

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

In re:

ENRON CREDITORS RECOVERY  
CORP., *et al.*,<sup>1</sup>

Reorganized Debtors.

SPRINGFIELD ASSOCIATES, L.L.C.,

Defendant-Appellant,

v.

ENRON CORP.,

Plaintiff-Appellee.

Chapter 11

Case No. 01-16034 (AJG)

(Jointly Administered)

District Court

Case No. 06-07828 (SAS)

Case No. 07-01957 (SAS)

**ORAL ARGUMENT REQUESTED**

**REPLY BRIEF OF PERMITTED INTERVENOR BANK CITIBANK, N.A.  
ON THE ISSUE OF EQUITABLE SUBORDINATION AND  
DISALLOWANCE OF TRANSFERRED CLAIMS**

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<sup>1</sup> Effective March 1, 2007, Enron Corp. changed its name to Enron Creditors Recovery Corp. Due to the name change, the caption of Enron Corp.'s chapter 11 cases has been modified.

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To the United States District Court for the Southern District of New York:

Intervenor Bank Citibank, N.A. (“Citibank”) respectfully submits this reply memorandum of law in further support of its opening brief on the issue of equitable subordination and disallowance of transferred claims (the “Opening Brief”) in the above-captioned proceeding.<sup>2</sup>

### PRELIMINARY STATEMENT

Our Opening Brief demonstrates that the Bankruptcy Court’s Equitable Subordination and Disallowance Opinions – which ruled, as a matter of law, that a transferee’s claims are subject to equitable subordination under Section 510(c) and disallowance under Section 502(d), based solely on the alleged conduct of its transferor – are inconsistent with the express terms of the respective statutes, their legislative purposes and the relevant caselaw, and should be reversed.

Enron offers five responses, none of which has any merit.

**First**, Enron imports two principles entirely unrelated to equitable subordination under Section 510(c) or disallowance under Section 502(d) and asserts, without basis, that these principles are universal truths that control the result here. Enron’s effort is misguided.

Specifically, Enron asserts that this appeal must be decided based on the supposedly fundamental rule that “[t]he relative rights among competing claims to a bankruptcy estate are fixed and determined as of the date of the petition.” (Appellee’s Brief in Support of Affirmance of the Bankruptcy Court’s Rulings Denying Defendants’ Motion to Dismiss (“Enron Br.”) 4). This “fundamental point,” now central to Enron’s position, had been relegated to two brief paragraphs in the 80+ pages of briefing Enron had previously submitted

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<sup>2</sup> Capitalized terms used but not otherwise defined in this reply have the meaning ascribed to them in the Opening Brief.

to this Court (and it was ignored by the Bankruptcy Court in its decisions). And for good reason: There is no such universal rule. The relative rights among competing claims routinely change based on *postpetition* events. And even if this principle somehow could be expanded beyond its proper scope (limited to claim measurement and fixed statutory priorities), it plainly cannot extend, as Enron urges, to equitable subordination under Section 510(c) or disallowance under Section 502(d). The application of these statutes, by their express terms, is not – and could not possibly be – “fixed and determined” as of the petition date.

Enron also suggests that this appeal must be decided based on principles of assignment law – under which “the assignee gets what the assignor had, nothing less and nothing more.” (Enron Br. 49). But, as discussed at length in Citibank’s Opening Brief, Enron’s (and the Bankruptcy Court’s) reliance on assignment law simply begs the question raised by this appeal: Enron assumes, without basis, that a claim’s susceptibility to equitable subordination or disallowance at the petition date becomes an attribute of the claim that attaches to and travels with the claim upon transfer, rather than a personal disability applicable only to a specific creditor. But, here, too, Enron grossly overstates the general rule: there are many circumstances (including in bankruptcy), where an assignee *does* obtain better rights than its assignor.

**Second**, Enron disregards the broad legal questions decided by the Bankruptcy Court and as to which this Court specifically granted an interlocutory appeal; instead, Enron tactically seeks to narrow the focus of this appeal to the specific *postpetition* transfer of bank debt at issue in the Springfield adversary proceeding (from Citibank to Deutsche Bank to Springfield) or, at most, to bank debt transfers. Only by tactically restricting its focus – and ignoring the specific issues framed by this Court (and the Bankruptcy Court) – can Enron assert that transferees “typically” or “customarily” (Enron Br. 27, 46, 47) obtain indemnities.

Straining even further, Enron argues that, through the operation of these private indemnities, equitable subordination under Section 510(c) and disallowance under Section 502(d) can still serve their legislative purpose even when applied to transferees.

But Enron's effort to recast the legal questions at issue on this appeal is misplaced. As Citibank (and Industry Amici) have demonstrated, and as even the Bankruptcy Court acknowledged, indemnities are *not* available in all cases; and, even where they are available, reliance on a system of indemnities is ultimately unworkable. Moreover, Enron's admission that, as applied to transferees, Sections 510(c) and 502(d) can only serve their legislative purpose where indemnities exist, demonstrates beyond a doubt that Congress could not possibly have intended, as Enron urges, that these statutes be applied to transferees. It would be irrational to assume that, in enacting these statutes, Congress was relying on the *prospective* development of a pattern of private contractual arrangements (nowhere mentioned in the statutes or legislative history) that might permit the statutes to serve their intended purpose. What is more, at the time these statutes were enacted, no case had *ever* equitably subordinated or disallowed the claims of a transferee based solely on the conduct of the transferor. Enron's position makes no sense.

**Third**, Enron resorts to tortured arguments of statutory construction that exaggerate beyond all proportion and logic the significance of the word "claim" in Section 510(c), the words "claim of" in Section 502(d), and the word "substitute" in a general housekeeping rule, Bankruptcy Rule 3001(e), which has absolutely no relevance here. In doing so, Enron completely disregards the larger context of the relevant statutes and their conceded purposes, each of which is inconsistent with the interpretations Enron now urges.

**Fourth**, Enron ignores the market disruption that follows from the Bankruptcy Court's flawed opinions, while making hysterical claims, without foundation, that a contrary

rule would “eviscerate” Sections 510(c) and 502(d), render them “a nullity,” and “effectively would deprive the bankruptcy court of [the] remedial power [of these statutes] altogether.” (Enron Br. 9, 31, 45). Ironically, Enron faults Citibank for proffering “no evidence” of market disruption as a result of the Bankruptcy Court’s ruling, while at the same time arguing that this Court should ignore evidence (submitted by Industry Amici) of the disruptive impact these rulings have already had in two significant bankruptcies.

