtor had no property interest in funds where they only briefly passed through debtor's account); *Branch v. Hill, Holliday, Connors, Cosmopoulos, Inc. Advert. (In re Bank of New England Corp.)*, 165 B.R. 972, 978 (Bankr. D. Mass. 1994) (debtor received funds from its subsidiaries for the specific purpose of paying creditor of subsidiaries).

bankruptcy jurisprudence regarding a wide variety of disparate legal issues is not a basis upon which to argue for the dismissal of the Complaint. The allegations of the Complaint more than sufficiently demonstrate that the Debtors had an interest in the Shareholders Transfers.

2. Earmarking Has No Application Here.

Defendants next turn, through an argument made in a footnote, to the earmarking doctrine, implying that the earmarking doctrine supports their argument that the Debtors did not have a property interest in the Facilities Proceeds used to make the Shareholder Payments.[51]

The earmarking doctrine is invoked (typically in cases involving preferential transfers) where a debtor obtains a new loan "earmarked" for repayment of an old loan. In such circumstances, where the incurrence of new debt and the payment of the old debt are a wash for the debtor, the debtor cannot avoid the payment to the old lender as a preference. *See generally United States Lines (S.A.), Inc. v. United States (In re McLean Indus., Inc.)*, 162 B.R. 410, 420 (S.D.N.Y. 1993), *rev. on other grounds*, 30 F.3d 385 (2d Cir. 1994). In arguing that this doctrine applies here, however, Defendants have chosen to ignore that the earmarking defense is not available to the extent that a debtor offers its own property as collateral for the new loan. In such cases, the transfer of the loan proceeds is indisputably a transfer of the debtor's interest in property. *See Cadle Co. v. Mangan (In re Flanagan)*, 503 F.3d 171, 184-85 (2d Cir. 2007) (affirming bankruptcy court holding that debtor could avoid earmarked loan payment to the extent that the new lender encumbered debtor's property to enable the payment). Here, as discussed *supra*, the incurrence of obligations under the Facilities and the simultaneous payment of Facilities Proceeds to shareholders were not a wash for the Debtors, but rather resulted in

[51] *See Rowley v. City of New York,* No. 00 Civ. 1793 (DB), 2005 WL 2429514, at *6 (S.D.N.Y. Sept. 30, 2005) (collecting cases and noting that "mere mention in a footnote does not amount to raising an argument"); *Halo Tech Holdings, Inc. v. Cooper*, Civ. No. 3:07-CV-489 (AHN), 2008 U.S. Dist. LEXIS 24831, *59-60 (D. Conn. March 27, 2008) (refusing to dismiss claim on grounds asserted in footnote and concluding argument was "not properly before the court"). Even if this Court does consider the argument, it should be rejected.

transferring the Debtors' value to Lyondell's shareholders. Stated in terms of the value transfer analysis of the court in *Mellon Bank*, quoted *supra*, the borrowings under the Facilities to the extent used for the Shareholder Transfers did not result in the replacement of new debt for old debt, but rather supplanted stockholders' equity with new debt. *See Mellon Bank*, 945 F.2d at 646; *see also FDIC v. Conte*, 204 A.D.2d 845, 845, 612 N.Y.S.2d 261, 262 (N.Y. App. Div. 3d Dep't 1994) (noting that transfer of loan proceeds derived from debtor's mortgage financing "appears to have been a contrivance designed to withdraw some of the equity from the [debtors'] home and place it beyond the reach of their creditors"). Unwinding the transaction in these circumstances is therefore necessary to place the Debtors in the position they were in prior to the Merger. *See OODC,* 321 B.R. at 139 (applying collapsing theory and noting that undoing the transaction would "leave the [target] and [its] creditors where they began, with all their assets and without the secured debt").

Quite notably, other than *Cadle*, none of the cases cited by Defendants on the earmarking defense involved a debtor using loan proceeds from a *secured* loan to make the challenged payment. *Cf. In re Kelton Motors*, 97 F.3d 22, 25 (2d Cir. 1996); *In re Eerie World Entm't LLC*, 2006 WL 1288578, at *6; *Northen v. Cetennial Healthcare Corp. (In re Oxford Health Investors, LLC)*, No. 00-80676C-7D, 2002 WL 31031631, at *7 (Bankr. M.D.N.C. Sept. 3, 2002); *Kapila v. Espirito Santo Bank (In re Bankest Capital Corp.)*, 374 B.R. at 342. Moreover, as noted above, in *Cadle*, the court actually held that "[t]o the extent that the debtor offered its own property as collateral for the [loan], the debtor transferred an interest in its property and therefore the earmarking defense is not available." *Cadle*, 503 F.3d at 184.

