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8 **UNITED STATES BANKRUPTCY COURT**
9 **NORTHERN DISTRICT OF CALIFORNIA**
10 **SAN FRANCISCO DIVISION**

11 In re

12 HELLER EHRMAN LLP,

13
14 Debtor.

Case No(s): 08-32514

Chapter 11

**RESPONSE OF AD HOC SHAREHOLDER
GROUP TO EMERGENCY
APPLICATION TO APPROVE, *NUNC
PRO TUNC* TO SEPTEMBER 22, 2009,
THE DEBTOR'S AGREEMENT TO
DESIGNATE THE OFFICIAL
COMMITTEE OF UNSECURED
CREDITORS AS THE REPRESENTATIVE
OF THE ESTATE TO BRING ANY AND
ALL CLAIMS AGAINST THE HELLER
EHRMAN LLP RETIREMENT PLAN**

[No Hearing Set]

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¹ There are presently approximately 90 former shareholders in the Ad Hoc Shareholder Group. As Bankruptcy Rule 2019 does not appear to be applicable, naming the members is not necessary and would be needlessly voluminous. However, should the Court wish a listing, we will provide it promptly.

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I.
Introduction

The undersigned, a group of approximately 90 former shareholders (the “Ad Hoc Shareholder Group”) of various professional corporations that were partners of Heller Ehrman LLP (“Debtor”), most of whom are also participants in the LEO Plan, respond to the *Emergency Application to Approve, Nunc Pro Tunc to September 22, 2009, the Debtor’s Agreement to Designate the Official Committee of Unsecured Creditors as the Representative of the Estate to Bring Any and All Claims against the Heller Ehrman, LLP Retirement Plan*, Dkt. No. 643 (the “Emergency Application”)² for the purpose of bringing certain facts to this Court’s attention and reserving their rights with respect thereto.³

The Ad Hoc Shareholder Group submits this pleading in order to make clear its view that the Official Committee of Unsecured Creditors (the “Committee”) has already interfered wrongfully with ERISA-protected retirement funds and inflicted substantial damages on affected former shareholders. Granting the Committee permission to file an action for injunctive relief – which has absolutely no chance of succeeding – will serve only to increase the shareholders’ damages and the Debtor’s expenses, as well as the Debtor’s exposure to future claims for wrongful interference.

As elaborated upon below, the Committee cannot prove that the LEO Plan contributions in question were fraudulent transfers and could not recover from the LEO Plan assets even if they were.

First, the Committee cannot show that the Debtor had unreasonably small capital – meaning that the firm was unable “to generate sufficient profits to sustain operations” and

² This response attempts to use the same terminology as the *Emergency Application*.

³ Some of the members of the Shareholder Group have filed proofs of claim, but they recognize that their interest in the issues presented here is not in that capacity. Although they may not have standing to oppose the *Emergency Application*, see, e.g., Adelphia Communs. Corp. v. Bank of Am. (In re Adelphia Communs. Corp.), 330 B.R. 364, 368 n.3 (Bankr. S.D.N.Y. 2005), this Court’s abilities to police this case and, as discussed below, to act as a prudent gatekeeper are not similarly constrained.

1 was “on the road to ruin” – at year-end 2007. On the contrary, the firm earned more than
2 \$175 million in profits during 2007. The firm’s bankers and auditors scrutinized the firm’s
3 books throughout 2007, and found no issue regarding its viability. In fact, the evidence will
4 demonstrate that the firm failed in September 2008 as a result of the most precipitous and
5 severe economic downturn since the Great Depression, a downturn which killed countless
6 venerable institutions, including, of particular significance to the Debtor, Lehman Brothers
7 (which failed the same week as the Debtor) and several other major law firms.

8 Second, the money paid to the shareholders under the Employment Agreements at the
9 end of 2007 was compensation for work done that year and thus was for reasonably
10 equivalent value. By distorting and selectively quoting from both the Employment
11 Agreement and the applicable law, the Committee tries to analogize the distributions to
12 dividends, but that case cannot stand even minimal scrutiny.

13 Additionally, as evanescent as the Committee’s case is as to the year-end
14 compensation generally, it is even less substantial with respect to the money in the LEO
15 Plan. Not only were the Debtor’s contributions made in exchange for services rendered by
16 Plan participants, the Debtor’s obligation to make those contributions became fixed and
17 binding as to a participant as soon as he or she worked 1,000 hours in any calendar year,
18 which happened in virtually all cases by mid-2007.

19 The Creditors Committee’s newly proffered “preference” argument is also of no
20 moment at all. As the LEO Plan contributions were made no later than January 2008, and
21 the Petition Date was more than eleven months later, the LEO contributions could be
22 avoidable only if the shareholders in question were “insiders” and the Debtor was insolvent
23 as of that time. There is no evidence to suggest insolvency (indeed, the Committee carefully
24 avoids so arguing) and, as we discuss below, nothing in the *Emergency Application* suggests
25 how or why each of roughly 250 shareholders of a multi-city international law firm was an
26 insider under the Code.

27 Perhaps most important for present purposes, even if the Committee could prove its
28 claims against the shareholders, the Committee could not – as a matter of law – recover

1 directly from the LEO Plan. Both the governing LEO documents and ERISA explicitly
2 provide that creditors cannot recover from a qualified retirement plan on claims against plan
3 participants. Courts have repeatedly held that ERISA qualified plan funds are sacrosanct
4 even against claims alleging that the funds in question were contributed as a result of
5 criminal fraud, so they are most assuredly untouchable in the present circumstances.