Instead, Enron argues that reversal of these rulings would render Sections 510(c) and 502(d) a “nullity” because a creditor otherwise subject to equitable subordination or disallowance under these statutes could “easily escape” these two defenses simply by assigning its claims. (Enron Br. 9). But there is absolutely no suggestion – let alone evidence – that “claimswashing” was behind any of the transfers at issue in any of the adversary proceedings that Enron has brought against transferees. (Indeed, most all of the claims that Citibank transferred postpetition, which Enron now seeks to subordinate or disallow in the transferees’ hands, were made pursuant to *prepetition* credit-default swap contracts Citibank executed years *before* Enron’s bankruptcy. Thus, the Bankruptcy Court’s ruling threatens to disrupt the legitimate prepetition expectation of the parties.)

The Bankruptcy Court expressly declined to rely on Enron’s “claimswashing” argument, and with good reason: a wrongdoer that assigns its claims remains subject to a direct action by the debtor for the same wrongdoing and a recipient of an avoidable transfer that assigns its claims remains subject to an avoidance action by the debtor for the return of that transfer. Enron’s suggestion that creditors would engage in rampant “claimswashing” to “escape” liability under one statute when they cannot avoid liability under others, should be seen for what it is: a transparent litigation construct.

**Finally**, Enron's brief is littered with *ad hominem* attacks against Citibank, asserting, without proof, that Citibank engaged in a massive fraud for which it deserves to be punished. As noted above, Enron's tactical effort to transform this interlocutory appeal into a referendum on Citibank's conduct as opposed to addressing the broad legal issues precisely framed by this Court in its January 30, 2007 Opinion and Order granting leave to appeal, speaks volumes about the merits of Enron's legal position. But Enron has disserved this Court in an even more fundamental way. Enron suggests that if this Court reverses the Bankruptcy Court decisions, then Citibank and any other party accused of fraud would be able to get away with its alleged misconduct without consequence. (Enron Br. 6-7). But that is not true. If a debtor can actually prove that a party engaged in wrongdoing that harmed creditors, then it is free to pursue appropriate and well-established remedies against that party to recover whatever damages may have been caused. And what Enron has not disclosed to this Court is that it has *already brought* precisely such a claim against Citibank, in a separate, pending adversary proceeding, the MegaClaim Action, in which it seeks the very same damages from Citibank. The entire premise on which Enron's "equitable" argument rests is fallacious.

\* \* \* \* \*

For all these reasons, Enron cannot defend the Bankruptcy Court's flawed decisions. This Court should reverse those decisions and find that – as a matter of law and consistent with the statutory language, legislative history and governing case law – claims held by a transferee are not subject to equitable subordination or disallowance under Sections 510(c) and 502(d) of the Bankruptcy Code, respectively, based solely on the alleged conduct of the transferor.

## ARGUMENT

### I. THE SUPPOSEDLY FUNDAMENTAL PRINCIPLE OF *SEXTON* AND *MARXEN* – THAT RIGHTS ARE FIXED AS OF THE PETITION DATE – HAS NO APPLICATION HERE

Enron now suggests that the key to this dispute is the supposedly fundamental rule, articulated in *Sexton v. Dreyfus*, 219 U.S. 339 (1911) and *United States v. Marxen*, 307 U.S. 200 (1939), that “[t]he relative rights among competing claims to a bankruptcy estate are fixed and determined as of the date of the petition.” (Enron Br. 4, 13-16). Enron had relegated this argument to two paragraphs in its previous extensive briefing before this Court (and the Bankruptcy Court did not rely on it at all in its opinions).<sup>3</sup> For good reason: *Sexton* and *Marxen* offer no guidance here, as shown below. But even if the “rule” of *Sexton* and *Marxen* were applicable here, which it is not, equitable subordination under Section 510(c) and disallowance under Section 502(d) are well-established exceptions since their application is not – and could not be – “fixed and determined” as of the petition date.

#### A. *Sexton* and *Marxen*

The Supreme Court in *Sexton* held that the petition date fixes the moment when claims are measured, and that, as a result, interest stops running as of the petition date. *Sexton*, 219 U.S. at 344 (holding that the “fundamental principle” of English bankruptcy law that “[i]nterest was not computed beyond the date of the commission” was “adopted by us when we copied the [English] system”). *Sexton* has no relevance here.

The Supreme Court in *Marxen* ruled on the appropriate application of a nonbankruptcy statute, which provided that “[w]hensoever any person indebted to the United

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<sup>3</sup> Thus, Enron’s hyperbole that “[i]t is remarkable” that Citibank’s Opening Brief does not “so much as acknowledge” (Enron Br. 19) an argument that Enron appeared to have abandoned (and that was not adopted by the Bankruptcy Court), is regrettable.

States is insolvent . . . the debts due to the United States shall be first satisfied.” *Marxen* at 203. The Court held that this statutory priority is fixed as of the petition date and a general unsecured claim transferred to the United States postpetition would not be entitled to priority under the statute. *Id.* at 207. In this connection, the Court stated that “the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy . . . both as to the bankrupt and among themselves.” *Id.* *Marxen* dealt with statutory priorities; these “rights” are “fixed” as of the petition date and cannot thereafter be changed (either diminished or aggrandized) by transfer.<sup>4</sup>

But equitable subordination under Section 510(c) and disallowance under Section 502(d) are not “rights”; nor can they be “fixed” at the petition date.

**B. The Application of Sections 510(c) and 502(d) Are Not Fixed as of the Petition Date**

Enron admits, as it must, that not all “rights” are fixed at the petition date and that postpetition events affect the recovery on an otherwise allowable claim. (Enron Br. 18-19). Enron, however, argues that this occurs only in “limited circumstances” and that these “exceptions” do not undercut application of the supposedly “fundamental principle” that

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<sup>4</sup> In fact, as *Shropshire* (on which the Bankruptcy Court relies) demonstrates, many statutory priorities can be understood to “attach” at inception, based on the nature of the claim. *Shropshire, Woodlife, & Co. v. Bush*, 204 U.S. 186 (1907). In *Shropshire*, the bankruptcy trustee argued that wage claims assigned prepetition should not be treated as priority wage claims since, as of the petition date, the transferee was not itself a “wage earner.” *Id.* at 188. The Supreme Court disagreed, finding that the statute focused on the *nature* of the debt entitled to priority, and that the nature of the debt was fixed at its inception. *Id.* at 189 (“When one has *incurred* a debt for wages due to workmen, clerks, or servants, that debt . . . is entitled to priority of payment . . . . The character of the debts was fixed when they were *incurred*, and could not be changed by an assignment.”) (emphasis added). Thus, *Shropshire* itself undercuts Enron’s argument that the petition date is the determinative “line of cleavage” for purposes of determining the status and priority of all claims since the Court held that a wage claim’s priority attaches *when it is incurred* – that is, *prepetition*. *Id.*

relative rights are fixed at the petition date. (*See id.*). In fact, postpetition events *routinely* affect the recovery on an otherwise allowed claim,<sup>5</sup> and equitable subordination under Section 510(c) and disallowance under Section 502(d) – the very statutes at issue on this appeal – are prime examples. These statutes require that the court engage in a conduct-based inquiry and adjust the priority (under Section 510(c)) or disallow (under Section 502(d)) an otherwise allowed claim based on, among other things, *postpetition* events that ultimately are unknowable as of the petition date.