III. <u>Defendants' "Standing" Arguments Are Not Cause For Dismissal</u>

Defendants argue that that the Lenders ratified the Merger through their conduct, and a that Plaintiff, to the extent the Plaintiff's claims include claims assigned by the Lenders, has no

"standing" to bring claims "on their behalf." This argument fails to state a grounds for dismissal of the pleadings, or any part of them, for two reasons.[52]

First, ratification is an affirmative defense to a claim, not a defect in "standing." *See Banque Arabe Et Internationale D'Investissement v. Maryland Nat. Bank*, 850 F. Supp. 1199, 1213 (S.D.N.Y. 1994), aff'd 57 F.3d 146 (2d Cir. 1995) (describing ratification as an affirmative defense upon which defendant bears burden of proof). Thus, Defendants' challenge on their motions to dismiss to "standing" the Trustee to seek all the damages requested is in fact an effort to reach the merits of claims being asserted by Plaintiff (but, as discussed below, only to the extent asserted in this action on behalf of one of three groups of Creditor Trust Beneficiaries—the Lenders). The merits of these Lender claims are not relevant to the Plaintiff's "standing"—only to the ultimate ability of Plaintiff to recover with respect to these claims on behalf of the Lenders. *See Flintkote Co. v. Gen. Acc. Assur. Co.*. 410 F. Supp. 2d 875, 884 (N.D. Cal. 2006). ("The fact that defendant has an affirmative defense which may undermine liability . . . is irrelevant to the question of plaintiff's standing to litigate issues prefatory to establishing ultimate liability. Thus, the plaintiff has standing"). As an affirmative defense, the issue of ratification can only be decided on a motion to dismiss if the defense "is obvious from the pleadings and papers before the court." *Landau v. American Int'l Grp.*, C.A. No. 97 Civ 3465, 1997 U.S. Dist. LEXIS 14325 at *9 (S.D.N.Y. Sept. 17, 1997). "[U]nless the relevant facts are undisputed, the question of ratification is one for the jury." *In re Nigeria Charter Flights*

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[52] Defendants preface their ratification argument with the statement that "it is well settled in this Circuit that a bankruptcy trustee lacks standing to bring avoidance claims under either Section 544 or 548 of the Bankruptcy Code where no benefit will accrue to uninvolved creditors of the debtor." Brief at 44. This statement seems to be a deliberate effort at obfuscation. First, Plaintiff does not, as Defendants are well aware, bring these claims as a "bankruptcy trustee" under either of the two Code sections mentioned but rather by assignment to the LB Creditor Trust of Creditor Claims. Thus, isues such as the presence of a "triggering creditor" are not relevant. Second, as Defendants do not even argue that there are not "uninvolved creditors" who would be able to benefit from the avoidance actions being pursued, even by its own terms, the Defendants' argument is pointless on a motion to dismiss.

Contract Litig., 520 F. Supp. 2d 447, 466 (E.D.N.Y. 2007).). Notably, the vast majority of the cases cited by Defendants were not decided on motions to dismiss.[53]

Ratification is not easily established. *See The Atrium v. Kenwin Shops of Crockett, Inc.,* 666 S.W.2d 315, 318 (Tex. App. 1984)("[w]hen a defendant moves for summary judgment on the basis of an affirmative defense, he must conclusively prove all essential elements of that defense. . . . This burden is particularly onerous in the case of waiver and ratification. . . . [Ratification] hinges on a question of intent." Recently, in *Adelphia Recovery Trust v. HBSC Bank USA, N.A.*, C.A. No. 09-0799, 2011 U.S. App. LEXIS 2380 (2d Cir. Feb. 8, 2011), the Second Circuit, reiterated the importance of establishing a knowing intent to ratify disagreeing with the districts court's conclusion that a creditor's conduct at a sale hearing supported a finding that it had ratified a sale price. *See HSBC Bank USA, N.A. v. Adelphia Commc'ns Corp.*, No. 07 Civ 553A, 2009 WL 385474 (W.D.N.Y. Fed. 12, 2009) (cited by Defendants). Furthermore, Defendants generally assert that the Lenders, as a whole, ratified the transaction, making no effort to distinguish among them. Each Lender's level of knowledge is an issue of fact unsuitable for a motion to dismiss.

