IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	)	Chapter 11
	)	
WASHINGTON MUTUAL, INC., *et al.*,[1]	)	Case No. 08-12229 (MFW)
	)	
	)	Jointly Administered
	)	
Debtors.	)	

JOINT MEMORANDUM OF LAW OF APPALOOSA MANAGEMENT L.P., CENTERBRIDGE PARTNERS, L.P. AND OWL CREEK ASSET MANAGEMENT, L.P. IN SUPPORT OF MOTION FOR LEAVE TO APPEAL FROM THE DECISION OF THE BANKRUPTCY COURT OR, ALTERNATIVELY, FOR ISSUANCE OF A WRIT OF MANDAMUS

Michael D. DeBaecke (DE No. 3186)
Victoria A. Guilfoyle (DE No. 5183)
BLANK ROME LLP
1201 North Market Street, Suite 800
Wilmington, Delaware 19801
(302) 425-6400

(Additional Counsel Listed on Signature Page)

Counsel for AOC

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[1] The Debtors in these Chapter 11 cases, along with the last four digits of each Debtor's federal tax identification numbers, are: (a) Washington Mutual, Inc. (3725); and (b) WMI Investment Corp. (5395). The Debtors' principal offices are located at 1301 Second Avenue, Seattle, Washington 98101.

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Pursuant to 28 U.S.C. § 158(a) and Rule 8003 of the Federal Rules of Bankruptcy Procedure, Appaloosa Management L.P. ("Appaloosa"), Owl Creek Asset Management, L.P. ("Owl Creek,") and Centerbridge Partners, L.P. ("Centerbridge," collectively "AOC"), on behalf of certain of their respective managed funds that are creditors of the above captioned debtors and debtors in possession (collectively, the "Debtors"), submit this joint memorandum of law in support of their motion (a) for leave to appeal from the September 13, 2011 opinion (the "Opinion") and order (the "Order") of the Bankruptcy Court for the District of Delaware granting a Motion for an Order Authorizing the Official Committee of Equity Security Holders (the "Equity Committee") to Commence and Prosecute Certain Claims of Debtors' Estates (the "Motion to Authorize" or "Motion"), or alternatively, (b) to vacate the Order through the issuance of a writ of mandamus. The reasons for granting relief are set forth below.

PRELIMINARY STATEMENT

This case presents a troubling instance of a bankruptcy court misapplying the federal securities laws to force an outcome that has no basis in law. As a result of the Order, four creditors, the Settlement Noteholders[2] – whose actions the Bankruptcy Court acknowledges "helped *increase* the Debtors' estates" pursuant to a plan of reorganization that was proposed in good faith – are nonetheless being coerced to settle with a hopelessly out-of-the-money constituency through court-ordered mediation or face frivolous and expensive litigation.

The events culminating in the Order began nearly a year ago, founded on baseless speculation of "insider trading" by a disgruntled security holder, which speculation the Bankruptcy Court itself acknowledged was inadmissible hearsay. Despite this, and in contravention of the basic protections against frivolous securities claims that every defendant is afforded under federal law – including a stay of discovery until a court determines whether the heightened pleading standards applicable to such actions have been met – the Bankruptcy Court authorized extensive discovery against the Settlement Noteholders and even held a full trial.

The trial revealed no basis for the asserted claims of insider trading against the Settlement Noteholders. In fact, the Debtors' representative testified that the actions of the Settlement Noteholders had been entirely proper and indeed beneficial, and both the Debtors and the Official Committee of Unsecured Creditors (the "Creditors' Committee"),[3] who have fiduciary duties to the Debtors' estates (the "Estates"), submitted post-hearing briefs confirming that there was no evidence of insider trading. Subsequently, on September 13, 2011, the Bankruptcy Court made the following findings of fact with respect to the Settlement Noteholders:

- The Settlement Noteholders participated in settlement negotiations with the Debtors and other creditors (Opinion at 72), as is encouraged by the bankruptcy courts, which ultimately contributed to the Debtors' fashioning a global settlement agreement.

- As a condition to their participation in settlement negotiations, the Settlement Noteholders entered into two formal confidentiality agreements with the Debtors. (Opinion at 66). The confidentiality agreements were of limited duration, and the Settlement Noteholders were required to either establish an ethical wall or restrict trading in the Debtors' securities during those periods. (Opinion at 66-67).

- The Settlement Noteholders abided by their agreements with the Debtors, and either established an ethical wall or restricted all trading during the confidentiality periods. (Opinion at 66-67).

- In turn, the "Debtors explicitly agreed to disclose any material nonpublic information at the end of each confidentiality period," and the Settlement Noteholders did not

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[2] The Settlement Noteholders consist of AOC and Aurelius Capital Management, LP ("Aurelius").

[3] None of the Settlement Noteholders were members of the Creditors' Committee.

resume trading until the Debtors had confirmed that they had done so. (Opinion at 132, 134-35).

- In connection with their participation in the settlement process, the Settlement Noteholders did not dominate or control the Debtors, as had been alleged, but rather "were only one of several groups of creditors involved." (Opinion at 72).

- The Settlement Noteholders did not harm the Debtors or their Estates. To the contrary, "*[d]espite the allegations of insider trading by the Settlement Noteholders, the Court [wa]s unconvinced that their actions had a negative impact on the Plan or tainted the [Global Settlement Agreement]. Rather, the actions of the Settlement Noteholders appear to have helped increase the Debtors' estates*," (Opinion at 71 (emphasis added)), and resulted in a plan that is fair and reasonable, and proposed in good faith. (Opinion at 73; *In re Washington Mutual, Inc*., 442 B.R. 314, 322 (Bankr. D. Del. 2011)).

In light of these findings, the Bankruptcy Court should have denied the motion to authorize insider trading claims for equitable disallowance against the Settlement Noteholders as frivolous. Unfortunately, with no basis in law, that is not what happened here. Instead, ignoring virtually every requirement of the insider trading laws as well as its own findings of fact, and in violation of Congress's express directive to apply heightened pleading requirements to the claims asserted here, the Bankruptcy Court authorized the Equity Committee to stand in the shoes of the Debtors and bring an action against the Settlement Noteholders seeking equitable disallowance of their claims against the Estates. Leave to appeal should be granted because of the multiple and clear errors made below.

The absence of any legal support for the Bankruptcy Court's decision is palpable. Since the Debtors never traded in their own securities, and the Bankruptcy Court found that the Settlement Noteholders helped, not harmed, the Estates, the Debtors (and the Equity Committee on their behalf) could never have standing to pursue these claims, even if the claims had merit – which they do not. The Bankruptcy Court simply ignored this fact and essential precept of securities law. Application of this fundamental rule, alone, should have led to dismissal.

In addition, the Bankruptcy Court erroneously found a colorable claim that the Settlement Noteholders – four independent creditors – were "insiders" of the Debtors under the federal securities laws, with fiduciary duties purportedly owed to the Debtors. There is no basis whatsoever for that unprecedented conclusion. Moreover, fundamental to an insider trading claim is scienter – *i.e.*, that the defendant acted with fraudulent intent – which a plaintiff is obligated to demonstrate by pleading particularized facts establishing a strong inference of such intent. Here, *no* facts were pled that established such an inference, certainly not a strong one. Even after having been afforded substantial discovery and a week-long trial, the Equity Committee itself had to acknowledge that it had no such facts. (8/24/2011 Tr. at 226). Similarly, the Equity Committee did not even attempt to show that the Settlement Noteholders had engaged in conduct that was in any way deceptive. Nor could they, given that the Debtors were fully aware of the trading. The Bankruptcy Court waived these fatal deficiencies away, ignoring the absence of deception in the case and holding that the Settlement Noteholders should be required to prove *the absence* of fraudulent intent. That is not the law – in fact, it is the opposite of the law.

The Bankruptcy Court also misstated the record, which resulted in a violation of the procedural due process rights of two creditors – Appaloosa and Owl Creek. The Equity Committee's motion for standing and proposed complaint named two other creditors, but not Appaloosa or Owl Creek. As a result, neither Appaloosa nor Owl Creek responded to the motion. But the Bankruptcy Court purported to grant the motion against Appaloosa and Owl Creek as well. In so doing, the Bankruptcy Court stated (without citation to the record) that the Equity Committee had "clarified" during argument that the motion was really against all four Settlement Noteholders – but a review of the record makes it clear that the Equity Committee did no such thing.[4] In other words, the Bankruptcy Court *granted a motion that was never made*, completely denying Appaloosa and Owl Creek the fundamental right to be heard. This violates basic concepts of fairness, which cannot be remedied by an amended motion made before the Bankruptcy Court, since the outcome would be a foregone conclusion.

The decision below, unless promptly reversed, also would allow and encourage the types of "abusive practices committed in private securities litigation" that Congress intended to avoid by enacting the United States Private Securities Litigation Reform Act of 1995 (the "PSLRA"). Such a result is antithetical to Congress's stated intent in enacting the PSLRA to reduce the number of frivolous lawsuits that impose unreasonable burdens on wrongly accused defendants.

AOC respectfully urge that leave to appeal be granted to correct the lower court's clear errors of law and abuse of discretion, to protect important public and legislative policies, and to uphold basic procedural due process rights. The fact that equity holders in this case will not receive a recovery – the outcome the Bankruptcy Court seeks to now reverse through the Order – is a function of the amount of assets available for distribution and the absolute priority rule applicable under the Bankruptcy Code. It cannot be laid at the doorsteps of the Settlement Noteholders, who the Bankruptcy Court acknowledged had increased, not decreased, the size of the Debtors' estates. Immediate appeal or mandamus is clearly warranted in this case.

[4] To the contrary, in response to a question by the Bankruptcy Court, the Equity Committee stated that it "ha[d] not discussed" the issue with its client and "reserve[d] the right" to amend if "the case [wa]s permitted to proceed." (8/24/2011 Tr. at 233-34).

STATEMENT OF FACTS

A. Procedural History

On September 26, 2008, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code.