### 1. Section 510(c)

The application of Section 510(c), by its express terms, *cannot* be assessed as of the petition date since it is a discretionary doctrine that a court “may” (or may not) choose to impose, under principles of equitable subordination, “after notice and a hearing.”<sup>6</sup> 11 U.S.C.

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<sup>5</sup> *See, e.g.*, § 1122(b) (court may approve class of claims to receive greater recoveries than otherwise entitled, if court finds it “reasonable and necessary for administrative convenience”); § 552(b)(1) & (2) (security interest in proceeds or rents derived from property will be enforced “except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise”); § 365(h) & (n) (if trustee rejects unexpired lease or intellectual property license, lessee and licensee have option to treat contract as terminated or to continue it subject to limitations).

<sup>6</sup> By contrast, the statutory priority conferred on “debts due to the United States” (*Marxen*) and “wage claims” (*Shropshire*) is mandatory and not subject to the court’s discretion. But a court may thereafter *adjust* these priorities under principles of equitable subordination. *See, e.g., Capital Bank & Trust Co. v. 604 Columbus Ave. Realty Trust (In re Columbus Ave. Realty Trust)*, 968 F.2d 1332, 1353 (1st Cir. 1992) (“The doctrine [of equitable subordination] permits a bankruptcy court to *rearrange* the priorities of creditors’ interests, and to place all or part of the wrongdoer’s claim in an inferior status.”) (emphasis added); *Burden v. United States (In re Burden)*, 917 F.2d 115, 117 (3d Cir. 1990) (“Section § 510(c)(1) of the [Bankruptcy Code] explicitly allows bankruptcy courts to *reorder existing* priorities among creditors under ‘principles of equitable subordination.’”) (emphasis added).

§ 510(c). It is equally clear (as Enron concedes) that equitable subordination can be based on *postpetition* misconduct. (Enron Br. 18-19).<sup>7</sup>

Thus, insofar as Section 510(c) is concerned, the “relative rights among competing claims against a bankruptcy estate” *cannot* be “fixed” or “determined” at the petition date. A creditor’s claims that would not be susceptible to equitable subordination on the petition date can be equitably subordinated in a creditor’s hands based on its *postpetition* conduct. (*See supra* n.7). So, too, a claim that, in the hands of the creditor holding it on the petition date, would benefit from equitable subordination of another creditor’s holdings, may lose that priority if the claim is transferred *postpetition*.

[T]he equitable power to subordinate claims of one creditor to those of another may not be exercised in the absence of injury to the other creditor. It is difficult to perceive injury on the part of [the current claimholders] who purchased their [claims] after the alleged misconduct of the Bank Claimants, the intervention of bankruptcy and at distressed prices.

*In re W.T. Grant Co.*, 4 B.R. 53, 78 (Bankr. S.D.N.Y. 1980), *aff’d*, 20 B.R. 186 (S.D.N.Y. 1982), *aff’d*, 699 F.2d 599 (2d Cir. 1983), *cert. denied*, 464 U.S. 822 (1983); *Consol. Pet Foods, Inc. v. Millard Refrigerated Servs., Inc. (In re S&D Foods, Inc.)*, 110 B.R. 34, 37 (Bankr. D. Colo. 1990) (“Equity does not aid those who purchase their claims after the alleged

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<sup>7</sup> See, e.g., *Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims*, 160 F.3d 982, 991 (3d Cir. 1998) (equitably subordinating fiduciary’s claims purchased *postpetition*, which were otherwise allowable as of the petition date, based on the fiduciary’s *postpetition* misconduct) (cited at Enron Br. 18); see also *Allied Eastern States Maint. Corp. v. Miller (In re Lemco Gypsum, Inc.)*, 911 F.2d 1553, 1558 (11th Cir. 1990) (equitably subordinating judgment claim acquired by insider *postpetition*, which otherwise was allowable as of the petition date, based on insider’s self-dealing); *Garlin Mortgage Corp. v. Kreisler (In re Kreisler)*, 352 B.R. 671 (N.D. Ill. 2006).

misconduct of other creditors and after the intervention of bankruptcy and at distressed prices.”).<sup>8</sup>

Far from being a “right” that “inheres . . . in the claim” as of the petition date and transfers with it to subsequent claimholders, as Enron argues (Enron Br. 20), these cases make clear that equitable subordination is an “extrinsic” benefit (or burden) that does not attach to particular claims as of the petition date. *See W.T. Grant*, 4 B.R. at 78. Instead, equitable subordination may only be imposed *after* a hearing in which the court – focusing on the conduct of the particular creditors holding the claims – finds misconduct by the claimant whose claims are to be subordinated and injury to the creditors whose claims are to benefit from the subordination. *See Benjamin v. Diamond (In re Mobile Steel Co.)*, 563 F.2d 692 (5th Cir. 1977).

## 2. Section 502(d)

Similarly, disallowance under Section 502(d), by its express terms, *cannot* be assessed as of the petition date. First, the question of disallowance must be determined “after notice and a hearing.”<sup>9</sup> Second, disallowance under Section 502(d), by its terms, can be

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<sup>8</sup> *See also In re Saxon Indus., Inc.*, 39 B.R. 945, 947 (Bankr. S.D.N.Y. 1984) (“The ‘speculator’ debentureholders who purchased their bonds after the commencement of Saxon’s reorganization proceedings may not be entitled to the equitable relief sought in the proposed action.”) (citing *In re W.T. Grant Co.*, 4 B.R. 53, 78 (Bankr. S.D.N.Y. 1980)); *Consol. Pet Foods, Inc. v. Millard Refrigerated Servs., Inc. (In re S&D Foods, Inc.)*, 110 B.R. 34, 37 (Bankr. D. Colo. 1990) (“Even if CAI does now hold a claim against the estate by virtue of its purchase of the FBS claim, it is not entitled to equitable subordination as a matter of law. It purchased the FBS claim well after the commencement of the bankruptcy estate for a substantial discount.”) (citing *In re W.T. Grant Co.*, 4 B.R. 53 (Bankr. S.D.N.Y. 1980) and *In re Saxon Indus., Inc.*, 39 B.R. 945 (Bankr. S.D.N.Y. 1984)).