6 The Emergency Application is a travesty. Given the obvious weakness of the
7 Committee's purported claims, we can only assume that it is being prosecuted in order to
8 gain tactical advantage and to put illegitimate pressure on former Heller shareholders. The
9 Court should not tolerate such gamesmanship.

10 **II.**
11 **Events Leading Up to Emergency Application**

12 1. The Debtor filed its chapter 11 case on December 28, 2008 ("Petition Date").
13 No trustee has been appointed.

14 2. The powers of the debtor-in-possession have been exercised since the Petition
15 Date by a four-person Dissolution Committee, comprised of Peter J. Benvenuti (now of
16 Jones Day LLP); Jonathan P. Hayden (now of Lovitt & Hannan, Inc.); Lynn J. Loacker (now
17 of Davis Wright Tremaine LLP); and Paul W. Sugarman (now inactive).⁴

18 3. The Committee was formed shortly after the case was filed and has been
19 investigating the Debtor's affairs for roughly eight months. *Declaration of Thomas A.*
20 *Willoughby etc.* ("Willoughby Decl."), ¶ 2, attached to *Emergency Application*.

21 4. Prior to the Petition Date, the Debtor dissolved and began winding up its
22 affairs. *Benvenuti Decl.*, ¶ 1. The wind-up included termination of its various ERISA-
23 qualified plans, including the LEO Plan. *Declaration of John D. Fiero* ("Fiero Decl."), ¶¶ 3-
24 4, attached to *Ex Parte Application for Order Authorizing the Debtor to Transfer Employee*

25 _____
26 ⁴ The members of the Dissolution Committee were disclosed in the *Declaration of Peter J.*
27 *Benvenuti in Support of First Day Motions*, Dkt. No. 10, ¶ 2 ("Benvenuti Decl."). The current
28 affiliations of the other members of the Dissolution Committee are obtainable on the websites of
the identified law firms and/or on the State Bar of California website
(http://www.calbar.ca.gov/state/calbar/calbar_home.jsp).

1 *Benefit Plan Administrator Duties under 11 U.S.C. §521(A)(7) to Keith Betzina* (“Betzina
2 Application”), Dkt. No. 573.

3 5. The termination of the LEO Plan continued during the course of the chapter 11
4 case, as did the Committee’s investigation. *Official Committee of Unsecured Creditors’*
5 *Non-Opposition to Ex Parte Application for Order Authorizing the Debtor to Transfer*
6 *Employee Benefit Plan Administrator Duties under 11 U.S.C. §521(A)(7) to Keith Betzina,*
7 (“Committee Non-Opposition”), Dkt. No.591, *passim*.

8 6. In late July 2009, on the eve of the planned distribution of all LEO Plan funds
9 to plan participants – after the Plan Administrator had already liquidated the investments and
10 transferred the proceeds to money-market funds for ease of distribution – the Committee,
11 without basis in fact or law (as discussed below) and aware that the LEO Plan was regulated
12 by ERISA, *id.*, ¶¶ 12-14, attempted first to prevent any distribution to LEO Plan participants.
13 The Committee ultimately withdrew that outrageous demand on the condition that
14 \$13,800,000 be withheld from the scheduled distribution. *Id.*, ¶ 16.

15 7. The Committee’s interference had its calculated effect, with the result that
16 there has been a two month delay in distributing \$13,800,000 of LEO Plan assets to
17 participants. Notably, during those two months, the Plan Administrator and his counsel have
18 incurred expenses, the assets have sat in a money market account (effectively earning no
19 interest), and the equity markets (where these funds were invested previously) have surged.
20 As a result, a period which should have produced gains for the LEO participants has
21 produced losses.⁵

22 8. This delay was procured (improperly, the Ad Hoc Shareholder Group submits)
23 under a protocol that, for all its infirmities, at least promised a prompt resolution of questions
24 the Committee had with respect to the LEO Plan assets. In aid of this protocol, and given its
25 counsel’s unfamiliarity with ERISA, the Committee expressly affirmed its willingness to rely
26

27 ⁵ In the two months since July 31, 2009 the S&P 500 has risen approximately 8%, meaning that if
28 the funds were in that broad based index they would have increased in value by over \$1 million
rather than declining as the result of administrative costs.

1 upon an ERISA expert, “the Debtor’s proposed pension plan counsel (who is being hired to
2 replace Greenberg Traurig LLP with respect to pension plan issues), [and who is advising]
3 the Committee pursuant to a common interest agreement executed by the Debtor and the
4 Committee.” *Committee Non-Opposition*, ¶ 12.⁶

5 9. The Committee has not revealed what Trucker Huss has concluded, but there is
6 certainly no evidence nor any basis to believe that Trucker Huss or anyone else has
7 concluded that these ERISA funds should be further detained. Indeed, all the indications are
8 to the contrary.