On October 6, 2010, the Debtors filed their Sixth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code (the "Sixth Amended Plan"). The Sixth Amended Plan was premised on the implementation of an Amended and Restated Global Settlement Agreement (the "Settlement Agreement") that was entered into by the Debtors, JPMorgan Chase Bank, N.A. ("JPMC"), the Federal Deposit Insurance Corporation ("FDIC"), the Creditors' Committee, and certain creditor constituencies – namely, the Settlement Noteholders.

The Bankruptcy Court held a hearing to consider confirmation of the Sixth Amended Plan from December 2, 2010 through December 7, 2010 (the "First Confirmation Hearing"). [D.I. 6203, 6256]. After the conclusion of the First Confirmation Hearing, the Court issued an opinion on January 7, 2011 denying confirmation of the Sixth Amended Plan. *In re Wash. Mut., Inc.*, 442 B.R. at 322. In denying confirmation of the Sixth Amended Plan, the Bankruptcy Court twice mentioned the (false) speculation of an individual security holder regarding insider trading, despite explicitly acknowledging that such speculation did not constitute evidence. *Id.* at 348, 360. Thereafter, the Debtors filed the Modified Sixth Amended Plan on February 7, 2011. [D.I. 6696].

"[T]aking its cue from th[e Bankruptcy] Court," (2/8/2011 Tr. at 33), on January 18, 2011, the Equity Committee moved to conduct a Rule 2004 examination on issues relating to securities fraud violations. (Motion of the Official Committee of Equity Security Holders for an

Order Pursuant to Bankruptcy Rule 2004 and Local Bankruptcy Rule 2004-1 [D.I. 6567] (the "EC Rule 2004 Motion")). Subsequently, on February 8, 2011, the Bankruptcy Court granted the motion, in part, and allowed discovery to proceed. (Order Granting, In Part, Motion of the Official Committee of Equity Security Holders for an Order Directing the Examination of the Washington Mutual, Inc. Settlement Note Holders Group [D.I. 6725]).

Consistent with the Bankruptcy Court's order, the Settlement Noteholders produced to the Equity Committee tens of thousands of pages in discovery, including all applicable trading records and documents reflecting information that the Settlement Noteholders had received from the Debtors during the settlement discussions. Additionally, the Equity Committee deposed a representative of each of the Settlement Noteholders, and of the Debtors, regarding: (a) any buying and selling of the Debtors' securities; (b) the receipt of confidential information, if any, during settlement negotiations; (c) each of the Settlement Noteholders' internal screening procedures; (d) any analyses and/or valuations of the Debtors that the Settlement Noteholders had performed; and (e) the Settlement Noteholders' participation in settlement negotiations.

On July 1, 2011, the Equity Committee filed an objection to confirmation of the Modified Sixth Amended Plan ("EC Objection" or the "Objection"). [D.I. 8192 (unsealed)]. The Objection asserted that two of the Settlement Noteholders traded on the basis of material, nonpublic information, but did not include such assertions against Appaloosa or Owl Creek. The Objection further asserted that all four Settlement Noteholders had "hijacked" the negotiations and dominated the Debtors. (Objection at ¶¶ 35, 70). On July 12, 2011, the Equity Committee filed the Motion to Authorize. [D.I. 8181]. Like the EC Objection, the Motion to Authorize –

and the draft complaint attached to it – did not include any allegations of insider trading against Appaloosa or Owl Creek, and did not name either of them as defendants.

B. The Confirmation Hearing and the Opinion

On July 13, 2011, the Court commenced an evidentiary hearing to consider confirmation of the Plan and the Motion to Authorize (the "Hearing" or "Confirmation Hearing"). The Hearing began on July 13, 2011 and concluded on July 21, 2011. On September 13, 2011, the Bankruptcy Court issued the Opinion denying confirmation of the Modified Sixth Amended Plan and granting, but staying, the Equity Committee's Motion to Authorize. [D.I. 8612].

As set forth in its Opinion, the Bankruptcy Court found that the Settlement Noteholders "were only one of several groups of creditors involved" in settlement negotiations with the Debtors. (Opinion at 72). To participate directly in these negotiations, the Settlement Noteholders entered into two confidentiality agreements with the Debtors. (Opinion at 66). During the periods covered by the confidentiality agreements, one of the Settlement Noteholders established an ethical wall and the other three restricted all trading in the securities of the Debtors. (Opinion at 66, 67). Under the terms of the agreements, the Debtors were required at the end of each confidentiality period to disclose all material, nonpublic information that the Settlement Noteholders had learned. (Opinion at 132-33). Additionally, the Settlement Noteholders were "free to trade" after each confidentiality period concluded. (Opinion at 126). As a result of the Settlement Noteholders' participation in the settlement negotiations, the value of "the Debtors' estates" "appear[s] to have . . . increased." (Opinion at 71).

Despite those findings of fact, the Bankruptcy Court found that the Equity Committee "stated a colorable claim that the Settlement Noteholders engaged in insider trading under the classical and misappropriation theories" under the theory that "[t]he threshold for stating a colorable claim is low and mirrors the standard applicable to a motion to dismiss for failure to state a claim." (Opinion at 109, 137).

Moreover, notwithstanding the fact that the Equity Committee's "Motion only sought disallowance of the claims of Aurelius and Centerbridge," (Opinion at 70 n.31), the Bankruptcy Court granted the Equity Committee standing to prosecute claims against all four Settlement Noteholders. (Opinion at 117-138). Without any citation to the record, the Bankruptcy Court claimed that "the Equity Committee's objection to confirmation asserts that equitable disallowance of the claims of all the Settlement Noteholders is warranted" and that "[a]t oral argument, the Equity Committee clarified that it seeks authority to bring such a claim against all four Settlement Noteholders." (Opinion at 70 n.31). In fact, far from seeking authority to prosecute a claim against "all four Settlement Noteholders," the Equity Committee stated only that amending its Motion to include all four Settlement Noteholders was "definitely an issue we want to reserve on, and we may well be coming back to the Court if the case is permitted to proceed, with a request to amend it for that purpose." (8/24/2011 Tr. at 233-34). Likewise, the Equity Committee's objection to confirmation explicitly stated it objected to the Plan "to the extent it provides for allowance of [two other Settlement Noteholders'] claims" – not "all [of] the Settlement Noteholders[']" claims. (EC Objection at ¶ 38).

ARGUMENT

I.
THIS COURT SHOULD GRANT LEAVE TO FILE AN INTERLOCUTORY APPEAL

A. Questions Presented

To the extent that the Order is not a final order, AOC respectfully request that the Court grant leave to file an interlocutory appeal regarding the following three questions:

1. Did the Bankruptcy Court err in construing the bankruptcy laws by:

    (a) holding that equitable disallowance exists as a remedy despite the fact that it is not provided for in the Bankruptcy Code and a recent United States Supreme Court decision makes clear that the only possible bases for claim disallowance are those that are expressly enumerated in the Code?

    (b) holding that equitable disallowance, even if theoretically viable, may be imposed as a remedy in this case, where the Bankruptcy Court found that, far from injuring the Debtors' estates, the actions of the Settlement Noteholders enhanced the Estates, and the Plan supported by the Settlement Noteholders was proposed in good faith?

2. Did the Bankruptcy Court err in construing the federal securities laws by:

    (a) holding that the Debtors had standing to seek equitable disallowance of the Settlement Noteholders' claims against the Estates based on purported violations of Section 10(b) when the Debtors did not contemporaneously trade in their own debt securities at any point in time and the Estates were not harmed?

    (b) finding there was a colorable claim that the Settlement Noteholders owed a duty to the Estates, where there is no legal basis whatsoever for that conclusion?

    (c) holding, as part of the asserted rationale for equitable disallowance, that the Debtors would have a defense under the securities laws to the Settlement Noteholders' claims as noteholders because of alleged violations of securities laws?

    (d) holding that a claim for insider trading may proceed in the absence of any allegation of deception or deceptive practices?

    (e) holding that scienter is not an element of insider trading?

3. Did the Bankruptcy Court violate the procedural due process rights of Appaloosa and Owl Creek by expanding, *sua sponte* and after the fact, the Equity Committee's Motion to Authorize to include Appaloosa and Owl Creek, despite the fact that the Motion to Authorize and its proposed complaint did not include them, thereby denying Appaloosa and Owl Creek a full and fair opportunity to be heard on the Motion?

B. <u>Relief Sought</u>

AOC respectfully submit that it can appeal from the Bankruptcy Court's Order as a final order appealable as of right under 28 U.S.C. § 158(a)(1), but alternatively, respectfully seek leave to appeal, which the Court may grant in its discretion, under 28 U.S.C. § 158(a)(3).

District courts have jurisdiction to review "final judgments, orders and decrees" of bankruptcy courts. 28 U.S.C. § 158(a)(1). The definition of a "final" order in the bankruptcy context "differs from litigation in an ordinary civil matter" and tends to be less stringent. *Southeastern Sprinkler Co. v. Meyertech Corp.* (*In re Meyertech Corp.*), 831 F.2d 410, 414 (3d Cir. 1987). Unlike in ordinary civil cases, the finality of a bankruptcy court order is determined upon consideration of the following factors: (1) the impact of the matter on the assets of the estate; (2) the necessity for further fact-finding on remand; (3) the preclusive effect of a decision on the merits; and (4) the interests of judicial economy. *See, e.g., In re Meyertech Corp.*, 831 F.2d 410, 414 (3d Cir. 1987); *In re Marvel Entm't Group, Inc.*, 140 F.3d 463, 470 (3d Cir. 1998).

Applying these factors here, the Order is final. The Bankruptcy Court's Order, which grants the Equity Committee standing to pursue insider trading claims that have no basis in law, will result in unnecessary delay and administrative burdens on the Estates that will adversely impact recoveries to the junior creditors. *See In re Market Square Inn, Inc.*, 978 F.2d 116, 120-21 (3d Cir. 1992) (finding that order was final because of impact on debtor's estate).

Reviewing the Order now will result in a dismissal of the Equity Committee's Motion as a matter of law, thus precluding any further fact-finding on these issues, obviating the need for further litigation, and advancing the interest of judicial economy. *See In re Meyertech Corp.*, 831 F.2d at 414 (order final where "[a] decision now will . . . preclude the necessity of further activity by the fact-finding tribunal, will obliterate the need for more litigation and serves the ever-prevailing interest of judicial economy."). Accordingly, the Order should be viewed as "final."