<sup>9</sup> *See* 11 U.S.C. § 502(b) (if objection to claim is made, “the court, after notice and a hearing, shall determine the amount of such claim . . . ”); Fed. R. Bankr. P. 3007 (governing objections to claims); Fed. R. Bankr. P. 9014 (requiring “notice and opportunity for hearing” for contested matters).

imposed based on the *postpetition* receipt of an avoidable transfer.<sup>10</sup> Third, disallowance may not be imposed if the creditor has availed itself, postpetition, of the statutory “cure” of returning any avoidable transfers for which it is liable. 11 U.S.C. § 502(d).

Thus, like Section 510(c), under Section 502(d), the relative rights among competing claims *cannot* be “fixed” or “determined” on the petition date. A creditor’s claims that would not be susceptible to Section 502(d) disallowance at the time of the petition date can be disallowed in that creditor’s hands if it receives a *postpetition* avoidable transfer. 11 U.S.C. §§ 502(d), 549; *e.g.*, *Hirsch v. Pennsylvania Textile Corp. (In re Centennial Textiles, Inc.)*, 227 B.R. 606, 610-11 (Bankr. S.D.N.Y. 1998). Equally, creditors that would benefit from the Section 502(d) disallowance of all of a particular creditor’s holdings, lose that advantage if the creditor avails itself of the *postpetition* “cure” and returns the avoidable transfers for which it is liable (which may be considerably less than all of its claim holdings). The benefits (and burdens) of Section 502(d) disallowance plainly do not attach as of the petition date.

\* \* \*

In sum, even if *Sexton* and *Marxen* state a principle of general applicability to all of bankruptcy practice (and they clearly do not), rules are proved by their exceptions. *Sexton* and *Marxen* teach us nothing about whether equitable subordination under Section 510(c) and disallowance under Section 502(d) are such exceptions. By their clear terms, and under existing case law, the application of Sections 510(c) and 502(d) are *not* – and cannot be – fixed at the petition date.

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<sup>10</sup> Section 502(d) requires disallowance of claims held by recipients of avoidable transfers under enumerated sections, including Section 549, unless the recipient has returned the transfers for which it is liable. 11 U.S.C. § 502(d). Section 549 permits the avoidance of unauthorized *postpetition* transfers. 11 U.S.C. § 549.

## II. PRINCIPLES OF NON-BANKRUPTCY ASSIGNMENT LAW AND BANKRUPTCY RULE 3001(e) HAVE NO RELEVANCE HERE

In addition to its newly prominent arguments about *Sexton* and *Marxen*, Enron argues that principles of assignment law – under which an assignee purportedly has no greater rights than its assignor – mandate the equitable subordination (under Section 510(c)) and disallowance (under Section 502(d)) of a transferee’s claim based solely on the conduct of the transferor. (Enron Br. 32-35). Enron also suggests that Rule 3001(e) of the Federal Rules of Bankruptcy Procedure, which treats a postpetition claim assignment as a “substitution,” supports its position. (*Id.* 16, 32). In fact, principles of assignment law and Rule 3001(e) are irrelevant to the questions at issue on this appeal.

### A. Assignment Law

Enron argues that principles of assignment law – and the supposedly universal principle that an “assignee gets what the assignor had, nothing less and nothing more” (Enron Br. 35, 49) – are determinative of this appeal. But, as demonstrated in Citibank’s Opening Brief, Enron misstates the law of assignments. Enron and its amici spend considerable time arguing that the Transferees here are not “holders in due course” and that the doctrine of “latent equities held by third parties” does not apply. (Enron Br. 35-40).<sup>11</sup> But that is not the point. The point is that there are numerous instances in which an assignee receives *more* than its assignor held. Indeed, it is well established that there can be disabilities in bankruptcy that are personal only. *See, e.g., In re Latham Lithographic Corp.*, 107 F.2d 749, 750 (2d Cir. 1939) (finding Section 44 of the Bankruptcy Act “creates a personal disability only. If a creditor who

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<sup>11</sup> Enron’s argument that the holder in due course doctrine does not apply assumes that the syndicated bank debt at issue here is not a security. (Enron Br. at 36). Enron fails to disclose, however, that the New York Court of Appeals recently held that debt evidenced by a promissory note is a “security” under Article 8 of the New York Uniform Commercial Code. *Highland Capital Mgmt. LP v. Schneider*, 2007 WL 966746 (N.Y. Apr. 3, 2007).

would be disqualified to vote the claim in the debtor's bankruptcy assigns it in good faith to a purchaser who is not disqualified, we can see no reason to bar the latter from voting it.”).

Thus, Enron's (and the Bankruptcy Court's) reliance on assignment law simply begs the question raised by this appeal. If, as the Bankruptcy Court posits, a claim's susceptibility as of the petition date to equitable subordination (under Section 510(c)) and disallowance (under Section 502(d)) becomes an attribute of the claim, then the law of assignment might have something to say about whether that attribute travels with the claim upon transfer. However, if Section 510(c) equitable subordination and Section 502(d) disallowance “create a personal disability only,” *see id.* (as the text and legislative histories of the statutes make clear), then the law of assignments has no applicability at all. (Opening Br. 22 - 25).

#### **B. Rule 3001(e)**

Enron's reliance on Rule 3001(e) of the Federal Rules of Bankruptcy Procedure (“Rule 3001(e)”) is specious. Rule 3001(e) provides that, where a claim is transferred after the transferor has filed a proof of claim, evidence of the transfer must be filed by the transferee and, in the absence of an objection by the transferor (or if such objection is resolved in favor of the transferee), the clerk shall enter an order “substituting the transferee for the transferor.” F. R. Bankr. P. 3001(e). In its brief, Enron argues that, because the transferee is “substituted” for the transferor, the transferee somehow is not a creditor in its own right for purposes of Sections 510(c) and 502(d). (Enron Br. 16). On its face, Rule 3001(e) is a housekeeping measure designed to ensure that the clerk has the correct list of claimholders for purposes of notice, voting and other administrative matters.<sup>12</sup> Indeed, no Bankruptcy Rule can alter a

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<sup>12</sup> *See, e.g., In re Pleasant Hill Partners, L.P.*, 163 B.R. 388, 391 n.5 (Bankr. N.D. Ga. 1994) (describing Bankruptcy Rule 3001(e) as “entirely administrative”).

party's rights under the Bankruptcy Code.<sup>13</sup> The case law is equally clear that the transferee remains a distinct creditor in its own right.<sup>14</sup> As Enron itself concedes, "substitution" is "entirely a matter of convenience" that does not affect the "respective substantive rights of the transferor or transferee." (Enron Br. 16 (quoting *Alfadda v. Fenn*, No. 90 Civ. 4470 (LMM), 1993 WL 526065, at \*4 (S.D.N.Y. Dec. 16, 1993)). Rule 3001(e) thus adds nothing to Enron's argument.