9 10. The lack of any lawful basis for further detention of the funds is also made
10 manifest by the *Emergency Application*, the urgency of which is premised upon a concern
11 that the mutually agreed upon replacement Plan Administrator, “Mr. Keith Betzina (per order
12 of August 18, 2009), could move to complete the closure of the LEO Plan and distribute the
13 Remaining LEO Plan Funds at any time.” *Emergency Application*, ¶ 6.⁷

14 11. Notably, as discussed below, the Committee has offered no facts and no law to
15 demonstrate that if Mr. Betzina did act as the Committee has speculated, he would be
16 proceeding in error.

17 **III.**
18 **The Court’s Obligation as Gatekeeper**

19 12. The lack of any discussion of the facts or the law by the Committee is
20 particularly notable because, even with a stipulation from the Debtor to pursue claims on
21 behalf of the estate, the Court still must find that “suit by the committee is (a) in the best
22

23 ⁶ Other filings make clear the Committee was referring to the Trucker Huss, P.C., which is
24 employed in this case as “Special Benefits Counsel.” Dkt. No. 588.

25 ⁷ Mr. Betzina, himself a lawyer at Davis Wright Tremaine, specializes in “issues concerning
26 employee pension and welfare benefit plans subject to ERISA, including a wide variety of design
27 and compliance issues involving virtually every conceivable type of plan.”
28 <http://www.dwt.com/People/keithbetzina>. Other communications have indicated Mr. Betzina,
his expertise notwithstanding, has counsel who are also ERISA experts. In addition to imposing
a distressing amount of expense on LEO participants, these multiple layers of ERISA experts
virtually ensure that any distributions from the LEO Plan would be entirely proper.

1 interest of the bankruptcy estate, and (b) is ‘necessary and beneficial’ to the fair and efficient
2 resolution of the bankruptcy proceedings.” Commodore Int’l Ltd. v. Gould (In re
3 Commodore Int’l Ltd.), 262 F.3d 96, 100 (2d Cir. 2001) (citing and relying upon In re
4 Spaulding Composites Co., 207 B.R. 899, 904 (9th Cir. BAP 1997)).

5
6 13. As the Eighth Circuit has explained:

7 [B]ankruptcy courts should not passively view the trustee’s consent as a proxy
8 that a proposed derivative action is “necessary and beneficial.” If they did, bankruptcy
9 courts would be effectively ceding their gatekeeper function to the trustee. ***We***
10 ***therefore make plain that a trustee’s consent is a necessary, but not sufficient***
11 ***condition for granting a creditor derivative standing in this context.*** Regardless of
12 whether a creditor seeks derivative standing because the trustee “unjustifiably”
13 refuses to pursue its claims or consents to the creditor’s complaint, ***the bankruptcy***
14 ***court has the same obligation – to carefully scrutinize the request and satisfy itself***
15 ***that derivative standing is proper under the circumstances.***

16 In a helpful footnote the Court explained what that latter requirement meant:

17 We noted above that ***bankruptcy courts should employ a cost-benefit analysis***
18 ***to determine whether derivative standing is appropriate*** under circumstances in
19 which the trustee “unjustifiably” refuses to bring the creditor’s claims. Bankruptcy
20 courts should perform a similar analysis when confronted with a request for
21 “consensual” derivative standing.

22 PW Enters. v. N.D. Racing Comm’n, (In re Racing Servs.), 540 F.3d 892, 903 & n.12 (8th
23 Cir. 2008) (emphasis added).

24 14. The *Emergency Application* offers no cost-benefit analysis from which the
25 Court could determine that granting the Committee derivative standing to pursue claims on
26 behalf of the estate would be proper. What the *Emergency Application* does suggest is that
27 several knowledgeable parties – Trucker Huss, Mr. Betzina and Mr. Betzina’s counsel – all
28 disagree with the Committee’s position (or the Committee would have no concern that a
distribution from the LEO Plan were going to occur). The only logical implication is that the
costs that will be imposed by the Committee’s intended action will exceed any purported
benefits because any litigation will be meritless, expensive and, as discussed below, create
liability for the Committee. See ¶¶ 45-48.

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IV.
The Emergency Application Is Woefully Inadequate

15. Of cardinal significance, the *Emergency Application* fails to even attempt to satisfy the standards set forth in the case law for the relief sought by the Committee.

16. All the *Emergency Application* alleges, *see* ¶ 10, is what this Court already knows: that the Debtor is controlled by a Dissolution Committee that has a conflict on this issue. *Betzina Application*, p. 2, lines 14-17 (“Because members of the Dissolution Committee are participants in the LEO Plan, and because the Dissolution Committee may need to evaluate the viability of any claims the Debtor may have against the Plan, the Debtor would like to avoid any potential conflicts of interest and assign the plan administrator obligations to Keith Betzina, a former Heller Ehrman attorney ... [who is] not a current participant in the LEO Plan....”). The Dissolution Committee’s decision to assume a hands-off position and accede to the Committee’s demand for standing is proof of absolutely nothing and is not a basis upon which to grant the *Emergency Application*.

V.
The Committee Seeks Permission to Pursue a Totally Unmeritorious Action

17. The Committee’s proposed assault on the LEO Plan is inappropriate for at least two independent reasons. First, the underlying claims that would be pursued by the Committee on behalf of the estate lack merit. Second, even assuming *arguendo* that the claims had merit, seeking to collect on those claims from an ERISA qualified plan would be improper, indeed illegal.