If the Court determines that the Order is not a final order, however, AOC respectfully seek leave to appeal pursuant to 28 U.S.C. § 158(a)(3). Section 158(a)(3) of the Judicial Code grants district courts jurisdiction to hear appeals from interlocutory orders and decrees of bankruptcy judges with leave of the district court. For the reasons set forth below, AOC respectfully request that the District Court grant it leave to appeal from the decision of the Bankruptcy Court or, alternatively, for issuance of a writ of mandamus. AOC are substantial creditors of the Debtors' Estates, and hold claims throughout the capital structure. Because the Bankruptcy Court's Order imposes undue administrative costs to the Estates, thereby substantially reducing recoveries to junior creditors, and places AOC's substantial claims in jeopardy, AOC have standing to appeal the Bankruptcy Court's Order. *See In re Combustion Eng'g, Inc.*, 391 F.3d 190, 214 (3d Cir. 2004); *Licensing by Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 388 (2d Cir. 1997).

C. <u>Summary of Reasons Why Leave to Appeal Should Be Granted</u>

Section 158(c)(2) provides that an appeal from interlocutory orders and decrees of the bankruptcy judges "shall be taken in the same manner as appeals in civil proceedings generally are taken to the courts of appeals from the district courts." Accordingly, the criteria of

28 U.S.C. § 1292(b) – the statutory provision governing appeals of interlocutory orders from district courts – apply.

Pursuant to Section 1292(b), an interlocutory appeal is appropriate where: "(1) a controlling question of law is involved; (2) the question is one where there is a substantial ground for difference of opinion; and (3) an immediate appeal would materially advance the ultimate termination of the litigation." *Patrick v. Dell Finc'l Sevs.*, 366 B.R. 378, 385 (M.D. Pa. 2007) (quoting *EDP Med. Computer Sys. v. United States*, 178 B.R. 57, 60 (M.D. Pa.1995) (citing 28 U.S.C. § 1292(b)). All three elements are present here. In addition, an immediate appeal is necessary to fulfill the intent of Congress in enacting the PSLRA, correct the dangerous precedent the Bankruptcy Court has set, and resolve the uncertainty now surrounding the roles and duties of creditors who are not members of a statutory committee. H.R. Rep. No. 104-369, at 41 (1995) (Conf. Rep.), reprinted in 1995 U.S.C.C.A.N. 730. Accordingly, there are extraordinary circumstances warranting an interlocutory appeal.

1. The Present Appeal Involves Controlling Questions of Law

A "controlling question of law" is an issue "which, if erroneous, would be reversible error on final appeal." *Katz v. Carte Blanche Corp.*, 496 F.2d 747, 755 (3d Cir.1974). "Controlling" means serious to the conduct of the litigation, either practically or legally." *Id.* The order need not be on the claim's merits, and reversal need not terminate the litigation, for it to be "controlling." *Id.*

As noted in Section I.A. above, the Opinion involves controlling issues of law. If this Court were to determine any of these issues in AOC's favor, the adversary proceeding would be dismissed as a matter of law and the Equity Committee's Motion to Authorize would be denied. *See Klapper v. Commonwealth Realty Trust*, 662 F. Supp. 235 (D. Del. 1987) ("Standing is a ‘controlling question of law’. If the plaintiffs have no standing, the litigation will be terminated, and such questions are particularly well suited for an interlocutory appeal.”). Likewise, the Opinion involves an additional controlling issue of law specific as to Appaloosa and Owl Creek: whether their procedural due process rights were violated when the Bankruptcy Court *sua sponte* granted the Equity Committee standing to prosecute certain claims against them without the Equity Committee’s asking for it and without providing Appaloosa and Owl Creek notice or an opportunity to be heard. There is only one remedy for such a violation – to vacate the Order as to Appaloosa and Owl Creek.

Therefore, the Opinion contains a number of controlling issues of law, and the prong is clearly met.

2. Substantial Grounds Exist for Difference of Opinion on the Controlling Questions of Law

Substantial grounds for difference of opinion exist when there is a “genuine doubt or conflicting precedent as to the correct legal standard.” *Knipe v. SmithKline Beecham*, 583 F. Supp. 2d 553, 599 (E.D. Pa. 2008) (quoting *Bradburn Parent Teacher Store, Inc. v. 3M*, No. 02-7676, 2005 WL 1819969, at *3 (E.D. Pa. Aug. 2, 2005)) (internal citations omitted); *see also Harter v. GAF Corp.*, 150 F.R.D. 502, 518 (D.N.J. 1993). In addition, the absence of controlling law on a particular issue can constitute substantial grounds. *See Chase Manhattan Bank v. Iridium Africa Corp.*, 324 F. Supp. 2d 540, 545 (D. Del. 2004).

There can be no doubt that substantial grounds exist for difference of opinion on controlling questions of law. First, the Third Circuit has not addressed whether equitable disallowance is an available remedy after enactment of the Bankruptcy Code, *see Citicorp Venture Capital Ltd.*, 160 F.3d 982, 991 n.7 (3d Cir. 1998), and the Supreme Court’s ruling in *Travelers* strongly suggests that it is not. The Bankruptcy Court’s finding that equitable disallowance was available despite finding that the Settlement Noteholders did not harm the Debtors’ estates – indeed enhanced them – also creates a legal issue for appeal. Orders that involve issues of first impression or unsettled questions of law, like these, make an interlocutory appeal particularly appropriate. *See Chase Manhattan Bank*, 324 F. Supp. 2d at 545. Thus, the viability of equitable disallowance as a remedy (and in any event, its availability in this case) is sufficiently in dispute to warrant immediate clarification by this Court before any further litigation continues.

Second, there are substantial grounds for disagreement with regard to each of the securities law questions. As noted in greater detail below, the Bankruptcy Court's grant of standing to the Equity Committee flies in the face of the PSLRA, and Supreme Court and Circuit Court precedent on standing, duty, deception and scienter. *See, e.g., Tellabs, Inc.*, 551 U.S. 308; *Blue Chips Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975); *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88 (2d Cir. 1981); *Walton v. Morgan Stanley & Co.*,, 623 F.2d 796 (2d Cir. 1980). Thus, there is genuine doubt (to say the least) as to whether the Bankruptcy Court's view of the securities laws is the correct legal standard. *Knipe v. SmithKline Beecham*, 583 F. Supp. 2d 553, 599 (E.D. Pa. 2008).

3. An Immediate Appeal Will Materially Advance the Ultimate Termination of this Litigation

An interlocutory appeal "materially advances the litigation's ultimate termination where the interlocutory appeal will eliminate the need for trial, complex issues, or issues that make discovery more difficult and more expensive." *In re Dwek*, 2011 WL 487582, at *4 (D.N.J. Feb. 4, 2011) (citing *L.R. v. Manheim Twp. Sch. Dist.*, 540 F. Supp. 2d 603, 613 (E.D. Pa. 2008). As noted below, resolution of any of the questions presented for review in favor of AOC will obviate the need for any further litigation on these issues in the Bankruptcy Court. Accordingly, this prong is clearly met.

4. An Immediate Appeal Is Necessary to Correct Fundamental Flaws in the Bankruptcy Court's Decision and Correct Serious Due Process Violations

An immediate appeal is needed to avoid the uncertainty engendered by the Bankruptcy Court's decision. As noted at the outset, the Bankruptcy Court misconstrued nearly every element of the securities laws in its ruling, thereby creating dangerous precedent and defeating the very purpose of the PSLRA, which was to limit the filing of frivolous lawsuits and to require plaintiffs to make a particularized showing of fraud *before* they pursue a suit. *Tellabs,* *Inc.*, 551 U.S. 308. Given the impact this type of opinion can have on other potential bankruptcies and securities suits, and the stay order currently in place, an immediate appeal should be granted at this stage and not after unnecessary and lengthy proceedings under the wrong legal standards.

Finally, an immediate appeal is necessary to correct violations of Appaloosa and Owl Creek's procedural due process rights. As discussed in further detail below, the Bankruptcy Court granted a motion against them that was never made. Fundamental to our adversarial process is the notion that every individual is entitled to notice and a right to be heard. The granting of a motion against Appaloosa and Owl Creek that had never been made violated each of those rights. Immediate appeal is mandated.

D. <u>Fundamental Errors of Law in the Bankruptcy Court's Decision</u>

1. The Bankruptcy Court Erred In Granting the Equity Committee Standing to Bring an Action for Equitable Disallowance

a. Equitable Disallowance Is Not an Available Remedy Under the Bankruptcy Code

The Bankruptcy Court erred in granting the Equity Committee standing to bring an action for equitable disallowance because such a claim does not exist as a matter of law. This is clear from both the plain language of the Bankruptcy Code itself – which does not provide for equitable disallowance – and a 2007 Supreme Court decision that addressed the available bases for the disallowance of claims in a bankruptcy case. The Bankruptcy Court's fundamental error necessitates immediate correction.