### **III. BECAUSE ENRON'S ARGUMENTS CONCEDEDLY DEPEND ON THE AVAILABILITY OF CONTRACTUAL INDEMNITIES, THESE ARGUMENTS CONFIRM THAT CONGRESS NEVER INTENDED FOR SECTIONS 510(c) AND 502(d) TO APPLY TO TRANSFEREES**

Enron ignores the legal questions decided by the Bankruptcy Court and as to which this Court granted interlocutory appeal. Enron instead seeks to narrow the focus of this appeal to the specific postpetition transfer of bank debt at issue in the Springfield adversary proceeding (from Citibank to Deutsche Bank to Springfield), or, at most, to postpetition transfers of bank debt.

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<sup>13</sup> *Term Loan Holder Comm. v. Ozer Group, L.L.C. (In re Caldor Corp.)*, 303 F.3d 161, 171 (2d Cir. 2002) (the Rule Enabling Act, 28 U.S.C. § 2075, dictates "that the [Bankruptcy] Code rather than the rules provides the controlling indication of Congress's intent with regard to substantive rights"); *United States v. Towers (In re Pacific Atlantic Trading Co.)*, 33 F.3d 1064, 1066 (9th Cir. 1994) ("[A]ny conflict between the Bankruptcy Code and the Bankruptcy Rules must be settled in favor of the Code.") (citation omitted); *In re Barnes*, 308 B.R. 77, 81 (Bankr. D. Colo. 2004) ("[T]he Bankruptcy Rules cannot override substantive provisions provided in the Bankruptcy Code . . .").

<sup>14</sup> *See, e.g., In re Northwood Props., LLC*, No. 05-18880-RS, 2006 WL 1738282, at \*1-2 (Bankr. D. Mass. Jun. 21, 2006) (parties who bought claims postpetition were entitled to rely on such claims to "facilitate their opposition to the [d]ebtor's reorganization plan, whether by way of plan rejection (voting the [c]laims against the [d]ebtor's plan) or by way of plan competition (formulating and filing their own plan)[.]"); *Power Five, Inc. v. General Motors Corp. (In re Automotive Armature Co.)*, 219 B.R. 513, 517 (S.D. Ind. 1998) (holding that "Power Five [a postpetition claims assignee] became one of the [d]ebtor's creditors when it acquired the claim against [d]ebtor from NBD [the assignor]").

Thus, rather than confront the general legal issues carefully framed by this Court in its January 30, 2007 Opinion and Order granting leave to appeal, Enron has tactically reframed the “Issue Presented” as whether “Citibank [can] immunize the claim it held against Enron on Enron’s bankruptcy filing date (the “Petition Date”) from equitable subordination under Bankruptcy Code section 510(c) and disallowance under section 502(d) by assigning that claim after the Petition Date.” (Enron Br. 1). Throughout its papers, Enron’s argument proceeds as if this appeal is somehow limited to the question of “bank debt that Citibank assigned postpetition, giving indemnities.” (Enron Br. 47; *see also id.* 3, 36). That, however, is not the issue framed by this Court. But Enron evidently appreciates that only by restricting its focus can it assert that transferees “typically” or “customarily” obtain indemnities.<sup>15</sup> (Enron Br. 27, 46, 47). Enron argues that, through the operation of these indemnities, equitable subordination under Section 510(c) and disallowance under Section 502(d) can *still* serve their legislative purpose *even* when applied to transferees. (Enron Br. 46).

Wholly apart from Enron’s refusal to address the issues framed by this Court, Enron’s arguments on the merits are fundamentally flawed. In the first place, the Bankruptcy Court’s rulings on their face were not restricted to bank debt protected by indemnities.<sup>16</sup>

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<sup>15</sup> Even the Bankruptcy Court acknowledged that, in certain contexts, a transferee cannot be protected by indemnification. *Subordination Opinion* at 39 n.15; *Enron Corp. v. Ave. Special Situations Fund II, LP (In re Enron Corp.)*, 340 B.R. 180, 204 n.23 (Bankr. S.D.N.Y. 2006).

<sup>16</sup> *See, e.g., Enron Corp.*, 340 B.R. at 204 (“There may well be transfers of claims that could not be reasonably protected by indemnification but whether the purchaser of a claim protects itself is not an issue with which a bankruptcy court need be involved. The concern of the Bankruptcy Code is the distribution on a claim. Whether that claim results from a bank loan, a bond, or any other types of debtor-creditor relationship, it is still a claim – characteristics of which are not altered by the transfer. . . . Whether or not a transferee enters into a negotiation process of contracting with a transferor to protect its interest is a matter of choice for such transferee and does not limit the debtor’s right to assert a section 502(d) defense against a claim.”).

Furthermore, indemnities from financially sound indemnitors plainly are not always available;<sup>17</sup> and, even in those circumstances where they are, reliance on a system of indemnities is ultimately unworkable.<sup>18</sup> Moreover, the fact that, as applied to transferees, Sections 510(c) and 502(d) can only serve their legislative purpose where indemnities exist, demonstrates that Congress could never have intended that these statutes apply to transferees.

Enron acknowledges that “equitable subordination is not designed to ‘punish,’ but rather is remedial.” (Enron Br. 31). Subordinating claims held by wrongdoers serves this remedial purpose. Subordinating claims held by transferees of wrongdoers does not. According to Enron, however, subordinating claims held by transferees of wrongdoers still can serve a remedial purpose to the extent indemnification provisions exist, because the indemnity will transfer the economic penalty to the wrongdoer.