18. The Committee articulated the claims it would pursue and its basic theory of recovery in the *Official Committee of Unsecured Creditors’ Second Interim Status Report* (“Status Report”), Dkt. No. 589. Remarkably, the entirety of the Committee’s rationale appears to be that because the Debtor’s litigation work and headcount declined during 2007, by “December 2007, Heller LLP was in demonstrable financial distress and was in a downward spiral from which it could not and did not recover,” *id.*, ¶ 38, such that every

1 single dollar it distributed to working shareholders from that moment on was not for
2 reasonably equivalent value. *Id.*, ¶ 42.

3 19. The Committee’s argument ignores both the facts of this case and well-
4 established law on the issues of unreasonably small capital and reasonably equivalent value.

5 **VI.**
6 **The Facts and Law Overwhelmingly Suggest the Debtor was Adequately**
7 **Capitalized at the End of 2007**

8 20. The Committee commits its first error by willfully ignoring the legal standards
9 for determining unreasonably small capital, including a widely-recognized key case on the
10 issue that it has previously cited.⁸ Moody v. Security Pac. Business Credit, 971 F.2d 1056
11 (3d Cir. 1992), cited by the Committee in the *Status Report*, ¶ 50, defined “unreasonably
12 small capital ... [as] the inability to generate sufficient profits to sustain operations.” 971
13 F.2d at 1070. Or as another court colorfully put it:

14 [U]nreasonably small capital means something more than insolvency or
15 inability to pay debts as they come due. Being left without adequate capital would
16 mean that the transaction in issue put Joy *on the road to ruin*.... To sustain his
17 burden, the Trustee must show something more than a deteriorated balance sheet after
18 the LBO or that Joy had difficulty paying its trade creditors....

19 [T]here is no doubt that the LBO significantly ‘increased the risk’ to Joy’s
20 creditors as claimed by Peltz. However, reducing the test for ‘unreasonably small
21 capital’ to such a showing would likely mean that any LBO would be a fraudulent
22 conveyance. As stated above, the goal of fraudulent conveyance law is not to provide
23 an insurance policy against business risk for creditors. Rather, the court must balance
24 the need to protect creditors from transactions that *cripple* a company with the need to
25 preserve the market for a debtor’s assets....

26 Further, courts will not find that a company had unreasonably low capital if the
27 company survives for an extended period after the subject transaction as Joy did. *See*

28 ⁸ The Status Report conveniently (and prudently) avoids trying to make the case that the Debtor was insolvent at the end of 2007. As the Committee is well aware, on a cash basis, Ernst & Young’s audited financials for the Debtor (issued in August 2008) reported net partner equity of over \$65 million as of year end 2007. On an accrual basis, the Debtor’s positive net worth would be much larger because it had over \$100 million in unencumbered (and ultimately collected) receivables and work in process. Notably, Ernst & Young did not include a going concern qualification in the Debtor’s audited 2007 financials. *See* note 9.

1 *Moody v. Security Pacific Business Credit*, 971 F.2d 1056, 1074 (3rd Cir. 1992) (no
2 unreasonably low capital where creditors paid for twelve months after transaction);
3 *MFS/Sun Life Trust*, 910 F. Supp. at 944 (same where company was viable for eight
4 months after LBO); *In re Ohio Corrugating Co.*, 91 B.R. 430, 440 (same creditors
5 paid for ten months); *Credit Managers Ass'n of Southern California v. Federal Co.*,
6 629 F. Supp. 175, 184 (C.D. Cal. 1986) (twelve months).

7 Daley v. Chang (In re Joy Recovery Tech. Corp.), 286 B.R. 54, 76 (Bankr. N.D. Ill. 2002)
8 (emphasis added).

9 21. As the Debtor had just concluded a year (2007) in which it earned over \$177
10 million (down 15% from a record year in 2006, but still the second best in firm history), and
11 that Ernst & Young issued a clean audit opinion on its 2007 financial statements (on 22,
12 August 2008), the Committee's suggestion that the Debtor was on the road to ruin at year
13 end 2007 is specious.⁹

14 22. Moreover, as almost everyone who hasn't slept through the last 18 months is
15 aware, we have just gone through the worst economic period since the Great Depression.

16 23. At year end 2007, the most commonly followed major stock indices stood
17 approximately 5% below their all time highs.¹⁰ The unemployment rate was 4.9%.¹¹ During

18 ⁹ The absence of a going concern qualification is a very significant data point. Generally accepted
19 auditing standards ("GAAS") require that, before issuing audited financials, an "auditor has a
20 responsibility to evaluate whether there is substantial doubt about the entity's ability to continue
21 as a going concern for a reasonable period of time, not to exceed one year beyond the date of the
22 financial statements being audited." AU § 341.02. Thus, if Ernst & Young had concluded, after
23 performing its audit procedures, that substantial doubt existed about the ability of the Debtor to
24 continue, it would have been required by GAAS to include "an explanatory paragraph [in the
25 report] to reflect that conclusion." AU § 341.12. Ernst & Young's audit report contained no such
26 explanatory paragraph, indicating one of the country's four largest and most respected
27 accounting firms did not believe that substantial doubt existed as to the firm's ability to continue
28 in operations. That conclusion by the firm's independent auditors is far more significant than the
Committee's unsupported speculation that the Debtor was in a death spiral as of December 31,
2007.