Section 502(b) of the Bankruptcy Code unambiguously provides that if an objection is filed to a creditors' claim, the court "shall allow" the claim unless it falls exclusively within one of nine enumerated exceptions therein. *See* 11 U.S.C. § 502(b). In *Travelers Casualty & Surety Co. of Am. v. Pac. Gas & Elec. Co.* (*Travelers*), 549 U.S. 443 (2007), the Supreme Court held that claims may only be disallowed if they fall squarely within one of the nine enumerated categories in section 502 of the Bankruptcy Code. *See id.* at 449 ("But even where a party in interest objects, the court 'shall allow' the claim 'except to the extent that' the claim implicates any of the nine exceptions enumerated in § 502(b)").[5] "Equitable disallowance" is not one of the nine enumerated categories and there is no "catch-all" provision in section 502(b) that would permit a bankruptcy court blanket discretion to consider the equities of a case and determine whether to allow or disallow a claim. The Supreme Court's decision in *Travelers*, which was based on the plain language of the Bankruptcy Code, is consistent with the fact that there is not a single reported decision since the Bankruptcy Code's enactment where a claim has been disallowed on the basis of equitable disallowance.[6]

Nevertheless, the Bankruptcy Court, relying primarily on the 1939 pre-Bankruptcy Code Supreme Court decision in *Pepper v. Litton*, 308 U.S. 295 (1939), and recent controversial *dicta* in a decision from the Adelphia bankruptcy,[7] determined that it had "the authority to disallow a claim on equitable grounds 'in those

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[5] The Court made clear what those exceptions were, none of which applies here: "where the claim at issue is 'unenforceable against the debtor ... under any agreement or applicable law,' § 502(b)(1); 'is for unmatured interest,' § 502(b)(2); 'is for [property tax that] exceeds the value of the [estate's] interest' in the property, § 502(b)(3); 'is for services of an insider or attorney of the debtor' and 'exceeds the reasonable value of such services,' § 502(b)(4); is for unmatured debt on certain alimony and child support obligations, § 502(b)(5); is for certain 'damages resulting from the termination' of a lease or employment contract, §§ 502(b)(6) and (7); 'results from a reduction, due to late payment, in the amount of . . . credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor,' § 502(b)(8); or was brought to the court's attention through an untimely proof of claim, § 502(b)(9)." *Id.*

[6] As the Equity Committee's own counsel recently stated in citing *Travelers* to support its argument in another case: "On what possible grounds can a bankruptcy court disallow a properly-filed claim that is not within one of the exceptions specified in 11 U.S.C. § 502(b)? How would such an order be upheld in the face of the language of § 502(b), which the Supreme Court has emphasized is mandatory language that a court 'shall' allow a claim unless it falls within the exceptions?" *See* Mason Capital Management, LLC's Objection to the Debtors' Disclosure Statement for Second Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors, Bankr. S.D.N.Y. Case No. 08-13555 (JMP) at ¶ 21 [D.I. 19151].

[7] The Supreme Court made clear in its recent decision in *Am. Elec. Power Co. v. Conn.*, 180 L. Ed. 2d 435 (2011) ("*AEP*"), that where Congress enacts legislation that addresses a particular issue, that legislation "displaces" prior federal common law. The Bankruptcy Court's reliance on the 1939 *Pepper v. Litton* decision as the common law source for equitable disallowance is therefore improper because, in 1978, Congress enacted the Bankruptcy Code, which directly addresses the bases for the disallowance of claims (and does not include equitable disallowance). The *AEP* Court noted that "[l]egislative displacement of federal common law does not require the same sort of evidence of a clear and manifest congressional purpose demanded for preemption of state law . . . . When Congress addresses a question previously governed by a

extreme instances – perhaps very rare – where it is necessary as a remedy.'" (Opinion at 115 (quoting *Adelphia Recovery Trust v. Bank of Am., N.A.*, 365 B.R. 24, 73 (Bankr. S.D.N.Y. 2007)).[8]

The Bankruptcy Court's holding is plainly wrong. As the Supreme Court made clear in *Travelers*, "where Congress has intended to provide . . . exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly." *FCC v. NextWave Personal Comm'ns Inc.*, 537 U.S. 293, 302 (2003). Had Congress intended to include an exception under section 502(b) to allow the Bankruptcy Court to consider equitable disallowance of claims, it would have done so. It did not, and therefore no such remedy exists.

While the plain meaning of the Bankruptcy Code makes clear that equitable disallowance is not an available remedy, the Bankruptcy Court improperly chose to look beyond the clear meaning of the Code and to examine the legislative history. *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) ("When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete.'") (citing *Rubin v. United States*, 449 U.S. 424, 430 (1981)); *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 304 (3rd Cir. 2010) ("Where the statutory language is unambiguous, the court should not consider statutory purpose or legislative history.").

Even if it were appropriate to delve into legislative history, it is clear that Congress, in the legislative process leading to the enactment of the Bankruptcy Code, considered – and then ultimately rejected – the inclusion of equitable disallowance as a remedy. A version of a Senate bill considered by Congress prior to the enactment of the Bankruptcy Code included the following language: "[a]fter notice and a hearing the court may disallow, in part or in whole, any claim or interest in accordance with the equities of the case." *See* S. 2266, 95th Cong. (1977) (§ 510(c)(3)), reprinted in COLLIER ON BANKRUPTCY, App. pt. 4(e) (16th ed., 2011) ("COLLIER"). However, shortly before Congress enacted the final legislation, which included the Bankruptcy Code, that language was deleted, which is clear evidence of Congress's intent to exclude the remedy altogether.

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decision rested on federal common law . . . the need for such an unusual exercise of law-making by federal courts disappears." *Id.* at 447 (internal quotes and brackets omitted).

[8] Ultimately, the courts in Adelphia neither applied equitable disallowance nor set forth standards as to its application. Indeed, subsequent to the bankruptcy court's decision, the District Court dismissed the equitable disallowance claim because the plaintiffs were unable to allege damage to the debtors' estates or their creditors. *Adelphia Recovery Trust v. Bank of Am., N.A.*, 390 B.R. 80, 99 (S.D.N.Y. 2008).

Bankruptcy courts are limited to the powers delineated in the Bankruptcy Code. The only general power provided to bankruptcy courts under the Bankruptcy Code is found in Section 105(a). That grant of equitable power, however, does not give a bankruptcy court the power to create rights or remedies that do not exist in the Bankruptcy Code itself. *See In re Owens Corning*, 419 F.3d 195, 209 n.14 (3d Cir. 2005) (citing *In re Combustion Eng'g, Inc.*, 391 F.3d at 236); *see also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."). A bankruptcy court cannot simply make up remedies that do not explicitly exist in the Bankruptcy Code.

b. Equitable Disallowance would Eviscerate the Statutory Limitations on Equitable Subordination

While equitable *disallowance* does not exist in the Bankruptcy Code, the Code does include a clear provision that allows for the equitable *subordination* of a claim as the result of inequitable conduct. *See* 11 U.S.C. § 510(c). Pursuant to Section 510(c) of the Bankruptcy Code, "under principles of equitable subordination," "claims may be subordinated to claims, and interests may be subordinated to interests, but claims may not be subordinated to interests." 4 COLLIER ¶ 510.05 (citing *Adelphia*, 390 B.R. at 99 ("[A] given claim may not be subordinated to an equity interest, but only to another claim . . .")). Put another way, under Section 510(c), *debt can never be subordinated to the level of equity* – the claim of a bondholder must always be paid before a shareholder's claim gets paid. This provision protects creditors from their claims being *de facto* disallowed by being subordinated to or below the level of equity. If equitable disallowance were an available remedy for a creditor's inequitable conduct, it would eviscerate this important protection that Congress explicitly created in drafting its remedy for inequitable conduct.

Indeed, here the Bankruptcy Court held that the Equity Committee had not stated a colorable claim for equitable subordination for this very reason, *i.e.*, because the shareholders could not benefit from any equitable subordination. That clear legislative protection for creditors would cease to exist if equitable disallowance were an available remedy. Otherwise, why would anyone bring an equitable subordination claim with all of its procedural hurdles if they could simply ask the bankruptcy court to apply the broader equitable power of equitable disallowance?

c. No Allegations were Made, Much Less Any Evidence Presented, That the Settlement Noteholders Injured the Debtors' Estates

Even assuming *arguendo* that equitable disallowance exists as a remedy, which it does not, the Bankruptcy Court's own findings would make it unavailable here. The Bankruptcy Court stated that a court only has "authority to disallow a claim on equitable grounds 'in those extreme instances – *perhaps very rare* – where it is necessary as a remedy.'" (Opinion at 115 (citing *Adelphia*, 365 B.R. at 73) (emphasis added)). Given that equitable subordination requires a demonstration of harm to the estate or its creditors, the "extreme circumstances" justifying equitable disallowance could not possibly exist where no such harm occurred. *See Adelphia Recovery*, 390 B.R. at 99 (dismissing the equitable disallowance claim because the plaintiffs were unable to allege damage to the debtors' estates or their creditors). The Bankruptcy Court did not conclude that the Settlement Noteholders injured the Debtors' estates in any way. To the contrary, the Bankruptcy Court expressly stated that "the actions of the Settlement Noteholders appear to have helped increase the Debtors' estates." (Opinion at 71). As a matter of law, actions that "helped increase the Debtors' estates" could not support a finding that equitable disallowance is justified.

d. Section 502(b)(1) is Not a Basis for Disallowance Because the Debtors Have No Standing to Bring a Securities Claim Against the Settlement Noteholders

Lastly, the Bankruptcy Court's reliance in the alternative on section 502(b)(1) as a basis for equitable disallowance is completely misplaced. (*See* Opinion at 115-16). Section 502(b)(1) only provides for the disallowance of a claim that is not enforceable against the debtor as a matter of contract or applicable non-bankruptcy law. *See* 11 U.S.C. § 502(b)(1). The Bankruptcy Court mistakenly concluded that "[b]ecause the Equity Committee seeks to disallow the claims of the Settlement Noteholders under facts that suggest they violated the securities laws, the Court believes the Debtors would have a defense to those claims outside of the bankruptcy context as well." This is error. Nothing in the securities laws would allow the Debtors to avoid their obligation to pay the Settlement Noteholders' claims. Indeed, the Debtors would have no standing to bring any securities claim against the Settlement Noteholders. Thus, neither Section 502(b)(1), nor Section 502 more generally, provide any basis for equitable disallowance of the Settlement Noteholders' claims.