Enron further acknowledges that Section 502(d) is concerned with coercing compliance with judicial orders to return avoidable transfers. (Enron Br. 46). *See, e.g., Campbell v. United States (In re Davis)*, 889 F.2d 658, 662-63 (5th Cir. 1989). Disallowing the claims of creditors that received avoidable transfers (and fail to return them) serves that statutory purpose. Disallowing claims of transferees that did not receive and cannot return avoidable transfers does not. According to Enron, however, disallowing claims of transferees can still serve the coercive purpose of Section 502(d) where indemnification provisions exist,

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<sup>17</sup> Trade creditors, for example, often depend on a liquid postpetition market in which to sell their claims, and not surprisingly, many may not be able to offer creditworthy indemnities.

<sup>18</sup> Under such a system, a prospective buyer would be required to conduct extensive due diligence on all previous sellers and to accept the potential costs and delay of litigation to enforce the indemnities. (*See* Opening Br. 40-41). In fact, market participants are unwilling to rely on the time consuming, expensive and uncertain “remedy” of indemnities and thus, following the Bankruptcy Court’s decisions, the market for bankruptcy claims has entirely dried up where rumors circulated about a risk of equitable subordination or disallowance. (*See* Reply Brief of Industry Amici 5, 9-11).

because the indemnity will impose pressure on the transferor to return the avoidable transfer. (Enron Br. 46).

But the Loan Syndication Trading Association Standard Terms for trades (a centerpiece of Enron's indemnification arguments) were not developed until 1996, at the earliest. It is irrational to assume, as Enron does, that 18 years earlier, in 1978, when Congress enacted Sections 502(d) and 510(c), Congress was relying on the *prospective* development of a pattern of private contractual arrangements that did not then exist – and were nowhere mentioned in the statute or legislative history – to enable these statutes to serve their respective purposes as applied to transferees. Moreover, at the time these statutes were enacted, no case had *ever* equitably subordinated or disallowed the claims of a transferee based on the conduct of the transferor. Plainly, Congress never intended for Sections 510(c) and 502(d) to be applied to transferees based on the conduct of transferors.

#### **IV. THE STATUTE, LEGISLATIVE HISTORY AND CASE LAW MAKE CLEAR THAT EQUITABLE SUBORDINATION UNDER SECTION 510(c) DOES NOT APPLY TO A TRANSFEREE'S CLAIMS BASED SOLELY ON THE CONDUCT OF THE TRANSFEROR**

As we have shown, the terms of Section 510(c), its legislative history and the applicable case law demonstrate that misconduct by a creditor holding a claim is a prerequisite to equitable subordination. (Opening Br. 13-22).

Enron offers three arguments in response. *First*, Enron argues that before the enactment of the Bankruptcy Code, it was well established (as per *Sexton* and *Marxen*) that the petition date fixed the rights and priorities of creditors, and thus, if Congress intended equitable subordination to be an exception to *Sexton* and *Marxen*, it should have explicitly said so. (Enron Br. 6, 21). *Second*, Enron argues that because the statutory language of Section 510(c) refers to “claims” – and not “creditors” or “holders” – the equitable subordination defense must attach to a claim on the petition date. (Enron Br. 19-20). *Finally*, Enron argues that Congress'

expectation that courts would continue to develop the doctrine of equitable subordination somehow justifies the Bankruptcy Court's Subordination Decision. (Enron Br. 31). Each of Enron's arguments is unpersuasive.

As discussed above, Enron misstates the relevance of *Sexton* and *Marxen*. These decisions (dealing with claim measurement and statutory priorities, respectively) did not create, as Enron suggests, a principle of universal application such that Congress was required explicitly to "opt out." (Enron Br. 6, 21). In any event, Section 510(c), on its face, "opts out" of any putative rule that would "fix and determine" all bankruptcy matters on the petition date. The statute makes clear that equitable subordination is a discretionary remedy ("the court may..."), the application of which is to be determined "*after* notice and a hearing" – not at the petition date. Furthermore, as Enron itself concedes (Enron Br. 22 n.12), the only case decided before the enactment of the Bankruptcy Code that dealt with equitable subordination in the context of postpetition transfers did not freeze the situation as of the petition date, but instead found that the principle of *Marxen* did *not* govern. *In re Multiponics Inc.*, 436 F. Supp. 1065 (E.D. La. 1977), *aff'd in part, rev'd in part, Machinery Rental, Inc. v. Herpel (In re Multiponics)*, 622 F.2d 709 (5th Cir. 1980).

In *Multiponics*, certain claims were held by a "blameless" creditor as of the petition date; the claims were then purchased, postpetition, by a company wholly owned by an insider guilty of inequitable conduct. *Id.* at 1069-70. Finding that the wholly owned company was the alter ego of the wrongdoer, the district court determined that its claims should be equitably subordinated, despite the fact that the claims could not have been subordinated in the transferor's hands as of the petition date. *Id.* at 1071-72. Notwithstanding Enron's argument that the petition date fixes the relative rights among competing claims against a bankruptcy estate, the district court found that the *Marxen* principle was *not* controlling and, instead,

focused on the conduct of the current claimholder (*i.e.*, whether the wrongdoer's conduct could be imputed to the company as an alter ego). *Multiponics*, 436 F. Supp. at 1072 (“The principle that claims are characterized at the time the reorganization petition is filed is not immutable, nor does it dictate the result in this case.”). Enron itself notes that the district court decision in *Multiponics* was “a prominent district court opinion.” (Enron Br. 21). Thus, the case law that existed at the time Congress enacted the Bankruptcy Code found that “principles of equitable subordination” were *not* governed by *Marxen*.<sup>19</sup>

Enron's argument that equitable subordination must attach to claims at the petition date because Section 510(c) refers to “claim” (but not “claimant”) is simply makeweight. (Enron Br. 30-31). Section 510(c) provides that “after notice and a hearing, the court may – under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim . . .” 11 U.S.C. § 510(c). The “equitable subordination principles,” as articulated in *Mobile Steel* and affirmed again and again by courts applying Section 510(c), require misconduct by the “claimant” as a prerequisite to subordination. The statute refers to “claim” simply in describing

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<sup>19</sup> On appeal, and several years *after* the enactment of the Bankruptcy Code, the Fifth Circuit reversed the district court's finding that the company was an alter-ego of the wrongdoer. *Machinery Rental, Inc. v. Herpel (In re Multiponics)*, 622 F.2d 709, 723-25 (5th Cir. 1980) (“*Multiponics II*”). In so ruling, the Fifth Circuit affirmed its earlier holding in *Mobile Steel* that equitable subordination required misconduct by the claimant and applied the *Mobile Steel* factors to the postpetition transferee (the wholly owned company) to determine whether a claim could be equitably subordinated in its hands. In dicta, the Fifth Circuit recognized that rights “*generally*” are determined as of the petition date, but refused to speculate on whether equitable subordination was the kind of “right” that invariably was determined at that time. *Multiponics II*, 622 F.2d at 725. Thus, contrary to Enron's assertion, the Fifth Circuit did not “squarely confront” the question of whether equitable subordination was the kind of right that attaches to a claim as of the petition date; nor did it express a “clear” view that equitable subordination is always measured at that time. (Enron Br. 6, 29). Far from it. Moreover, the Fifth Circuit's dicta on this score has never been cited by any other court.

the method by which courts may apply the remedy (*i.e.*, subordinate all or part of an allowed claim to all or part of another allowed claim), once the court has found inequitable conduct by the claimant.