¹⁰ The S&P 500 index closed 2007 at 1478 vs. an all-time closing high (less than three months
earlier) of 1565. The Dow industrials closed 2007 at 13,264 vs. an all-time closing high (also
less than three months earlier) of 14,164. Source: <http://finance.yahoo.com>.

¹¹ Source: <http://stats.bls.gov>.

1 the course of the next nine months, beginning roughly in March 2008, the economy took an
2 almost unprecedented fall.

3 24. Many pillars of the financial community – Bear Stearns, Lehman, Merrill
4 Lynch, Washington Mutual – failed. Others, including the lenders in this case – Citibank,
5 Bank of America – survived only by the grace of U.S. taxpayers.

6 25. Law firms were certainly not immune to these general economic conditions.
7 Thacher Proffitt & Wood (founded 1848), Wolf Block (founded 1903), Thelen (founded
8 1924) all dissolved in 2008. Many other lesser known names perished as well, numerous
9 firms came close to ceasing their existence, and others may yet topple.

10 26. These exogenous events are of great significance, especially for this case and
11 the Committee’s purported theory of recovery. As then Professor, now Judge, Markell
12 explained:

13 The last prerequisite to finding inadequate capital is that the transfer must
14 directly lead to non-payment....

15 This additional requirement is also necessary because subsequent events may
16 make it inequitable to prefer a creditor over a transferee. Take, for example, the
17 occurrence of an unforeseen and unforeseeable calamity after a transfer. If this
18 calamity would have accounted for non-payment even if adequate reserves had been
retained, the presence of this intervening and supervening cause should bar fraudulent
transfer liability....

19 The case law has recognized this common sense notion. Early cases
20 recognized that ‘losses in trade, or by fire, or by storms’ cut off liability to future
21 creditors. More recent cases have added to this list. For example, in *Jenney v. Vining*,
22 a husband and wife had transferred ownership of their house from joint ownership to
23 sole ownership by the wife. Later, one of the husband’s business associates
24 challenged this transfer in order to levy execution on the house. The husband had not
25 paid the judgment leading to the levy because, four months after the transfer, he and
26 his business had entered into a new venture, and that venture had failed.

27 After finding that the transfer left the husband solvent, the equity master found
28 that the new venture was not in contemplation at the time of the conveyance, and was
the cause of the demise of the husband’s business. In short, although the master, by
implication, found that non-payment was reasonably foreseeable given the low level
of capital left by the transfer, he also found the new venture was not reasonably
foreseeable. This subsequent event was thus held to override the level of capital

1 remaining after the transfer.

2 Similarly, in *Credit Managers Association of Southern California v. Federal*
3 *Co.*, a management led leveraged buyout failed. An attack was mounted along
4 unreasonably small capital lines. Although the court found that capital was adequate
5 on the basis of cash flows developed at the time of the cash flows, it also inquired into
6 intervening events. In particular, the transferee pointed to two unforeseen events: the
7 loss of a major customer, and a four month labor strike by the Teamsters' union. Both
8 of these events adversely affected an admittedly marginal operation; indeed, the court
9 characterized the strike as a 'crippling blow from which the transferor never fully
10 recovered.' As a consequence, the court did not allow the ultimate failure of the
11 business to lead, in an 'almost tautological manner' to a finding of unreasonably small
12 capital. Rather it viewed these events to be in the nature of supervening causes,
13 excusing or exonerating the transferor. This holding recognizes that businesses fail for
14 all sorts of reasons, and that fraudulent transfer laws are not a panacea for all such
15 failures.

16 Markell, *Toward True and Plain Dealing: A Theory of Fraudulent Transfers Involving*
17 *Unreasonably Small Capital*, 21 Ind. L. Rev. 469, 504-06 (1988) (footnotes omitted);
18 *accord*, Moody v. Security Pac. Business Credit, Inc., 127 B.R. 958, 977-78 (W.D. Pa. 1991)
19 (recession and increased competition), *aff'd*, 971 F.2d 1056 (3d Cir. 1992); Credit Managers
20 Ass'n of Southern California v. Federal Co., 629 F. Supp. 175, 184 (C.D. Cal. 1986) (loss of
21 a major customer and labor strike); In re Ohio Corrugating Co., 91 B.R. 430, 440 (Bankr.
22 N.D. Ohio 1988) (industry-wide downturn).

23 27. The Committee already has a high hurdle to clear based on this record and
24 controlling law, and does not remotely suggest how it could surmount that hurdle in light of
25 these circumstances. Its main argument appears to be that Heller distributed approximately
26 \$98 million at the end of 2007 and beginning of 2008 (*Status report*, ¶ 37);¹² Heller went
27 bankrupt in 2008; therefore, Heller was undercapitalized at the end of 2007. Q.E.D.
28 According to the Committee, the intervening economic events were of no consequence. The
"logical fallacy of *post hoc, ergo propter hoc*," see Kozulin v. INS, 218 F.3d 1112, 1117 (9th
Cir. 2000), is one this court ought not tolerate, particularly given the massive and

¹² And apparently, per the Committee, should have distributed \$9-15 million less. *Id.*, ¶ 39.

1 unprecedented shocks the economy (and the law business) suffered from March to
2 September 2008.