Second, even assuming *arguendo* that Lenders ratified the transactions that Plaintiff seeks to avoid on their behalf and even assuming that such ratification is "obvious" from the pleadings —contentions rejected by Plaintiff—Defendants leave unsaid what they would have this Court do at this juncture in the proceedings. As Defendants acknowledge, Plaintiff seeks to recover not

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[53] *See Eberhard v. Marcu*, 530 F.3d 122 (2d Cir. 2008) (decided on appeal of bench trial); *Vintero Corp. v. Corporacion Venezolana de Fomento (In re Vintero Corp.)*, 735 F.2d 740 (2d Cir. 1984)(on appeal from grant of summary judgment); *Whiteford Plastics Co. v. Chase Nat'l Bank*, 179 F.2d 582 (2d Cir. 1950) (following the confirmation of a plan of arrangement, court held that creditor's security interest was not void and debtor did not have right to retain collateral); *HSBC Bank USA, N.A. v. Adelphia Commc'ns Corp.*, 2009 WL 385474, *6 (decided on appeal from summary judgment, and not on standing grounds); *In re Best Prods. Co.*, 168 B.R. 35 (Bankr. S.D.N.Y. 1994) (discussing remedies when approving settlement); *Harris v. Huff (In re Huff)*, 160 B.R. 256 (M.D. Ga. 1993) (after trial, holding that estate lacked standing because only triggering creditor had released its claims); *In QSI Holdings, Inc. v. Alford*, 382 B.R. 731 (W.D. Mich. 2007) (on appeal from summary judgment, holding that the Section 546(e) safe harbor provision prevented recovery of fraudulent transfers from shareholders).

solely on behalf of the Lenders, but also on behalf of trade creditors and bondholders holding approximately $2.4 billion of claims. Defendants do not argue that a ratification defense is available at all with respect to these other creditors, much less one that is apparent from the pleadings. Defendants even acknowledge that only "some portion" of the claims asserted on behalf of trade creditors and bondholders have been paid under the Plan—thereby acknowledging that "some portion" has not. Brief, at 47. This case is therefore quite different than the "standing" cases cited by Defendants; in each of those cases, *no* creditors existed that could have brought claims, and so the court dismissed claims brought by representatives of those creditors. *See Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 80, 83 n.3 (S.D.N.Y. 2008) (where subsidiary creditors were paid in full on confirmation, and had no claims to assign to litigation trust, trust had no standing to bring claims on their behalf); *Miller v. CFSB (In re Refco Secs. Litig.)*, C.A. No. 07 MDL 1902 GEL, 2009 WL 7242548 (S.D.N.Y. Nov. 13, 2009) (where no creditors of debtor existed other than creditor whose ratification of the fraudulent transaction was apparent from the complaint, trustee in bankruptcy had no standing to bring fraudulent transfer claim). Indeed, Defendants do not appear to challenge the "standing" of the Plaintiff independent of the assertion of the non-viability of the claims asserted on behalf of the Lenders.[54]

Since Defendants' "standing" argument, even if, *arguendo*, accepted by the Court, does not entitle Defendants to any relief, much less dismissal, it should simply be disregarded.

IV. Defendants Were Not "Mere Conduits"

A. The Financial Institution Defendants Have Failed To Demonstrate the Applicability of the "Mere Conduit" Defense.

[54] Defendants' assertion that the Lenders would be the primary beneficiaries of recovery in this action, *see* Brief at 13, is misguided, as the Lenders are not beneficiaries of the Creditor Trust at all (and are not entitled to receive any distributions) until other creditors have been paid in full. *See* Plan, § 5.8(b).

Defendants argue that the claims against certain financial institutions (the "Financial Institution Defendants") should be dismissed because these institutions did not obtain any benefit from transfers of Merger Consideration, but functioned instead as "mere conduits" that passed such transfers on to beneficial holders. *See* Brief at 42-44.[55] This argument fails for two reasons. First, the claims asserted against certain of the Financial Institution Defendants are not limited to those Shareholder Transfers received by them for further transfer to others, but also to include Shareholder Transfers received by the Financial Institution Defendants for their own benefit. Second, the Financial Institution Defendants are not entitled to assert a "mere conduit" defense because they must establish an evidentiary record, which is improper on a motion to dismiss, and which in any event, they have not done.