Finally, Enron suggests that Congress' intent that courts would be free to develop the equitable subordination doctrine – rather than freeze that doctrine consistent with pre-1978 law – somehow justifies the Bankruptcy Court's decision here. (Enron Br. 31). But “Congress meant to give the courts *some* leeway to develop the doctrine,” not *carte blanche* to depart from it.<sup>20</sup> Citibank's Opening Brief discussed the very limited exceptions to the requirement of creditor misconduct that have developed, as well as the Supreme Court's decision in *Noland* that casts doubt on the continued viability of these exceptions. (Opening Br. 19-22). The Bankruptcy Court's extension of equitable subordination to transferees based solely on inequitable conduct by their transferors cannot be characterized as an incremental development of the doctrine: it is a radical and unprecedented departure.<sup>21</sup>

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<sup>20</sup> *United States v. Noland*, 517 U.S. 535, 540 (1996) (emphasis added); *see also In re Lifschultz Fast Freight*, 132 F.3d 339, 348 (7th Cir. 1997) (“Congress meant to give courts some leeway to develop the doctrine of equitable subordination, a premise that the Supreme Court may have tepidly endorsed. . .”) (internal citations and quotations omitted); *Burden*, 917 F.2d at 123 (Alito, J., dissenting) (noting that while Congress meant development of equitable subordination to be left to the courts, this “‘development,’ however, while very likely meant to permit the kind of incremental change effected by *In re Stirling Homex*, cannot include a fundamental break from ‘existing case law[.]’”).

<sup>21</sup> Enron contends that *Columbus Ave. Realty Trust* and similar receivership cases are instances where courts have subordinated claims in the hands of a transferee based solely on a transferor's misconduct. (Enron Br. 22-23). Not so. A federal bank receiver acquires its rights by virtue of a specific statutory grant under which the receiver effectively becomes the failed bank, thus providing a classic basis for imputation. Thus, in *Columbus Avenue Realty*, the court contrasted the situation where the FDIC functions as a receiver and “manages the assets of the failed bank on behalf of the bank's creditors and shareholders” with the situation where the FDIC operates in its corporate capacity through a purchase and assumption transaction. 968 F.2d at 1336-37, 1353-56. The court held that when the FDIC acts as a receiver, the failed bank's inequitable conduct can be imputed to the FDIC for purposes of equitable subordination; whereas, if the FDIC is acting in its

For this reason, Enron's constant criticism of Citibank for failing to cite a case dealing with the question of subordination of a transferee's claim based on its transferor's conduct (Enron Br. 5, 22, 23, 27, 49), is highly ironic. No such case exists precisely because, in the last 100 years, no party has ever attempted to do what Enron has attempted here, since the notion is wholly foreign to principles of equitable subordination.

**V. THE STATUTE, LEGISLATIVE HISTORY AND CASE LAW MAKE CLEAR THAT DISALLOWANCE UNDER SECTION 502(d) DOES NOT APPLY TO A TRANSFEREE'S CLAIM BASED SOLELY ON THE CONDUCT OF THE TRANSFEROR**

As set forth previously in our Opening Brief, the statutory language and legislative purpose of Section 502(d) demonstrate that the statute cannot be applied to transferees based solely on the transferor's receipt of an avoidable transfer. (*See* Opening Br. 28-36). In response, Enron engages in a misleading textual analysis that would inflate out of all proportion the significance of the words "claim of" as used in the statute, while disregarding whether, under its tortured reading, the statute could accomplish its legislative purpose.

Pointing to Sections 502(b)(6) and (b)(7), which address how to calculate the appropriate recovery on a "claim of a lessor" and "claim of an employee," respectively, Enron observes that the calculation described in these subsections applies even if the claim has been transferred to a non-lessor or non-employee. Accordingly, Enron suggests that disallowance under Section 502(d) should continue to apply to the "claim of any entity [that received an

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corporate capacity in the context of a purchase and assumption, it is protected as a "holder in due course." Similarly, in *Kingsway Revocable Trust v. Fed. Sav. & Loan Ins. Corp. (In re C.P.C. Dev. Co. No. 5)*, 113 B.R. 637, 642-43 (Bankr. C.D. Cal. 1990), the court found that the "alleged bad acts of [the failed savings and loan] may be imputed to the FSLIC/FDIC for purposes of equitable subordination" where the FSLIC/FDIC acted as a receiver and thus acquired the claims "not by purchase and assumption but by transfer through legal process." *Id.* Cases dealing with receivers are entirely inapposite.

avoidable transfer]” and held it as of the petition date, even if such claim has been assigned to an entity that never received an avoidable transfer.

But Enron’s argument for interpretive “symmetry” not only elevates minutiae over substance, but it also fails on its own terms. Whether a claim is a “claim of a lessor” or “claim of an employee” is fixed when the obligation is incurred and does not change upon prepetition or postpetition transfer. *See Shropshire, Woodlife, & Co. v. Bush*, 204 U.S. 186, 189 (1907). By contrast, whether a claim is the “claim of any entity [that received an avoidable transfer]” is not fixed when the obligation is incurred; nor is it fixed as of the petition date, since Section 502(d) disallowance, by its terms, can be based entirely on the receipt of a postpetition avoidable transfer. Principles of statutory construction do not support the Bankruptcy Court’s Disallowance Opinion.

In fact, such principles mandate reversal of the decision. As the Supreme Court has directed:

courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy.