2. The Bankruptcy Court Misapplied the Federal Securities Laws

In its decision, the Bankruptcy Court acknowledged that the Equity Committee's claim for equitable disallowance turned on the Equity Committee's ability to stand in the shoes of the Debtors and derivatively pursue claims premised on alleged violations of the securities laws. In order to do this, the Bankruptcy Court acknowledged that it had to find that the Debtors had refused to prosecute these claims and that such refusal was not justified. The Bankruptcy Court further acknowledged that "whether that [refusal] was justified depends on whether the claim is colorable and the costs of pursuing that claim."[9] (Opinion at 108-09). For a claim to be colorable, it needs to survive a motion to dismiss. (Opinion at 109). In the securities context, however, claims for insider trading must be pled with particularity, and can only survive a motion to dismiss if there is a "strong inference" of fraud. 15 U.S.C. § 78u-4(b)(2); *Tellabs Inc. v. Makor Issues & Rights, Ltd.* 551 U.S. 308, 323 (2007). *See also Inst. Investors Group v. Avaya, Inc.*, 564 F.3d 242, 252-53 (3d Cir. 2009).

The Bankruptcy Court fundamentally misconstrued the federal securities laws and the standard for dismissal under the PSLRA and *Tellabs*. According to the Bankruptcy Court, and despite the plain reading of the PSLRA, the "threshold for stating a colorable claim is low." (Opinion at 109). Thus, rather than determining as a matter of law (i) whether the Debtors had standing to bring an insider trading claim against the Settlement Noteholders; and (ii) if so, whether the Equity Committee had alleged particularized facts sufficient to show that the Settlement Noteholders had engaged in insider trading, the Bankruptcy Court erroneously found that the Equity Committee's assertions of insider trading – even absent a clear showing of standing, duty, deception or scienter – were sufficient to state a claim.

The Bankruptcy Court not only ignored the heightened pleading requirements for securities claims, but made at least four fundamental errors of law in construing the federal securities laws. First, the Bankruptcy Court erroneously ignored the plain language of Section 20A and the judicial interpretation of Section 10(b) and Rule 10b-5, which require a plaintiff to show that it contemporaneously traded with a defendant to have standing to bring a private cause of action for damages. Second, the Bankruptcy Court ignored the great weight of authority regarding the definition of "temporary insider," and erroneously found a colorable claim that the

[9] Tellingly, the Bankruptcy Court never actually engaged in the very cost-benefit analysis it said was required.

Settlement Noteholders were insiders of the Debtors merely because they received confidential information and were "one of several groups of creditors involved" in negotiating a settlement agreement. (Opinion at 72, 130). Third, the Bankruptcy Court erred in failing to address deception as a required element of any claim of a violation of Rule 10b-5. Fourth, the Bankruptcy Court did not require the Equity Committee to make a showing of scienter, erroneously finding instead that the mere existence of insider trading policies was sufficient to show knowing and reckless conduct. (Opinion at 134-35). As a result of these errors, the Bankruptcy Court completely misconstrued the securities laws. Granting leave to appeal is warranted.

a. The Bankruptcy Court Erroneously Held that the Equity Committee Had Derivative Standing to Bring Claims Premised on Purported Violations of the Insider Trading Laws Against the Settlement Noteholders.

Section 10(b), and Rule 10b-5, prohibit (a) the "use or employ[ment] . . . [of] any . . . manipulative or deceptive device," (b) "in connection with the purchase or sale of any security," (c) "in contravention of" federal securities "rules and regulations." 15 U.S.C. § 78j(b); *see also Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 341 (2005). The use of a "manipulative or deceptive device" includes "trading on the basis of material, nonpublic information about [a] security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information." 17 C.F.R. § 240.10b5-1(a). Under Section 20A of the Exchange Act, private litigants may bring private lawsuits against insiders who trade "contemporaneously" with plaintiffs in "securities of the same class" in violation of Rule 10b-5. *See* 15 U.S.C. § 78t-1(a).

In short, to have standing, a plaintiff must be an actual purchaser or seller of the Debtors' securities, and have traded contemporaneously in the same class of securities as the defendant. *See Blue Chips Stamps v. Manor Drug Stores,* 421 U.S. 723, 731, 733-34, 749 (1975) (foreclosing sources of information who were deceived by a misappropriator's trading, but who did not trade in those securities, from bringing a cause of action under Section 10(b)); *Wilson v. Comtech Telecomms. Corp.*, 648 F.2d 88, 94-95 (2d Cir. 1981) (holding that the duty of disclosure on the part of insiders trading in the open market "is owed only to those investors trading contemporaneously with the insider; non-contemporaneous traders do not require the protection of the 'disclose or abstain' rule because they do not suffer the disadvantage of trading with someone who has superior access to information."); *Neubronner v. Milken*, 6 F.3d 666, 669–70 (9th Cir.1993) (agreeing with Second Circuit's approach in *Wilson* and stating that the contemporaneous requirement must be pled with particularity under Rule 9(b)); *Copland v. Grumet*, 88 F. Supp. 2d 326, 333 (D.N.J. 1999) ("Accordingly, we hold that in order to satisfy the 'contemporaneous' requirement applied in insider trading claims under §§ 10(b) and 20A of the Exchange Act, a plaintiff must at this stage plead that he or she bought stock on the same dates on which the defendant's sales took place.").

The requirement that plaintiffs trade "contemporaneously" with the defendant is an essential element, and "serves as a substitute for the traditional requirement that only those clearly ascertainable individuals who stand to be exploited by the insider trading – for example, by personally trading with the insider or, in the context of the federal laws, by trading on the same market with the insider – can be said to have individual interests that are directly implicated by the insider trading for which they may seek direct redress." *In re MicroStrategy Inc. Secs. Litig.*, 115 F. Supp. 2d 620, 662 (E.D. Va. 2000) (internal quotations and citation omitted).

There is no dispute that the Debtors did not buy or sell their own securities at any point during this bankruptcy proceeding, and the Bankruptcy Court did not find that they did. Thus, in accordance with Supreme Court precedent, the Debtors (and the Equity Committee seeking to act on behalf of the Debtors) do not have standing to pursue remedies against AOC premised on purported violations of Section 10(b) and Rule 10b-5. *See Blue Chips Stamps*, 421 U.S. at 731, or Section 20A, *see* 15 U.S.C. § 78t-1(a). This is not a technical point – only individual creditors or equity owners who traded contemporaneously with AOC can bring an insider trading action against them, and must do so outside the bankruptcy process, in a district court, subject to the substantial statutory and common law requirements applicable to such claims. *See also Picard v. HSBC Bank PLC*, 2011 WL 3200298 (S.D.N.Y. 2011) (finding that trustee lacks standing to pursue claims against third parties who allegedly violated a duty to the debtor's *customers*). Thus, the Bankruptcy Court's ruling that the *Debtors* (and, derivatively, the Equity Committee) have standing to pursue these claims is error.[10]

b. The Bankruptcy Court Erred in Holding that AOC Traded in Breach of a Fiduciary Duty or Another Duty of Trust and Confidence Owed to the Debtors and the Estates

(i) The Settlement Noteholders Were Not "Insiders" Of The Debtors Under Established Securities Law And Therefore Cannot Be Liable Under The Classical Theory Of Insider Trading

Under the "classical theory," liability for insider trading can attach only when a "corporate insider trades in the securities of his corporation on the basis of material, nonpublic information." *See United States v. O'Hagan*, 521 U.S. 642, 651-52 (1997). The insider's trading on such information qualifies as a "deceptive device" under Section 10(b) because a relationship of trust and confidence exists between corporate insiders and the company's shareholders. *Id*. at 652 (quoting *Chiarella v. United States*, 445 U.S. 222, 228 (1980)).

[10] In essence, the Bankruptcy Court's opinion amounts to the conclusion that a debtor could provide information to a party, inform the party that the information is not material, and then bring a claim against the party for alleged misuse of material nonpublic information.

For purposes of federal securities law, "insiders" include only traditional corporate insiders, such as officers or directors, and certain "temporary insiders" who work on behalf of the company. The Supreme Court set forth the temporary insider standard in *Dirks v. SEC*, 463 U.S. 646 (1983):

> Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes. . . . For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Id. at 655, n.14.

The Bankruptcy Court's finding that there was a colorable claim that the Settlement Noteholders "became temporary insiders of the Debtors when the Debtors gave them confidential information and allowed them to participate in negotiations with JPMC for the shared goal of reaching a settlement that would form the basis of a consensual plan of reorganization," bears no resemblance to the test for temporary insider status established by the Supreme Court. (Opinion at 130).

First, as made clear in *Dirks*, temporary insiders must be "working for the corporation" and given access to confidential information "solely for corporate purposes." *Dirks* at 655, n.14; *see also Sawant v. Ramsey*, 742 F. Supp. 2d 219, 238 (D. Conn. 2010) (temporary insider doctrine inapplicable to major shareholder who obtained confidential information but was "not a professional advisor or consultant, and was not employed by [the company] as such"). The Settlement Noteholders were not working for the Debtors, or given confidential information solely for a corporate purpose. On the contrary, at all times, the Settlement Noteholders, as in most large bankruptcy cases, were one of many interested parties acting in their own independent capacity and in their own interest. As the Bankruptcy Court itself previously acknowledged, "[t]he Settlement Noteholders were not acting in this case in any fiduciary capacity." *In re Wash. Mut., Inc*., 442 B.R. at 349. The fact that the Debtors' interest in reaching a settlement was sometimes aligned or even "shared" with the Settlement Noteholders did not make the Settlement Noteholders "insiders." It is undisputed that the Settlement Noteholders had their own goals in the process and were not working for the Debtors. The Settlement Noteholders were independent creditors who obtained a limited amount of confidential information from the Debtors pursuant to confidentiality agreements negotiated at arm's length.

Indeed, it is well-established that the mere receipt of confidential information does not give rise to temporary insider status. *See, e.g., United States v. Chestman*, 947 F.2d 551, 567 (2d Cir. 1991) ("a fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information"); *see also Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir. 1980) (receipt of confidential information "did nothing, in and of itself" to create a fiduciary relationship).