1. The Complaint Asserts a Fraudulent Transfer Claim Against the Financial Institution Defendants.

Defendants argue that the Financial Institution Defendants must be dismissed because the Plaintiff has "acknowledged" through his Complaint that they acted as mere conduits. Brief at 43. Citing the allegations against the transferees of certain Financial Institution Defendants, Defendants argue that the Plaintiff is only seeking to clawback money received by the transferees and not the Financial Institution Defendants. Brief at 43. This is simply not true. In a number of cases, the Plaintiff sued both (i) Financial Institution Defendants as transferees of Shareholder Transfers, and (ii) subsequent transferees of those Financial Institution Defendants who may also have received Shareholder Transfers. See, e.g., Complaint at ¶¶ 17-18. Nowhere does the Plaintiff acknowledge that such Financial Institution Defendants served as "mere conduits" for

[55] Several other Defendants have argued that the federal "mere conduit" rule applies under preemption principles. *See* Proskauer Memo at 17-18. While these defendants' view of preemption with regard to the "mere conduit" issue is misguided, it is irrelevant, as the same rule applies under federal, New York and Texas law.

their transferees.[56] To the contrary, the Complaint clearly alleges that these Financial Institution Defendants "held in several accounts . . . Lyondell stock and, as a result, received . . . Merger Consideration…." Id. If a Financial Institution Defendant received Merger Consideration on account of shares that it held in its own accounts, as the Complaint clearly alleges, it is not a "mere conduit." Because the Complaint asserts direct claims against certain Financial Institution Defendants as transferees of Merger Consideration received on account of any Lyondell shares they held at the time of the Merger, the Plaintiff has not "acknowledged" that these Financial Institution Defendants have a viable "mere conduit" defense.

2. A "Mere Conduit" Defense Cannot Be Assessed on a Motion to Dismiss.

In any case, Defendants cannot properly assert a "mere conduit" defense on a motion to dismiss. A "mere conduit" defense is an "equitable exception[]" to the status of the initial transferee under 11 U.S.C. § 550(a)(1).[57] *In re Maxwell Newspapers, Inc.*, 151 B.R. 63, 70 (Bankr. S.D.N.Y. 1993). As an "equitable exception," the burden is on the defendant to establish that it is entitled to assert this defense. *Jalbert v. Allpro Corp. (In re Left-Way Corp.)*, Case No. 07-10355, 2010 Bankr. LEXIS 216, at *2 (Bankr. D. Mass. Jan. 19, 2010). Courts have held that for a defendant to properly assert a "mere conduit" defense, the defendant must establish an evidentiary record that it "had no discretion or authority to do anything else but transmit the [transfer]." *Christy v. Alexander & Alexander of NY Inc.*, (In re Finley, Kumble, Wagner, Heine,

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[56] The Creditor Trustee has offered to dismiss claims asserted against any true "mere conduit" without prejudice and assert claims instead against the beneficial holder, upon such defendant's provision of discovery evidencing such facts. To date, the Creditor Trustee has dismissed five Defendants who have produced such discovery.

[57] Although there is virtually no Texas or New York state law cases involving the "mere conduit" defense in the creditor context, in fact, the contours of that test – the lack of discretion over the property at issue – were "derived from the seminal decision in *Carson v. Fed. Reserve Bank of New York*, 254 N.Y. 218 (1930)." *Hooker Atlanta Corp. v. Hocker (In re Hooker Invs., Inc.)*, 155 B.R. 332, 338 (Bankr. S.D.N.Y. 1993). Therefore, the Trustee's reliance on federal cases in this section in no way implies that federal law applies in this case, but rather, these cases are analogous to how a state court would likely rule on the "mere conduit" defense raised by the Defendants in this case.

Underberg, Manley, Myerson & Casey), 130 F.3d 52, 59 (2d Cir. 1997). Therefore, this Court and others have consistently held that a mere conduit defense cannot or should not be assessed on a motion to dismiss and is better left to summary judgment. *See The Global Crossing Estate Representative v. Alta Partners Holdings LDC, (In re Global Crossing Ltd.)*, 385 B.R. 52, 56 n.1 (Bankr. S.D.N.Y. 2008) (Gerber, J.) ("One defendant . . . asserts that it too was a mere conduit. If factually supported, such a defense might well have merit, but it is better addressed on summary judgment."); *Astropower Liquidating Trust v. Xantrex Tech., Inc., (In re Astropower Liquidating Trust)*, No. 04-10322, 2006 Bankr. LEXIS 685, at *4-*5 (Bankr. D. Del. Apr. 19, 2006) (Denying motion to dismiss based on "mere conduit" defense, because it is "an affirmative defense that is properly raised in a summary judgment motion but not in a Rule 12(b)(6) motion to dismiss."); *see also Eastern Retailers Serv. Corp. v. Wertheim Schroder & Co. (In re Ames Dep't Stores, Inc.*), 161 B.R. 87, 90 (Bankr. S.D.N.Y. 1993) (denying motion for summary judgment where record did "not provide enough information regarding whether [defendant] was a 'mere conduit' or an 'initial transferee.'").