*Securities and Exchange Comm’n v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-51 (1943).<sup>22</sup> The purpose of Section 502(d) is to coerce compliance with judicial orders to return

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<sup>22</sup> *See also Dickerson v. New Banner Inst., Inc.*, 460 U.S. 103, 118 (1983) (“As in all cases of statutory construction, our task is to interpret the words of [the statute] in light of the purposes Congress sought to serve.”) (citation and quotation omitted); *United States v. Mitchell*, 328 F.3d 77, 81 (2d Cir. 2003) (“In determining the scope of the statute and the persons to whom it is applicable, we must consider not only the plain meaning of the language used in the statute, but also must interpret that language in light of the purposes Congress sought to serve by promulgating the relevant laws.”) (citation and quotation omitted).

avoidable transfers. *In re Davis*, 889 F.2d at 661 (“The legislative history and policy behind Section 502(d) illustrates that the section is intended to have the coercive effect of insuring compliance with judicial orders.”). The purpose of Section 502(d) is “not to punish, but to give creditors an option to keep their transfers (and hope for no action by the trustee) or to surrender their transfers and their advantages and share equally with other creditors.” *Petitioning Creditors of Melon Produce, Inc. v. Braunstein (In re Melon Produce, Inc.)*, 112 F.3d 1232, 1239 (1st Cir. 1997) (citation and quotation omitted). Transferees that themselves received no avoidable transfers cannot be “coerced” to – nor do they have the “option” to – return the avoidable transfers.<sup>23</sup> The Bankruptcy Court’s interpretation of Section 502(d) must be rejected, because extending the reach of the statute to transferees (based solely on the conduct of transferors) manifestly does not serve the legislative purpose.

**VI. SOUND POLICY REASONS COUNSEL AGAINST THE BANKRUPTCY COURT’S IMPERMISSIBLE EXTENSION OF EQUITABLE SUBORDINATION UNDER SECTION 510(c) AND DISALLOWANCE UNDER SECTION 502(d)**

As demonstrated above, the statutory language and legislative history make clear that neither Section 502(d) nor Section 510(c) was intended to apply to a transferee based solely on the conduct of the transferor. Moreover, as Citibank and the Industry Amici have shown, this Court should not adopt a doubtful statutory interpretation that would disrupt the market for postpetition claims.

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<sup>23</sup> As discussed above (*see supra* at pp. 15-16), it is no answer to argue that (in the case of bank debt) claim transfers “typically” carry indemnities that may operate to coerce the return of the transfer. A court should not prefer an interpretation that may “typically” accomplish the statutory purpose in a subset of cases. *See Mitchell*, 328 F.3d at 81. Moreover, it cannot be presumed that Congress legislated in reliance on the prospective development of a pattern of private contractual arrangements that would permit the statute to serve its avowed purpose. (*See supra* at pp. 16-17).

In response, Enron insists that there will be no market disruption. (Enron Br. 46-47). Enron ignores the brief submitted by Industry Amici (representing virtually every relevant trade organization) and the numerous recent articles (*see* Opening Br. 39) depicting the Bankruptcy Court’s decisions as a dramatic departure from precedent. Instead, Enron assures the court that traders in distressed debt “have long understood” that a transferee can be equitably subordinated based solely on the misconduct of its transferor because of six articles Enron located, suggesting – in the absence of *any case ever* imposing the remedy in these circumstances – that this was a risk. (Enron Br. 3, 7-8, 46). Additionally (and ironically), Enron faults Citibank for proffering “no evidence” of market disruption as a result of the Bankruptcy Court’s decisions, while at the same time arguing that this Court should ignore evidence (submitted by Industry Amici) of the disruptive impact these rulings have already had in two significant bankruptcies. (Enron Br. 8, 47 n.26).

While ignoring the reality of market disruption, Enron (and the Amici Enron Creditors<sup>24</sup>) make overblown claims, with no foundation, that contrary rulings would “eviscerate” Sections 510(c) and 502(d), render them “a nullity,” and “effectively [] deprive the bankruptcy court of [the] remedial power [of these statutes] altogether,” because a creditor otherwise subject to equitable subordination or disallowance could “easily escape” these two defenses simply by assigning its claims. (Enron Br. 7, 9, 31, 45; *see also* Enron Br. 7, 49). But there is absolutely no suggestion – let alone evidence – that “claimswashing” was behind any

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<sup>24</sup> While Citibank does not oppose the motion of the Amici Enron Creditors to file a brief in support of Enron’s position, Citibank points out that the Amici Enron Creditors likely have no stake in the question at issue in this appeal. The Amici Enron Creditors describe themselves as purchasers of distressed debt in the secondary market; to the extent they purchased claims “after the alleged misconduct[], the intervention of bankruptcy and at distressed prices,” the claims they purchased postpetition would not benefit from equitable subordination of the wrongdoer’s (or its transferee’s) claims. *W.T. Grant*, 4 B.R. at 78; *see also In re S&D Foods, Inc.*, 110 B.R. at 37.

of the transfers at issue in any of the adversary proceedings that Enron has brought against transferees. Indeed, almost all of the claims that Citibank transferred postpetition, which Enron now seeks to subordinate or disallow in the transferees' hands, were made pursuant to *prepetition* credit-default swap contracts Citibank executed years *before* Enron's bankruptcy.<sup>25</sup>

The Bankruptcy Court expressly declined to rely on Enron's "claimswashing" argument,<sup>26</sup> and with a good reason: a wrongdoer that assigns its claims remains subject to a direct action by the debtor for the same wrongdoing and a recipient of an avoidable transfer that assigns its claims remains subject to an avoidance action by the debtor for the return of that transfer. (Indeed, Enron has brought precisely such a direct action against Citibank in this case.) The notion that creditors would engage in rampant "claimswashing" to "escape" liability under one statute when they cannot avoid liability under others, is illogical.<sup>27</sup>

## CONCLUSION

For the foregoing reasons, this Court should reverse the Subordination Order and the Disallowance Order.

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<sup>25</sup> The Bankruptcy Court explicitly stated that the logic of its opinions should apply equally to *prepetition* agreements, such as credit-default swaps, which result in postpetition transfers. *Subordination Opinion* at 39 n.15. Transactions such as credit default swaps are intended to put a postpetition mechanism firmly and reliably in place before – often long before – a bankruptcy petition is filed. If the swap works as intended, one or both of the parties will have the absolute contractual right after the petition to force the transfer of claims. As applied to credit default swaps, the rule Enron promotes would disrupt the legitimate *prepetition* expectation of the parties.

<sup>26</sup> *Subordination Opinion* at 32-33; *Enron Corp.*, 340 B.R. at 200.

<sup>27</sup> Moreover, to the extent that misconduct exists with any given transfer, *i.e.*, if a creditor engaged in deliberate "claimswashing" – which Enron does not allege here – Section 510(c) would provide an adequate remedy as applied to the facts of that case.

Dated: New York, New York  
May 14, 2007

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