Furthermore, the Bankruptcy Court did not even address the fact that under *Dirks* and subsequent cases a duty will not be imposed giving rise to temporary insider status absent an expectation by the corporation that "the outsider . . . keep the disclosed nonpublic information confidential." *Dirks* at 655, n.14; *see also Simon DeBartolo Group, L.P. v. Richard E. Jacobs Group, Inc.*, 186 F.3d 157, 169 (2d Cir. 1999) ("For such a duty to be imposed . . . the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.") (quoting *Dirks* at 655, n.14). Here, it is undisputed that the parties' understandings and expectations regarding the confidentiality of the limited information shared with the Settlement Noteholders were set forth in the confidentiality agreements dated March 9, 2009 and November 16, 2009, respectively. The Settlement Noteholders' confidentiality obligations terminated upon expiration of the confidentiality agreements. Thus, it is undisputed that the Debtors had *absolutely no expectation* that the Settlement Noteholders would keep any information confidential or refrain from trading in the Debtors' securities beyond the terms of the confidentiality agreements. To the contrary, in response to direct questioning about the Debtors' expectations, the Debtors' Chief Restructuring Officer testified at trial that "at the conclusion of the confidential periods in [the confidentiality agreements] *the parties are free to do whatever they want to do. . . [because] the agreement is no longer in place*." (7/21/2011 (Kosturos) Tr. 153 (emphasis added)). Thus, even if the Settlement Noteholders were somehow temporary insiders by reason of their access to confidential information during the periods covered by the confidentiality agreements, their duties and concomitant temporary insider status would have been limited to the periods covered by those agreements—*time periods in which none of Appaloosa, Centerbridge or Owl Creek made any trades in the Debtors' securities*. Accordingly, for this additional reason, the Bankruptcy Court erred in concluding that the Equity Committee has stated a colorable claim for insider trading based on a theory that the Settlement Noteholders were temporary insiders.

Finally, the Bankruptcy Court's conclusion that the Equity Committee has alternatively stated a colorable claim that the Settlement Noteholders are corporate insiders for insider trading purposes on grounds that they are "non-statutory insiders" under bankruptcy law[11]

[11] A "non-statutory insider" under bankruptcy law is a party that is not in one of the categories enumerated in Section 101(31) of the Bankruptcy Code but has such a close and controlling

is equally flawed. First, the Opinion relies on the Settlement Noteholders' "status as holders of blocking positions in two classes of the Debtors' debt structure" to conclude that "[a]s such, it could be found that [the Settlement Noteholders] owed a duty to the *other members of those classes* to act for their benefit."[12] (Opinion at 132 (emphasis added)). But it is irrelevant whether the Settlement Noteholders had duties to other members of certain classes of debt (which they did not).[13] The issue is whether the Settlement Noteholders were insiders of the *Debtors*, with fiduciary duties to the Debtors. And, as the Bankruptcy Court already found, the Settlement Noteholders did not owe any such duties to the Debtors. *See In re Wash. Mut., Inc.*, 442 B.R. at 349 ("The Settlement Noteholders were not acting in this case in any fiduciary capacity; their actions were taken solely on their own behalf, not others.").

Furthermore, the Bankruptcy Court cites no basis upon which to import the bankruptcy law concept of non-statutory insiders into the securities law. We are aware of no case that equates, or supplements, the temporary insider analysis with a non-statutory insider analysis. But even if it were appropriate to do so, there is no basis here to conclude, even under the "colorability" standard that the Bankruptcy Court espoused, that the Settlement Noteholders were non-statutory insiders. Quite simply, the Settlement Noteholders did not have the type of influence or control over the Debtors to suggest that transactions between them "were not

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relationship with a debtor so as to suggest that transactions with a debtor were not conducted at arm's length.

[12] In this respect, it bears noting that none of the Settlement Noteholders was obligated to vote in any particular way, and any Settlement Noteholder blocking positions would have been illusory in any event, as the Debtors could "cram down" the reorganization plan even on creditors who held such blocking positions. *See* 11 U.S.C. § 1129(b).

[13] The Settlement Noteholders vigorously dispute any suggestion that they had fiduciary duties to any other creditors, or to each other.

conducted at arm's length." *See Shubert v. Lucent Techs., Inc. (In re Winstar Commc'ns, Inc*.) 554 F.3d 382, 396-97 (3d Cir. 2009). The Bankruptcy Court itself concluded that the Settlement Noteholders did not "dominate" or "hijack" the settlement negotiations, and that the Plan was proposed in good faith. (Opinion at 27-29). Moreover, all of the cases referenced in the non-statutory insider portion of the Opinion deal with facts that are radically different than those present here,[14] or do not concern the non-statutory insider issue at all.[15]

(ii) There Is No Basis for An Insider Trading Claim Against The Settlement Noteholders Under The Misappropriation Theory

The Bankruptcy Court's holding that the Equity Committee and certain holders of the Trust Preferred Securities (the "TPS Group")[16] have stated a colorable claim that the Settlement Noteholders engaged in insider trading under the misappropriation theory is baseless,

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[14] *See Schubert*, 554 F.3d 382 (in context of a preference dispute, court held creditor as non-statutory insider when it used its pre-petition dual role as trade vendor and lender to transform the Debtor into a "mere instrumentality to inflate [the creditor's] own revenues."); *In re Allegheny Int'l, Inc.*, 118 B.R. 282, 298-99 (Bankr. W.D. Pa. 1990) (creditor "exploited" access by, among other things, seeking information from employees in violation of court orders).

[15] *See In re Wash. Mut., Inc.*, 419 B.R. 271 (Bankr. D. Del. 2009) (dispute regarding whether Bankruptcy Rule 2019 disclosure requirements applied to ad hoc group of creditors); *Official Comm. of Equity Sec. Holders of Mirant Corp. v. Wilson Law Firm, P.C. (In re Mirant Corp.)*, 334 B.R. 787 (Bankr. N.D. Tex. 2005) (preliminary injunction action regarding whether enjoining the representative of a shareholder class from disseminating misleading solicitation materials would be an impermissible restraint on free speech); *Rickel & Assocs., Inc. v. Smith (In re Rickel & Assocs., Inc.)*, 272 B.R. 74 (Bankr. S.D.N.Y. 2002) (creditor using his position on the creditors' committee to advance his personal interests); *Luedke v. Delta Air Lines, Inc.*, 159 B.R. 385 (S.D.N.Y. 1993) (claims based upon fact that defendant creditors' committee was a joint sponsor and proponent of plan and had, among other things, allegedly intentionally leaked counsel communications to the press).

[16] The Bankruptcy Court concluded that both the Equity Committee and the TPS Group had stated such a claim when, in fact, the TPS Group never sought standing to bring any claims or joined in the Equity Committee's Motion to Authorize, and the Equity Committee explicitly stated that it was *not* proceeding under the misappropriation theory. (8/24/2011 Tr. 225 ("And,

wrong and without support in the record. (Opinion 135-37). Under this theory, a person engages in insider trading when he or she "trades while in knowing possession of material, non-public information that has been gained in violation of a fiduciary duty to its source," regardless of whether that source is an insider. *United States v. Cusimano*, 123 F.3d 83, 87 (2d Cir. 1997). The record below is clear and unequivocal – there was no misappropriation and no evidence of misappropriation was provided to the Court.

In its consideration of the misappropriation theory, the Bankruptcy Court relied on the unsupported and baseless allegation that Fried Frank – lawyers representing the Settlement Noteholders[17] – may have shared confidential information with the Settlement Noteholders in violation of a confidentiality agreement that Fried Frank entered into with the Debtors. There was no evidence at trial that Fried Frank had violated this agreement. Indeed, at the close of evidence, Debtors' lead counsel, as an officer of the court, affirmatively represented on the record that "the debtors have seen nothing, and no one has presented any evidence that such confidentiality agreements with Fried Frank, with White & Case, or with any other party that had one executed was breached by any of those counsel." (8/24/2011 (Rosen) Tr. 47). Thus, as the Debtors' attorney made clear, at no time did Fried Frank breach any agreements with the Debtors or fail to adhere to its confidentiality undertakings. Nor is there any evidence whatsoever that the Settlement Noteholders believed or had reason to believe that Fried Frank had done so.

Accordingly, the Bankruptcy Court's holding was clearly in error.

c. The Bankruptcy Court Erred in Failing to Address Deception as a Required Element of a Claim for Insider Trading

A "deceptive or manipulative device" is a required element of any claim of insider trading, regardless of whether it is asserted under the classical theory or the misappropriation theory. In this case, deception has not been asserted or shown, and it was simply unaddressed by the Bankruptcy Court. *See* Post-Confirmation

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so I think that's a critical point given *we're not arguing a misappropriation theory*, Your Honor; we are resting on the two grounds that I've argued here today." (emphasis added)).

Hearing Brief of Centerbridge Partners, L.P. in Support of the Modified Sixth Amended Plan of Reorganization, at ¶¶ 75-79.

Rule 10b-5 – entitled "Employment of Manipulative and Deceptive Devices" – requires that the party accused of violating the rule deceive someone to whom it owes a fiduciary duty or a similar duty of trust and confidence. In the classical theory context, an insider's trading on the basis of material non-public information qualifies as a "deceptive device" under Section 10(b) and Rule 10b-5 because a relationship of trust and confidence exists between corporate insiders and the company's shareholders. This relationship creates the expectation that the corporate insider will not use the information to which it became privy by virtue of its insider status for its own personal benefit, rather than the benefit of the corporation. *See United States v. O'Hagan*, 521 U.S. 642, 652 (1997) (quoting *Chiarella v. United States*, 445 U.S. 222, 228-29 (1980)). Corporate insiders who trade on the information deceive the company and its shareholders by breaching this fundamental expectation arising out of their relationship. Likewise, under the misappropriation theory, a party violates Rule 10b-5 when it trades on material non-public information in breach of a duty of trust and confidence owed to the source of the information, because its "undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information." *Id.* In other words, the "deceptive device" in the context of the misappropriation theory is "fiduciary-turned-trader's deception of those who entrusted him with access to confidential information." *Id.*

However, as the Supreme Court has made clear, "if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation." *O'Hagan*, 521 U.S. at 655.

Because deception is the touchstone of any Rule 10b-5 violation, no such violation exists without the requisite deceptive conduct. The uncontroverted facts establish that there was no deception here. There is no dispute that the Debtors, the source of the information and the party to whom any duty would be owed, were not deceived by the Settlement Noteholders in any way. Quite to the contrary, the Debtors were aware of and sanctioned the Settlement Noteholders' trading following each of the confidentiality periods. (7/21/2011 (Kosturos)

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[17] In July 2009, Fried Frank only represented two of the four Settlement Noteholders, Appaloosa and Centerbridge.