In fact, Defendants in effect concede this point, as every case they cite granting dismissal upon the mere conduit defense was decided on a motion for summary judgment, not a motion to dismiss.[58] *See Christy v. Alexander & Alexander of NY Inc.*, 130 F.3d at 55; *Tese-Milner v. Moon (In re Moon)*, 385 B.R. 541 (Bankr. S.D.N.Y. 2008); *Geltzer v. D'Antona (In re Cassandra Group)*, 312 B.R. 491 (Bankr. S.D.N.Y. 2004); *Newsome v. Charter Bank Colonial*, 940 S.W.2d 157 (Tex. App. 1996); *Kaiser Steel Res. v. Jacobs (In re Kaiser Steel Corp.)*, 110 B.R. 514 (D. Colo. 1990), *aff'd*, 913 F.2d 846 (10th Cir. 1990). In each of these cases, the courts

[58] The one case that the Defendants cite that was decided on a motion to dismiss, *Securities Investor Protection Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293 (Bankr. S.D.N.Y. 1999), is not relevant here – defendant there sought dismissal based on a failure to plead fraud with particularity pursuant to Fed. R. Civ. P. 9(b) and the court found that the complaint failed to sufficiently plead a claim pursuant to 11 U.S.C. § 550(a). Here, the Complaint contains significant and detailed allegations demonstrating the fraudulent conduct that took place.

only granted the motions for summary judgment after the defendant established an evidentiary record that the "mere conduit" defense was applicable. *See id.*

Even if this Court were inclined to consider dismissal based on a "mere conduit" defense at this juncture, which it should not, Defendants have not even attempted to provide the Court with a basis for doing so. Defendants have not pointed to a single piece of evidence to establish that the Financial Institution Defendants acted as "mere conduits" in connection with the transactions at issue. Instead, their assertion of the defense relies solely on their misreading of the Complaint to assert that the Creditor Trustee is only really seeking to clawback transfers made to the transferees of the Financial Institution Defendants, rather than the Financial Institution Defendants themselves. As discussed above, the Complaint asserts claims for transfers made both to the Financial Institution Defendants, as well as their transferees. Accordingly, the Financial Institution Defendants have failed to meet their burden to establish their entitlement to "mere conduit" defense, and therefore, their attempt to seek dismissal on this ground should be rejected.

V. Actual Fraudulent Intent Is More Than Adequately Pled.

Defendants argue that Count Two must be dismissed because the Creditor Trustee has not adequately and with specificity pled actual fraudulent intent. *See* Brief at 49-59. This argument is frivolous.

First, Defendants' repetition of meritless arguments advanced by defendants in the Blavatnik Action and addressed at the hearing conducted on March 10, 2011, *see* Brief at 49-59, is unavailing. Because (i) the state law applicable here, like federal bankruptcy law, requires the pleading of "actual intent" to "hinder, delay or defraud" creditors, *see* Texas Bus. & Comm. Code, § 24.005; N.Y. Debt. & Cred. § 276; and (ii) the allegations of the Complaint regarding intent are for the purposes relevant here the same as those at issue in the Amended Complaint in

the Litigation Trust Action, the Creditor Trustee in the interests of efficiency incorporates by reference certain arguments advanced by the Litigation Trustee in the Litigation Trust Action. In particular, as set forth by the Litigation Trustee in his Opposition to the Motion to Dismiss Count 4 ("**LT Count Four Opp.**"):

- the misconduct of Smith and his inner circle is imputed to Lyondell under ordinary agency principles, *see* LT Count Four Opp. at 19;[59]

- the adequacy of fraudulent intent pleading should be assessed under the federal securities fraud scienter pleading standard, which is satisfied by the allegation of facts that either demonstrate that defendants had "motive and opportunity" to commit fraud or constitute strong circumstantial evidence of "conscious misbehavior or recklessness," *see* LT Count Four Opp. at 28-29;

- there is no question that the allegations at issue satisfy the "motive and opportunity" test, as the Complaint alleges that Smith, the Chairman and CEO of Lyondell, and his inner circle of senior Lyondell management used their corporate positions to manipulate earnings projections in order to induce Blavatnik to enter into the Merger Agreement and thereby reap concrete and personal benefits in the form of Change of Control Payments and other Merger Consideration, *see* LT Count Four Opp. at 29-31;