3
4 **VII.**
5 **The Shareholders Were Entitled to the Reasonable Compensation**
6 **They Received at Year End 2007**

7 28. The Committee is also well-aware of controlling California law that provides
8 that lawyers even in insolvent law firms are entitled to reasonable compensation. Annod v.
9 Hamilton & Samuels, 100 Cal. App. 4th 1286 (2006).¹³ *Status Report*, ¶ 45. Indeed, in
10 language that could as easily be written about the Debtor, the California Court of Appeal
11 explained the applicable law.

12 Paragraph 12 of the partnership agreement provided a committee would set the
13 respective partner draws within the first three months of each fiscal year. The amounts
14 of the draws were to be based on the results of operation for the prior fiscal year, the
15 expected results of operation for the fiscal year for which draws were being set, the
16 requirements of operating capital and the partners' respective interests in the firm. It
17 did not state that draws would be reduced later in the year if there were unpaid bills or
18 that draws would be halted if there were net losses at any given moment in time. The
19 provision did permit the committee, in its discretion, to change the amount of the
20 draws from time to time, but did not require the committee to do so.

21 In the order granting the Green Motion, the court specifically found that the
22 moving partners' conduct in taking draws and making withdrawals from their capital
23 accounts was "consistent with the Partnership Agreement." In the order granting the
24 Adams Motion, the court found "[t]he individual partners had no obligation under the
25 partnership agreement . . . to refrain from receiving compensation" under the
26 circumstances. *Annod* cites no provision of the partnership agreement showing the
27 trial court's interpretation of the document is incorrect.

28 100 Cal. App. 4th at 1301-02.

29 29. The Committee mischaracterizes *Annod* as dependent on the partners only
30 taking their draws and sometimes drawing less than their secretaries. *Status Report*, ¶ 45
31 n.13. However, no fair reading of *Annod* made those facts determinative or even important.

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¹³ "Where an intermediate appellate state court rests its considered judgment upon the rule of law which it announces, that is a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise." West v. Am. Tel. & Tel., 311 U.S. 223, 237 (1940).

1 30. What was important, and is equally true here, was that the lawyers were paid
2 consistent with their Employment Agreements. Although the Committee seeks to
3 characterize year-end payments, including contributions to the LEO Plan, as something other
4 than compensation (essentially dividends), the Committee carefully avoids quoting section
5 4.5 of the Employment Agreement, which provides that “Employee’s compensation shall be
6 determined only as provided in this Agreement and *shall not be based upon Employee’s*
7 *holdings of capital stock* of the Company.” Employment Agreement, § 4.5 (emphasis
8 added).

9 31. What were payments to the “Employee” based upon? The Employment
10 Agreement, again selectively ignored by the Committee, makes that equally clear.

11 In addition to the Base Salary, the Company may pay to Employee
12 *compensation* in the form of an annual bonus (the “Annual Bonus”). The Annual
13 Bonus, if any, shall be paid in December of the Fiscal Year in question, or at such
14 other time as the Company may determine. The amount of the Annual Bonus, if any,
15 and all of its terms and conditions, shall be set by the Company in its discretion;
16 provided, however, that, subject to Section 9.4 of this Agreement: (i) the *Annual*
17 *Bonus* shall bear a *relationship* to the *Company’s success*, to *Employee’s abilities*,
18 and to *Employee’s contributions* to the profitable professional practice of the
19 Company affecting such period...

20 Employment Agreement, § 4.2 (emphasis added).

21 32. In the same section, the Employment Agreement further provided that the
22 amounts paid thereunder and in the preceding section (base salary), together with assorted
23 benefits, including “all contributions by the Company to any pension or profit sharing plans
24 qualified under the Employee Retirement Income Security Act of 1974 (‘ERISA’) ... plus
25 any additional bonuses paid by the Company pursuant to Section 4.3 constitut[ed] ‘Total
26 *Compensation*’” of the “Employee.” *Id.* (emphasis added).

27 33. As alluded to in the quoted provisions, and as in *Annod*, these amounts paid at
28 year end were not decided at year end, but rather were disclosed to the shareholders early in
the relevant year when points were assigned to them. The value of the points may have been
variable, but that did not make the year end bonus a discretionary payment. The Debtor was
obligated to pay that compensation. The Debtor was also obligated to make the full LEO

1 Plan contribution (per Article 5.1(f) of the Plan) at the point in the calendar year when the
2 participant worked 1,000 hours, although that contribution did not have to be made until
3 year-end or the beginning of the following calendar year.

4 34. Moreover, even if the year end payment were discretionary it would still be
5 compensation. As explained in a case with analogous facts, Cohen v. UN-Ltd. Holdings,
6 Inc. (In re Nelco, Ltd.), 264 B.R. 790 (Bankr. E.D. Va. 1999):

7 Pursuant to 11 U.S.C. § 548(a)(1)(B) the trustee seeks to recover an
8 \$ 800,000.00 bonus payment made to Nelson in December 1995. The trustee may
9 recover under § 548(a)(1)(B) if the debtor received less than reasonably equivalent
10 value for the services rendered by Nelson, and Nelco was insolvent or became
11 insolvent as a result of the transfer. *See* 11 U.S.C. § 548(a)(1)(B). The burden of proof
12 for both elements is with the trustee. []

13 Whether reasonably equivalent value was received by the debtor on the date of
14 transfer is a two step analysis: (1) did the debtor receive value, and (2) was the
15 payment reasonably equivalent to the value extended? []