Tr. 101-02, 122-23, 128-29, 151, 153). In the face of Rule 10b-5, which requires a finding of deception in any case of insider trading, and the evidence on the record, which plainly shows that no such deception existed in this case, the Bankruptcy Court's conclusions cannot stand.

d. The Bankruptcy Court Erred in Not Requiring the Requisite Evidence of Scienter

The Bankruptcy Court erred in determining that the Equity Committee stated a "colorable claim" of insider trading against the Settlement Noteholders despite the Equity Committee's lack of any evidence of scienter and its express concession that it did not have "the kind of scienter evidence that would be expected in some sort of a government criminal case" – an argument which is clearly contrary to the directive of Congress and the Supreme Court that such actions have to be pled with particularity, and can only survive a motion to dismiss if there is a "strong inference" of fraud. 15 U.S.C. § 78u-4(b)(2); *Tellabs Inc. v. Makor Issues & Rights*, 551 U.S. 308, 322-23 (2007). *See also Inst. Investors Group v. Avaya, Inc.*, 564 F.3d 242, 252-53 (3d Cir. 2009). (8/24/2011 Tr. 226; Opinion at 135). Given the Equity Committee's failure to plead *any* particularized facts with respect to scienter for any of the Settlement Noteholders, the Bankruptcy Court's determination that the Equity Committee's claim was "colorable" essentially eliminates scienter from the insider trading laws, and flouts Congress's and the Supreme Court's directive that scienter be plead with particularity *at the pleading stage*. *See Tellabs, Inc.*, 551 U.S. at 319 (emphasis added).

Scienter is a necessary element of insider trading. *See Tellabs, Inc.*, 551 U.S. at 319 (2007); *Aaron v. SEC*, 446 U.S. 680, 691 (1980). In private lawsuits alleging insider trading, a complaint filed by a plaintiff must "state with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind" with respect to "each act or omission alleged to violate" the federal securities laws. 15 U.S.C. § 78u-4(b)(2); *See Tellabs*, 551 U.S. at 322-23; *Inst. Investors Group v. Avaya, Inc.*, 564 F.3d 242, 252-53 (3d Cir. 2009). The inference of scienter must be at least as compelling as any competing innocent inference. *Avaya*, 564 F.3d at 267-68 (citing *Tellabs*, 551 U.S. at 323-24). This is true despite the fact that a plaintiff is not supposed to have access to discovery at the pleading stage. *See SG Cowen Securities Corp. v. U.S. Dist. Court for the N. Dist. of Cal.*, 189 F.3d 909, 912-13 (9th Cir. 1999) (granting mandamus to restore discovery stay in insider trading case where the district court had rejected the pleadings for insufficient particularity, but nonetheless authorized limited discovery to support the plaintiffs' allegations of insider trading); *Winer Family Trust v. Queen*, 2004 WL 350181, at *1 (E.D. Pa. Feb 6, 2004).

Thus, even before discovery is taken, a plaintiff must be able to show with particularity that a defendant acted with "a knowing or reckless state of mind." *Avaya*, 564 F.3d at 252. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) ("the term 'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud"); *SEC v. Infinity Group Co.*, 212 F.3d 180, 192 (3d Cir. 2000). Here, the Equity Committee failed to make a particularized claim that the Settlement Noteholders acted with such a state of mind even after the Equity Committee was afforded discovery and a full hearing.

A showing of knowledge or recklessness is required with respect to both (1) the "deceptive device" employed vis-à-vis the source of the information, and (2) the materiality of the information in the defendant's possession. *See McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979) (internal citations omitted) ("[T]he scienter element in a § 10(b) case require[s] 'a conscious deception or . . . a misrepresentation so recklessly made that the culpability attaching to such reckless conduct closely approaches that which attaches to conscious deception.'"); *SEC v. MacDonald*, 699 F.2d 47, 50 (1st Cir. 1983) (requiring a plaintiff to show that a defendant knew the information in its possession was material).

As discussed above, there has been no showing that the Settlement Noteholders knowingly or recklessly employed a "deceptive device" when trading in the Debtors' securities.

To the contrary, the Debtors knew and sanctioned the Settlement Noteholders' trading following the expiration of each confidentiality period.

Additionally, with respect to knowledge of materiality, the Equity Committee was required to state with particularity, for each particular trade at issue, facts that made a compelling showing (a) that the Settlement Noteholders *knew* the information they possessed was material or (b) that the information was "so obvious[ly]" material that the Settlement Noteholders must have understood its importance. Despite extensive discovery on these issues and days of testimony, the Equity Committee failed to set forth any facts giving rise to a strong inference of either recklessness or knowledge. To the contrary, given the Bankruptcy Court's uncertainty about the materiality of the information at issue – the Bankruptcy Court could only find that it "*may* have shifted *towards* the material end of the spectrum" – the Equity Committee failed to make a particularized showing that the Settlement Noteholders acted recklessly or knowingly as a matter of law. (Opinion at 128 (emphasis added)). Indeed, the uncontested (and only) facts elicited with regard to state of mind established that the Settlement Noteholders did not believe that the information at issue was material, and that the Debtors and Debtors' securities counsel at Weil, Gotshal & Manges LLP had independently assured the Settlement Noteholders that the information at issue was *not* material *prior* to the Settlement Noteholders making any trades.[18]

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[18] The Bankruptcy Court improperly rejected this evidence on the ground that there is no "reliance exception to the scienter element of insider trading." It is unclear what the Bankruptcy Court meant by this statement. The fact that the Settlement Noteholders consulted with the Debtors and their counsel to obtain an independent assessment of materiality showed a clear lack of scienter on the part of the Settlement Noteholders, and is further evidence that the information at issue was not "so obvious[ly]" material. *See Avaya*, 564 F.3d at 267 n.4. Moreover, the Settlement Noteholders' reliance on the Debtors' assessment that all material information had been disclosed was reasonable. Not only were the Debtors required under the confidentiality agreements to publicly disclose any material information that they had shared with the Settlement Noteholders, they were also required to do so by law under Regulation FD: "when an

Avaya, 564 F.3d at 267-28 (quoting *Tellabs*, 551 U.S. at 323-34) (directing courts to "weigh the 'plausible nonculpable explanations for the defendant's conduct' against the 'inferences favoring the plaintiff,'" and not merely focus on "'whether any individual allegation, scrutinized in isolation, meets that standard'"). The uncontested facts also showed that, to avoid running afoul of the insider trading laws, the Settlement Noteholders voluntarily restricted themselves from trading at times even though the Debtors did not require them to do so. (Opinion at 67, 68, 123).

Given all of the evidence supporting the Settlement Noteholders' contention that they did not act with scienter, and the complete lack of facts to the contrary, dismissal of the Equity Committee's Motion was required as a matter of law. *See Tellabs*, 551 U.S. at 323-24; *Avaya*, 564 F.3d at 267-68. The Bankruptcy Court's failure to do so improperly lowered – indeed, removed – the scienter requirement under the securities laws, and committed precisely the type of judicial legislation repeatedly disparaged by the Supreme Court. *See Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2301 (2011) ("in analyzing [a claim] for purposes of Rule 10b–5, we are mindful that we must give narrow dimensions to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law." (internal citations omitted)); *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 163 (2008) ("It is appropriate for us to assume that when § 78u–4 was enacted, Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further."). The Bankruptcy Court had no authority to do this. Indeed, if the well-

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issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it *must make public disclosure of that information*." Rel. Nos. 33-7881, 34-43154, IC-24599, available at http://sec.gov/rules/final/33-7881.htm (emphasis added). *See* 15 U.S.C. § 78j(b); 17 C.F.R. §§ 240.10b-5, 243.100.

settled law on scienter is to change, that is a change that only Congress or the Supreme Court is authorized to make. An immediate appeal is, therefore, warranted.

Finally, the Bankruptcy Court erred when it ruled, as a matter of law, that an advice of counsel defense would be unavailing to the Settlement Noteholders. (Opinion at 135). Such a ruling conflicts with the Third Circuit's statement that "[a]dvice of counsel may bear upon scienter in some cases: where, for example . . . counsel mistakenly but in good faith represent that some information is either immaterial or clear," and therefore raises a substantial difference of opinion that should be resolved by an Article III court. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 680 F.2d 933, 942-43 (3d Cir. 1982). *See also United States v. Bush*, 626 F.3d 527, 539 (9th Cir. 2010) (recognizing an advice of counsel defense, but requiring that the defendant "show that he made a full disclosure of all material facts to his attorney and that he then relied in good faith on the specific course of conduct recommended by the attorney.") (internal quotation marks and citations omitted); *Zacharias v. S.E.C.*, 569 F.3d 458, 467 (D.C. Cir. 2009) (noting that the existence of an advice of counsel defense is an open question in the D.C. Circuit); *United States* v. *Wenger*, 427 F.3d 840, 853 (10th Cir. 2005) (finding that the good faith reliance on counsel is a "factor a jury may consider when determining whether a defendant acted willfully"); *Markowski v. S.E.C.*, 34 F.3d 99, 104–05 (2d Cir.1994) (same).

3. Appaloosa and Owl Creek's Procedural Due Process Rights Were Violated

In one of the most glaring examples of error prejudicing the Settlement Noteholders, the Bankruptcy Court granted a purported motion against Appaloosa and Owl Creek that was never made and as to which Appaloosa and Owl Creek were never granted the right to be heard. *See generally Alexander v. Primerica Holdings, Inc.*, 10 F.3d 155, 166 (3d Cir.

1993). This action by the Bankruptcy Court plainly violated Appaloosa and Owl Creek's procedural due process rights, and undermined notions of fundamental fairness and proper administration of justice. *See Chambers Dev. Co., Inc. v. Passaic County Utilities Auth.*, 62 F.3d 582, 584 n.5(3d Cir. 1995) (holding that the district court erred in entering a summary judgment motion *sua sponte* without first placing the adversarial party on notice, and providing that party with an opportunity to present relevant evidence in opposition to that motion).