- there is no question that the allegations at issue satisfy the "recklessness" standard, as the Complaint alleges that Smith and his inner circle provided to Basell and the Lenders fabricated earning projections for the Houston refinery and Lyondell's EC&D divisions that they knew or should have know were misleading, disregarded internal procedures to reverse-engineer such projections, and knew or should have known that a capital structure that relied upon such projections was not viable, *see* LT Count Four Opp. at 31-34;

[59] Defendants, parroting an incorrect argument advanced by the Lyondell Director and officer Defendants in their reply papers in the *Blavatnik Action*, argue that "while the Complaint focuses on the alleged intent of Lyondell's CEO Dan Smith, applicable state law required that the Merger be approved by Lyondell's board of directors, not its management." Brief at 56. But as counsel for the Litigation Trustee explained at the March 10, 2011 argument, the misconduct of senior management of Lyondell, such as Lyondell CEO and Chairman Dan Smith and his inner circle of senior management, is imputed to Lyondell as a matter of law under ordinary agency imputation principles, *see, e.g.*, *In re James River Coal Co.*, 360 B.R. 139 (E.D. Va. 2007), *Albert v. Alex Brown*, No. Civ. A 762-N, Civ. A. 763-N, 2005 WL 2130607 (Del. Ch. Aug. 26, 2005), *Kirschner v. KPMG*, 15 N.Y.3d 446, 465-66 (Oct. 2010) ("As we explained long ago, a corporation is represented by its officers and agents, and their fraud in the course of the corporate dealings is in law the fraud of the corporation . . . . [W]here the conduct falls within the scope of the agents' authority, everything they know or do is imputed to their principals"), *FDIC v. Ernst & Young*, 967 F.2d 166, 170-171 (5th Cir. 1992) and (ii) there are in any case allegations in the Complaint concerning the knowledge of the outside members of the Board of Directors, for example that they should have known that the earnings projections upon which the Merger financial case was being based were unsupportable in light of prior projections that they had reviewed, *see* Compl. ¶ 323. *See also* Wissner-Gross Decl., Exh. E at 22:10, 45:12-47:5, 52:14-57:15, 69:5-70:3. In short, as demonstrated at the March 10, 2011 hearing, this argument lacks any merit.

- though pleading badges of fraud is not required, the Complaint also more than adequately pleads several badges of fraud, *see* LT Count Four Opp. at 28, 34-40;

- the principle that a transfer made with the knowledge that present or future creditors will be hindered or delayed as a result may be found to be intentionally fraudulent as to creditors, even where the primary purpose is not to harm creditors, is well-established and has been applied in the LBO context; *see* LT Count Four Opp. at 20-27; and

- the argument that allegations that Blavatnik and the Lenders put money at risk in a doomed enterprise are not plausible is unavailing, in light of allegations that, *inter alia,* (i) Lyondell management fabricated projections in order to deceive Blavatnik and the Lenders and secure their participation in the Merger, (ii) neither Blavatnik nor the Lenders had a means to break the deal without exposing themselves to enormous liabilities, (iii) the Lead Arrangers intended to shift the Merger financing risk off their books through syndication, and (iv) Blavatnik attempted to hedge his bets by drawing hundreds of millions of equity out of Basell in 2007 and requiring that $1.2 billion of Merger Consideration be used to pay his Toe-Hold position and refusing to contribute any cash to the deal structure, *see* LT Count 4 Opp. at 41-44. Indeed, notwithstanding Defendants' argument that sophisticated financial institutions would not take on risk in a doomed enterprise, as the Court observed during the plausibility argument at the March 10, 2011, the Litigation Trustee takes the position that the allegations of the Amended Complaint are that the institutions here had a plan to syndicate the risk, such that as the Court observed at the March 10, 2011 hearing, "this is kind of like the mortgage crisis, where you can dump the economic risk on somebody else." *See* Mar. 10, 2011 Hearing Tr. at 61:24-65:1. The Creditor Trustee takes the same position here.

Moreover, as set forth in the Litigation Trustee's Opposition to the Motion to Dismiss Count II ("**LT Count Two Opp.**"):

- under prevailing case law, the Merger and related transactions are collapsed, and all transfers of the Debtor's property[60] are thereby treated as transfers by the Debtor made with the intent of the Debtor, *see* LT Count Two Opp. at 18-24; and

- in any event, the Complaint sets forth allegations sufficient to infer that Blavatnik participated in the Merger with the requisite intent to defraud creditors such that his intent may be imputed to Basell entities, *see* LT Count Two Opp. at 24-30.[61]

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[60] For the reasons set forth in Part 1-A, *supra*, the transfers here at issue were of property of the Debtors, and Defendants' argument that the transfers at issue concern funds that Lyondell and Basell "would not have had . . . in the first place," *see* Brief at 57, is without merit.