16 ***The court finds that the debtor received value from the services of Nelson. He operated the business of Nelco, and when the bonus was paid management believed that Nelco had generated substantial profits for the company during 1995. Nelson was essential to Nelco's business operations: he was the founder of the company, and it was through his efforts that Nelco operated as a successful computer leasing company until the discovery of the stealth fraud. In exchange for the bonus payment, Nelco received the continuing goodwill and loyalty of Nelson in his capacity as president of the debtor.***

17 The court also finds that the payment was reasonably equivalent to the value
18 extended. ***Reasonably equivalent value is determined from the totality of the circumstances surrounding the transaction. [] Among the factors to be considered by a court are: (1) the good faith of the transferee; (2) the amount of discrepancy between the amount paid and fair market value; (3) the ratio or percentage of the amount paid to fair market value; and (4) whether there was an arms length transaction between willing parties.*** [] Here the court finds that parties acted in good
19 faith. They acted without knowledge of Nelco's insolvency and in accordance with
20 the parties prior practice. Nelson's bonus payment in 1995 was not substantially
21 higher than in previous years. Furthermore, the court is not persuaded by the trustee's
22 evidence that the bonus payments made to Nelson were substantially above the fair
23 market value for CEO's in the computer leasing business. In fact, there is evidence to
24 support Nelson's argument that his total 1995 compensation was reasonable.

25 Because Nelco received reasonably equivalent value for Nelson's \$ 800,000.00
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1 bonus payment, the question of Nelco's insolvency need not be addressed.
2 Accordingly, the court finds that the trustee has not sustained his burden of proof on
3 this issue and will dismiss Count VIII of the trustee's complaint.

4 *Id.* at 813-14 (citations omitted; emphasis added); *accord*, In re Dondi Financial Corp., 119
5 B.R. 106, 110 (Bankr. N.D. Tex. 1990) (judgment for defendant on discretionary bonus
6 where "Defendant's regular salary, aside from deferred bonuses, was relatively low in
7 comparison to the market.").

8 35. In short, unless the Committee can demonstrate that an individual shareholder
9 received, as the result of all the elements of his or her compensation, "substantially above the
10 fair market value" for comparable lawyers, and it almost certainly cannot,¹⁴ whether the
11 Debtor was solvent or insolvent, adequately capitalized or undercapitalized, the
12 compensation the shareholders received, both directly and through contributions to the LEO
13 Plan, are unavoidable.

14 **VIII.**

15 **The Committee's Preference Claim Is a Non-Starter**

16 36. As it has characteristically done, the Committee again changes direction (from
17 the *Status Report*), suggesting in "by the way" fashion that the contributions to the LEO Plan
18 may constitute preferential transfers. *Emergency Application*, ¶ 3. The Committee offers no
19 support, factual or legal, for this off-handed assertion.

20 37. Clearly the contributions were made more than 90 days prior to the Petition
21 Date, so the only way they could be subject to avoidance as preferential transfers is if they
22 were paid to or for the benefit of insiders of the Debtor. 11 U.S.C. § 547(b)(4)(B).
23 Additionally, the Committee would bear the burden of proof of demonstrating that the
24 Debtor was insolvent at the time of the contributions (January 2008, at the latest), unaided by
25 any presumption of insolvency. 11 U.S.C. § 547(f) & (g). That is no small task. *See* ¶¶ 18-
26 27.

27 ¹⁴ It appears to be the Committee's contention that the exact opposite was the case with the result
28 that "[k]ey shareholders began leaving, taking their books of business with them." *Status Report*,
¶ 34.

1 38. It is also no small task to show that the shareholders were insiders, given that
2 the Debtor, as a limited liability partnership, is a corporation for purposes of bankruptcy law,
3 11 U.S.C. § 101(9)(a)(ii), and nearly all of the shareholders would not qualify as directors,
4 officers or persons in control of the Debtor, and not a single shareholder held 20% of more of
5 Debtor's securities. *See* 11 U.S.C. § 101(2)(B) & 31(B).¹⁵

6 39. Of course, the Committee had good reason to simply mention this theory in
7 passing without support, as it was and is nonsense.

8 **IX.**
9 **Even if the Committee Had a Claim,**
10 **It Could Not Collect It from an ERISA Qualified Plan**

11 40. The Committee makes a second fatal error in seeking to recover funds directly
12 from the LEO Plan. As noted above, and as the Committee is quite aware, the LEO Plan is
13 an ERISA qualified plan. ERISA imposes a series of obligations and restrictions on
14 qualified plans in order to protect accrued benefits from creditors both of the employer and
15 the employee in order to ensure that those benefits are available to plan participants. ERISA
16 requires that “[e]ach pension plan shall provide that benefits provided under the plan may not
17 be assigned or alienated.” 29 U.S.C. § 1056(d)(1).

18 41. Consistent with ERISA's anti-alienation provision, the LEO Plan in Article
19 14.4 provides that “[b]enefits payable under the Plan shall not be subject in any manner to
20 anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, charge,
21 garnishment, execution, or levy of any kinds, voluntary or involuntary.”

22 42. The anti-alienation provisions of ERISA qualified plans, which generally
23 prohibit creditors from satisfying their claims from plan assets, are strictly enforced by the
24 courts to protect the interests of plan participants. *See e.g. Patterson v. Shumate*, 504 U.S.