As is clear from the record, on July 12, 2011, the Equity Committee filed a Motion "authorizing [it] to commence and prosecute certain claims and causes of action . . . against Centerbridge Partners, L.P. and certain of its managed funds ("Centerbridge") and Aurelius Capital Management, LP and certain of its managed funds ("Aurelius") on behalf of the Debtors' Chapter 11 estates." (Motion to Authorize at 1). The Motion to Authorize and the proposed complaint appended to it did not name as defendants or make any specific allegations against either Appaloosa or Owl Creek, but rather sought redress against two entirely different creditors. (*Id.* at 1, 2, 3, 6).

During oral arguments on August 24, 2011, the following colloquy between counsel for the Equity Committee and the Bankruptcy Court occurred:

> THE COURT: I have one question; I think your motion and proposed complaint only mentions two settlement noteholders. Is your request to be able to pursue all four or only those two?
>
> MR. FOLSE: . . . .When we filed the motion for leave to file the adversary proceeding, we explicitly stated in there that we reserve the right to ask for permission to pursue claims – additional claims – against the two parties that were named in the proposed complaint at the time, as well as against other parties. And to be honest, Your Honor, we wanted to see what came out at the plan confirmation hearing. *But Your Honor, we do reserve the right – and I suspect it's likely we have not discussed this with the equity committee, one thing at a time, it's an issue that obviously requires the Court to decide that the case will be able to go forward at all –*

> *but that is definitely an issue we want to reserve on, and we may well be coming back to the Court if the case is permitted to proceed, with a request to amend it for that purpose.*[19]

(8/24/2011 Tr. 233-34 (emphasis added).

Despite the Equity Committee's explicit acknowledgement that it was not seeking standing for an action against Appaloosa or Owl Creek and *despite making no allegations against them in the Motion to Authorize and not naming them in the accompanying proposed complaint*, the Bankruptcy Court nonetheless found that the Equity Committee had set forth a colorable claim of insider trading against them, and granted relief to the Equity Committee which it did not seek and on which the Committee expressly told the Court it was reserving. A reservation of rights to assert a claim is not a claim, much less a pleading. The Bankruptcy Court thus also placed Appaloosa and Owl Creek in an untenable position by ordering them to mediate an action for which there are no stated claims and no damages alleged as against them.

All of this was clearly error and an abuse of the Bankruptcy Court's discretion. As the Supreme Court has explained:

> In our adversary system, in both civil and criminal cases, in the first instance and on appeal, we follow the principle of party presentation. That is, we rely on the parties to frame the issues for decision and assign to courts the role of neutral arbiter of matters the parties present. . . . [A]s a general rule, "[o]ur adversary system is designed around the premise that the parties know what is best for them, and are responsible for advancing the facts and arguments entitling them to relief."

Greenlaw v. United States, 554 U.S. 237, 243-44 (2008) (quoting *Castro v. United States*, 540 U.S. 375, 381-383, 386 (2003)).

[19] The Equity Committee asserted its view that "all four" of the Settlement Noteholders traded while in possession of material, nonpublic information for the first time on August 10, 2011 when it filed its Post-Hearing Brief in Opposition to Confirmation. At no point, however, did the Equity Committee seek to amend its Motion to Authorize.

Misstating the record, the Bankruptcy Court asserted that "[a]t oral argument, the Equity Committee [had] clarified that it [sought] authority to bring such a claim against all four Settlement Noteholders." (Opinion at 70 n.31). As reflected above, however, the Equity Committee never sought such authority, and never brought such a motion.[20] Appaloosa and Owl Creek were not apprised of the pendency of an action against them (because there was none), and were not afforded the opportunity to be heard. *See In re Mansary-Ruffin*, 530 F.3d 230, 239 (3d Cir. 2008) (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."); *Eash v. Riggins Trucking Inc.*, 757 F.2d 557 (3d Cir. 1985) (vacating and remanding an order of the district court which imposed sanctions *sua sponte* against counsel without any notice to the parties or any hearing); *Scott Finance Co. v. Andrews*, Civ. No. 90-4574 (CSF), 1991 WL 37883 (D.N.J. Mar. 18, 1991) (reversing the imposition of sanctions on counsel by the U.S. Bankruptcy Court for the District of New Jersey on the grounds that sufficient notice was not provided).

Because it is axiomatic that every litigant appearing before a United States tribunal be afforded the same basic rights – including, the right to a full "opportunity to present [] objections" before a "fair tribunal" – an immediate appeal is warranted. *In re Mansary-Ruffin*, 530 F.3d at 239 (citing *Mullane*, 339 U.S. at 314); *Haines v. Ligget Group Inc.*, 975 F.2d 81, 98 (3d Cir. 1992) (citing *In re Murchison*, 349 U.S. 133, 136 (1955)).

[20] The Equity Committee could not have sought to amend its Motion and join Appaloosa and Owl Creek at that juncture in any event without affording them an opportunity to be heard.

II.
IN THE ALTERNATIVE, A WRIT OF MANDAMUS SHOULD BE GRANTED

The Bankruptcy Court's order equally merits reversal or vacatur through the issuance of a writ of mandamus.[21]

Mandamus is proper when (i) "the party seeking issuance of the writ . . . [has] no other adequate means to attain the relief he desires"; (ii) the petitioner shows "that [his] right to issuance of the writ is clear and indisputable"; and (iii) "the issuing court, in the exercise of its discretion, [is] satisfied that the writ is appropriate under the circumstances." *Cheney v. U.S. Dist. Court for Dist. of Columbia*, 542 U.S. 367, 380-81 (2004) (internal quotation marks and citations omitted). All three factors are satisfied here.

First, absent exercise of this Court's appellate jurisdiction under Section 158(a)(3), AOC have no adequate alternative remedy for (a) preventing the substantial depletion of the Estates' resources as a result of the inevitable delay that will result from this frivolous lawsuit; and (b) correcting the serious constitutional violations suffered by Appaloosa and Owl Creek. Thus, the first prong is met. *Stein v. KPMG, LLP*, 486 F.3d 753, 759 (2d Cir. 2007).

Second, AOC's right to issuance of the writ is clear and indisputable. As the Third Circuit held, "mandamus is appropriate when a district court has failed to adhere to the mandate of an appellate court"[22] – something the Bankruptcy Court clearly did here when it ignored Supreme Court precedent concerning the federal securities laws. *See supra* pp. 22-39.

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[21] AOC incorporates all of the arguments set forth in Section I, *supra*, as a basis for granting the issuance of a writ of mandamus.

[22] *In re Chambers Dev. Co.*, 148 F.3d 214, 223, 224 (3d Cir. 1998). *See also In re BP Lubricants USA Inc.*, 637 F.3d 1307 (Fed. Cir. 2011) (granting mandamus to resolve the "basic and undecided" question of the "requisite level of pleading required" for false marking cases).

Third, the writ is clearly appropriate under these circumstances. Adjudication of the issues raised in this petition involves pure questions of law. Given the Bankruptcy Court's grant of a stay and forced mediation, the failure to issue a writ will cause months, if not years, of delay and significant administrative costs to the Estates. By contrast, resolution of this matter now will prevent this meritless adversary proceeding from moving forward, and likely result in prompt distributions to creditors.

By ignoring controlling precedent, the decision of the Bankruptcy Court caused, and is continuing to cause, significant reputational harm to four creditors. That is unacceptable: "neither this court, nor any other court, [should] tolerate a situation where a judge decides to follow his/her own custom and concepts of justice rather than the precedent of the applicable appellate court or the United States Supreme Court. Ours is a nation of laws, not judges." *United States v. Higdon*, 638 F.3d 233, 247 (3d Cir. 2011).

Mandamus is warranted.

CONCLUSION

For all the reasons set forth above, AOC respectfully request leave to appeal the Bankruptcy Court's decision or, alternatively, vacatur through the issuance of a writ of mandamus.

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BLANK ROME LLP

/s/ Michael D. DeBaecke
Michael D. DeBaecke (DE No. 3186)
Victoria A. Guilfoyle (DE No. 5183)
1201 Market Street, Suite 800
Wilmington, Delaware 19801
Telephone: (302) 425-6400
Facsimile: (302) 425-6464
Email: debaecke@blankrome.com
Email: guilfoyle@blankrome.com

-and-

Barry G. Sher, Esq.
Maria E. Douvas, Esq.
PAUL HASTINGS LLP

75 East 55th Street
New York, New York 10022
Telephone: (212) 318-6000
Facsimile: (212) 319-4090
E-mail: barrysher@paulhastings.com
mariadouvas@paulhastings.com

Attorneys for Appaloosa Management L.P., on behalf of Appaloosa Investment L.P. I, Palomino Fund Ltd., Thoroughbred Fund L.P. and Thoroughbred Master Ltd.

-and-

Alan Glickman, Esq.
Adam C. Harris, Esq.
William H. Gussman, Jr., Esq.
SCHULTE ROTH & ZABEL LLP
919 Third Avenue
New York, New York 10002
Telephone: (212) 756-2000
Facsimile: (212) 593-5955
E-mail: alan.glickman@srz.com
adam.harris@srz.com
bill.gussman@srz.com

Attorneys for Owl Creek Asset Management, L.P., on behalf of Owl Creek I, L.P., Owl Creek II, L.P., Owl Creek Overseas Master Fund, Ltd., Owl Creek SRI Master Fund, Ltd., Owl Creek Asia I, L.P., Owl Creek Asia II, L.P. and Owl Creek Asia Master Fund, Ltd.

-and-

Richard D. Owens, Esq.
Mark A. Broude, Esq.
LATHAM & WATKINS LLP
885 Third Avenue, Suite 1000
New York, New York 10003
Telephone: (212) 906-1200
Facsimile: (212) 751-4864
E-mail: richard.owens@lw.com
mark.broude@lw.com

Attorneys for Centerbridge Partners, L.P., on behalf of Centerbridge Special Credit Partners, L.P., Centerbridge Credit Partners, L.P. and Centerbridge Credit Partners Master, L.P.