[61] Although the Litigation Trustee's brief concerned in particular two Basell entities involved in the Toe-Hold transactions, the same argument applies more broadly to Basell entities involved in the Merger, as the Complaint

For these reasons, among others, the Complaint more than adequately satisfies the pleading standard for actual fraudulent intent.[62]

Second, Defendants' argument that to the extent New York law applies, the intentional fraudulent transfer claims must be dismissed because the Creditor Trustee has not alleged that the transferees have acted with fraudulent intent, *see* Brief at 50 n.28, is without merit. Through use of a "but see" citation, Defendants allow that there may be a split in this District as to whether under Section 276 a transferee's intent must in fact be pled along with a transferor's. *Id.* However, as a court in this District has made clear, this is not a "split" in which courts have reached differing conclusions on an open issue of law, but rather an error which, although later corrected by the mistaken court through publication of a corrected decision, has been repeated and cited without analysis:

> "The defendants point to a prior decision of this Court, *Gentry v. Kovler (In re Kovler)*, 249 B.R. 238 (Bankr. S.D.N.Y. 2000), *citations corrected*, 329 B.R. 17 (Bankr. S.D.N.Y. 2005), as authority that under N.Y. Debt. & Cred. Law § 276 a plaintiff must prove that both the transferor and the transferee acted with "actual intent." *Kovler's* statement of the law was corrected and updated in the 2005 citation above. The original *Kovler* decision is one of several cases which mistakenly suggest that under Section 276 a plaintiff must prove the malicious intent of both the transferor and the transferee (with some citing *Kovler* for that proposition). These cases are in direct conflict with governing decisions in this

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alleges that Blavatnik was the owner of Basell and its subsidiaries and used that control to cause Basell to acquire Lyondell. *See* Complaint ¶¶ 1, 5, 10, 210, 233, 234.

[62] Defendants argue that the more liberal version of the Rule 9(b) pleading standard that is applied to a bankruptcy trustee because he is an outsider to the transaction, *see Pereira v. Grecolas Ltd. (In re Saba Enters.)*, 421 B.R. 626, 640-41 (Bankr. S.D.N.Y. 2009), should not be applied here because the Creditor Trustee is in receipt of extensive discovery taken in the *Blavatnik Action*. *See* Brief at 51 n.29. This argument is beside the point, as the Creditor Trustee more than satisfies the ordinary Rule 9(b) pleading standard for the reasons set forth in this Section. However, as the revelation that hundreds of pages of Robert Salvin's handwritten notes containing key evidence documenting the reverse-engineering of Lyondell earnings projections was withheld during discovery and was not produced in the *Blavatnik Action* until days before Salvin's deposition and substantial other discovery further confirming the fraud was first obtained in discovery after the filing of this Complaint, *see* March 10, 2011 Hearing Tr. 44:14-45:10, again makes clear, the Creditor Trustee simply is not in the same position as an insider to the transaction. Moreover, in light of the voluminous additional discovery acquired, the Creditor Trustee currently intends, as noted above, to propose to file an amended complaint in this action before the hearing on this motion scheduled for May 12, 2011.

> Circuit holding that only the intent of the transferor is relevant under Section 276."

In re Bayou Group, 396 B.R. 810, 826 n.5 (Bankr. S.D.N.Y. 2008) (internal citations omitted), *rev'd in part on other grounds*, 439 B.R. 284 (S.D.N.Y. 2010). The *Kovler* decision, one of the two decisions in which the misstatement of law originated, issued a corrected decision in 2005 making clear that the mutuality of intent requirement applied only to recovery of attorney fees under Section 276-a. *See In re Kovler,* 329 B.R. 17, 18 (Bankr. S.D.N.Y. 2005). In the other decision relied upon for the misstatement of law, the attention paid to a transferee's intent was based upon Section 278, not Section 276, *see In re Corcoran*, 246 B.R. 152, 161 (E.D.N.Y. 2000).[63] With this confusion put aside, there is no question that under Section 276, it is the intent of the transferor that is dispositive. *See, e.g., Sharp Int'l,* 403 F.3d 43, 56 (2d Cir. 2005) ("[T]o prove actual fraud under § 276, a creditor must show intent to defraud on the part of the transferor.").