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27 ¹⁵ We understand the Committee may suggest that the control test is met because the shareholders
28 had the right to elect members of various governing committees. By that standard, the
undersigned counsel is an insider of Microsoft, which might come as a surprise to Messrs. Gates
and Ballmer.

1 753, 760 (1992); Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 376
2 (1990) (“Nor do we think it appropriate to approve any generalized equitable exception –
3 either for employee malfeasance or for criminal misconduct – to ERISA’s prohibition on the
4 assignment or alienation of pension benefits. Section 206(d) [29 U.S.C. § 1056(d)] reflects a
5 considered congressional policy choice, a decision to safeguard a stream of income for
6 pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if
7 that decision prevents others from securing relief for the wrongs done them. If exceptions to
8 this policy are to be made, it is for Congress to undertake that task.”); Kickham Hanley P.C.
9 v. Kodak Retirement Income Plan, 558 F.3d 204, 206 (2d Cir. 2009) (reversing a preliminary
10 injunction on disbursements from a pension plan as violative of 29 U.S.C. § 1056(d)(1)).

11 43. The restrictions on alienation of ERISA qualified plan assets are enforceable
12 even where those assets are alleged to have been fraudulently conveyed to the plan in an
13 effort to hinder, delay and defraud creditors. *See e.g.* Ellis Nat'l Bank v. Irving Trust Co.,
14 786 F.2d 466, 468-71 (2d Cir. 1986) (“The central question in this case is whether the anti-
15 alienation provision of ERISA prohibits an employer from reclaiming certain funds
16 contributed to an employee’s pension plans while the employer was unaware that those funds
17 represented monies derived from fraudulent practices for which the employee was
18 subsequently indicted and convicted and for which the employer effectively became liable to
19 defrauded customers.... Despite its equitable appeal, the ‘criminal misconduct’ exception ...
20 in our view undermines a fundamental purpose of ERISA that we believe should be
21 modified, if at all, only by Congress.”); Butler v. Becton, Dickinson & Co. et al., (In re
22 Loomer), 198 B.R. 755, 760 (Bankr. D. Neb. 1996) (contributions to ERISA qualified plan
23 are not subject to avoidance as fraudulent transfers under either the Bankruptcy Code or state
24 law “even if the debtor’s acts . . . were motivated by an actual intent to hinder, delay or
25 defraud creditors, or were preferential as to other creditors”).

26 44. As a result, even if the Committee could somehow show that the contributions
27 under the LEO Plan were fraudulent transfers (which it cannot), it could not possibly succeed
28 in recovering those funds given the anti-alienation provisions of the LEO Plan and ERISA,

1 just as the Committee could not recover a judgment from exempt assets of the LEO Plan
2 participants.¹⁶ Indeed, whether the Committee may succeed in proving the merits of its
3 claim is largely irrelevant, as “any transfer found to be avoidable” in an action commenced
4 by the Committee “may not be recovered from an ERISA plan.” *Loomer*, 198 B.R. at 761.
5 The trust established by the LEO Plan is a distinct legal entity with a separate existence from
6 the Debtor such that any assets held in the trust are exempt from, and not subject to, any
7 claims that may be asserted by the Debtor’s creditors or derivatively by the Committee on
8 behalf of the estate.

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10 **X.**
The Pursuit of the LEO Plan
May Well Expose this Estate to Massive Administrative Liability

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12 45. Obviously, the Ad Hoc Shareholder Group is greatly concerned by the harm
13 that its members have suffered to date and will continue to suffer by the wrongful detention
14 of their LEO Plan funds. *See* note 5. However, to be clear, they are not the only ones who
15 should be concerned. No one, least of all this Court, should allow this harm to occur
16 needlessly, particularly because it could very well result in a massive administrative claim
17 against the estate.

18 46. Under Reading v. Brown, 391 U.S. 471, 483-84 (1968), claims arising from
19 torts committed by an estate representative are entitled to administrative priority. *Reading*
20 remains good law. In re Metro Fulfillment, 294 B.R. 306, 310 (9th Cir. BAP 2003). All
21 interested parties should know that if the members of the Ad Hoc Shareholder Group, and
22 probably others, suffer harm, they will act by seeking redress and financial compensation
23 from the estate. And, ultimately, they will prevail.

24 47. Given the clarity of the law, if the Committee is given standing to sue and
25 causes damages, and a court determines, as the above indicates it will, that the action was

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28 ¹⁶ The recipients would not be freed from fraudulent transfer liability, of course, which is yet another reason why it is so outrageous that these funds are being tied up.

1 brought and prosecuted for a collateral purpose or without a reasonable basis in fact and law,
2 then this estate will necessarily face significant claims from every harmed participant.

3 48. This is clearly not a result that anyone should desire, and it is absolutely not
4 what the Ad Hoc Shareholder Group seeks. Rather, the Ad Hoc Shareholder Group submits
5 it would be far better to avoid any further damage in the first place and hopes and trusts that
6 fair consideration of the points raised herein will lead in that direction.

7 Dated: October 1, 2009

KLEE, TUCHIN, BOGDANOFF & STERN LLP

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9
10 By: _____



DAVID M. STERN

Attorneys for Ad Hoc Shareholder Group