Third, Defendants' silly argument that the Creditor Trustee's intentional fraudulent conveyance claim is merely a constructive fraudulent conveyance in disguise, *see* Brief at 49, 54, is undone by a mere perusal of the allegations in the Complaint, all of which were based squarely upon the record developed in discovery in the *Blavatnik* Action. Defendants argue that "[t]he Trustee cannot plead a claim for intentional fraudulent transfer by alleging, at most, a case of constructive fraudulent transfer." Brief at 54. The Complaint in this action alleges a serious financial fraud that was perpetrated, resulting in billions of dollars of creditor losses. Defendants further note that intentional fraudulent transfer claims receive different treatment under the law

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[63] Subsequent to the decisions in *Kovler* and *Corcoran*, and notwithstanding the *Kovler* court's later correction of its error, certain federal courts in this District have issued decisions that simply adopted the incorrect analysis of those two cases. *See Gredd v. Bear, Stearns Sec. Corp. (In re Manhattan Inv. Fund Ltd.)*, 310 B.R. 500, 508 (Bankr. S.D.N.Y. 2002) (citing *In re Kovler* and *In re Corcoran*); *Picard v. Taylor (In re Park S. Sec., LLC)*, 326 B.R. 505, 517 (Bankr. S.D.N.Y. 2005) (citing *In re Manhattan Inv. Fund*); *Andrew Velez Constr. v. Consol. Edison Co. of N.Y. (In re Andrew Velez Constr.)*, 373 B.R. 262, 276 (Bankr. S.D.N.Y. 2007) (citing *In re Park S. Sec*).

than constructive fraudulent transfer claims, citing as an example the fact that Section 546(e) does not apply to intentional fraudulent transfer claims under Section 548(a)(1)(A). *Id.* at 54 n.31. But these observations about the different treatment of actual and constructive fraudulent transfer actions are beside the point. The law establishes a test to determine whether actual fraudulent intent has been adequately pled. As set forth above, that test is more than satisfied here. Nothing further is required.

CONCLUSION

For the foregoing reasons, Defendants' motions to dismiss should be denied. In the alternative, Plaintiff should be granted leave to replead.[64]

Dated: March 25, 2011
New York, NY

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[64] Rule 15(a) of the Federal Rules of Civil Procedure, applicable to adversary proceedings pursuant to Rule 7015 of the Federal Rules of Bankruptcy Procedure, provides that "when justice so requires," leave to amend should be "freely granted." *See* Fed. R. Civ. P. 15(a)(2). Under Rule 15(a), leave to amend a complaint should not be denied absent undue delay, bad faith, undue prejudice to the non-movant, or futility. *Foman v. Davis*, 371 U.S. 178, 182 (1962). Defendants cannot establish any of these grounds for denial. *See also Barr v. Charterhouse Grp. Int'l., Inc. (In re Everfresh Beverages, Inc.)*, 238 B.R. 558, 584 (Bankr. S.D.N.Y. 1999) (party opposing a motion for leave to amend has a "weighty burden") (quoting Fed. R. Civ. P. 15(a)); *Official Comm. of Unsecured Creditors v. JP Morgan Chase Bank, N.A. (In re M. Fabrikant & Sons, Inc.)*, 394 B.R. 721, 746-47 (Bankr. S.D.N.Y. 2008) (permitting leave to amend to correct two pleading deficiencies: (i) particularization of transfers that were contended to have been made with fraudulent intent; and (ii) pleading of facts necessary to support inference of transferees' actual or constructive knowledge of fraudulent scheme); *Angell v. First Eastern, LLC (In re Caremerica, Inc.)*, Adv. Pro. No. L-08-00157-8-JRL, 2009 Bankr. LEXIS 2331 (Bankr. E.D.N.C. July 28, 2009) (permitting leave to file second amended complaint and re-plead intentional and constructive fraudulent transfer claims).

Notably, the mere fact that discovery preceded the initial complaint "does not conclusively demonstrate undue delay and prejudice." *See e.g. Del Rosario v. New York City Dep't of Corr.*, 07 Civ. 2027, 2009 U.S. Dist. LEXIS 66018, at *2-*3 (S.D.N.Y. May 15, 2009) (Permitting amendment of complaint after fact discovery closed). Moreover, as set forth above, while the Complaint is more than adequate from a pleading perspective, the Creditor Trustee is in the process of amending the Complaint in this action, *inter alia*, to (i) incorporate additional factual detail regarding the fraud at Lyondell at (ii) add new defendants based upon discovery of beneficial holders obtained to date.