REMEMBER WHEN—RECOLLECTIONS OF A TIME WHEN AGGRESSIVE ACCOUNTING, SPECIAL PURPOSE VEHICLES, ASSET LIGHT COMPANIES AND EXECUTIVE STOCK OPTIONS WERE POSITIVE ATTRIBUTES*

AN ABI ROUNDTABLE DISCUSSION

Mr. Robin Phelan: Since we're going to be talking about Enron, WorldCom and some of the other cases currently pending, and our firm's those cases, and Judge Case is constrained by some ethical obligations of current sitting judges on current cases. I just want to say that anything that I say today is — typical governmental disclaimer — my own personal opinion and does not reflect those of any clients of our firm, or anybody else in the universe, and probably some of our clients would shoot me for what I'm going to say anyway.

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* Roundtable discussion moderated by Mr. Robin Phelan on December 7, 2002 at La Paloma Resort in Tuscon, Arizona. The participants included Mr. Philip Corwin, the Honorable Charles G. Case II, and by telephonic participation: Mr. Larry Frazen, Ms. Laura Davis Jones, and Mr. William Brandt. Robin E. Phelan is a partner at Haynes and Boone, LLP specializing in insolvency, reorganization and related areas, including litigation in bankruptcy and other federal courts. Mr. Phelan has contributed to several major treatises on bankruptcy and has testified before the Congressional Bankruptcy Review Commission and the United States Congress. Mr. Phelan has recently participated in a program sponsored by the United States Department of State and the United Nations to develop model cross-border insolvency provisions. Mr. Phelan is a former President of the American Bankruptcy Institute. Philip S. Corwin is a partner in the Washington, D.C. law firm of Butera & Andrews specializing in bankruptcy, financial services, intellectual property and electronic commerce. Mr. Corwin testified before Congress, is a frequent speaker before legal, banking, technology, digital entertainment, and financial services industry audiences and served as an adviser to the National Association Of Insurance Commissioners. Honorable Charles G. Case II was appointed a United States Bankruptcy Judge for the District of Arizona on January 5, 1994. Prior to that time, he was a member of the Phoenix law firm Meyer, Hendricks, Victor, Osborn & Maledon, P.A., where he concentrated in bankruptcy, chapter 11 reorganizations, secured transaction, and commercial litigation. Judge Case is a fellow of the American College of Bankruptcy and a member of the American Law Institute, the International Insolvency Institute and the American Bankruptcy Institute. Judge Case has taught secured transactions, bankruptcy and creditors' rights at Arizona State University College of Law and has been a guest lecturer at Harvard Law School on real estate reorganizations. Laurence M. Frazen is a partner with Bryan Cave, LLP in Kansas City, Missouri, specializing in the representation of creditors, debtors, creditors committees, and other interested parties in bankruptcy proceedings across the country. He has authored, co-authored, and edited many works, including a chapter in the Missouri CLE *Bankruptcy Desk Book* and "Chapter 8: The Automatic Stay in the Chapter 11 Case" in *Advanced Chapter 11 Bankruptcy Practice*, published by John Wiley & Sons in April 1994. Mr. Frazen has lectured on bankruptcy and reorganization topics for the American Bar Association and numerous other professional and trade organizations. Laura Davis Jones is the managing shareholder of Pachulski, Stang, Ziehl, Young, Jones & Weintraub's Delaware office, specializing in bankruptcy litigation, commercial workouts, international insolvency and out-of-court debt restructuring. She has represented many significant constituencies in national chapter 11 cases and workout proceedings. Ms. Davis teaches at national bankruptcy and litigation seminars and has authored many articles. Bill Brandt is President and CEO of the restructuring advisory firm, Development Specialists, Inc., ("DSI") which has been involved in many well-known matters, including those of *Mercury Finance Company*, *Commercial Financial Services*, *Breed Automotive* and *Valeo Electrical Systems, Inc*. Mr. Brandt has been recently working with representatives of the People's Republic of China on approaches to the reorganization of some of that country's state-owned industries. He was the principal author of the amendment to the Bankruptcy Code which permits the election of trustees in chapter 11 cases.

These cases involve a lot of different issues, and one of the first things that comes to mind in connection with these high profile cases now are the influence of the criminal authorities. You've got to deal with criminal authorities in these cases, and I've always found that to be a problem in the cases I've been involved with because people don't ever get charged with stealing or theft. It always involves something vague, like conspiracy to obstruct justice, or conspiracy to conduct mail fraud or some other vague type of thing. I once had a business professor tell me the difference between check-kiting and good cash management was a Harvard MBA.

Okay. Actual disputes. For example, if I've got a contract with you, and I don't pay because you breached, and you go to the prosecutor saying that I cheated you, that's mail fraud and wire fraud and, if I use the money, it's money laundering. If I call you to say that you breached the contract, then I'm obstructing justice by tampering with their witness.

Which leads me to the conviction of Arthur Andersen in the Enron case. As near as I can tell, unless everybody has a different opinion, it looked to me like they got convicted of editing a draft of an internal memo. Not insider trading, not shredding documents, not killing witnesses, not running a conspiracy scam with their bookkeeping, but a house counsel edited a draft of an internal memo, and that constituted obstruction of justice.

Now, is that the type of experience you guys have been running into in your cases? Judge, do you ever get any of that in your situations?

Judge Charles Case: I've seen very little interplay, at least in cases I've had, between the bankruptcy case and the criminal prosecution. I've had some cases where there have been prosecutions arising out of what occurred during the bankruptcy case, but usually not the ordinary commercial transactions that you're talking about, Robin, but rather something having to do with misleading statements or non-disclosures, or something that actually took place in a bankruptcy case.

Phelan: Laura, what happens in some of those cases? Have you had any problems with criminal authorities?

Ms. Laura Davis Jones: In the American Tissue case,[1] as debtor's counsel there, Robin, what we've tried to do is really keep the bankruptcy and the criminal proceedings separate. And, indeed, a week or two before filing, I made sure that the estate went and retained white collar criminal counsel, if you will, to deal with those issues and really to get the court here comfortable that I was dealing with the issues by people who knew what they're talking about, and really kind of keeping it separate and apart from trying to maximize value for the creditors, and so far it has worked very well.

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[1] LaSalle Nat'l Bank Ass'n v. Gabayzedeh, No. 02 CV 734, 2003 WL 134997 (N.D. Ill. Jan. 17, 2003) (holding Gabayzedeh, chief executive officer of American Tissue, liable for loan repayment).

There are a lot of issues, allegations and so forth made in that case,[2] because the same family controlled a multitude of companies, including the companies that I had filed bankruptcy for, which is only a subpart of that conglomerate.

And while the DA's office in New York and others all had been involved with those issues, we've really been trying to deal with them separately, and even to the extent that when people are seeking 2004 examinations[3] and what have you on the criminal side, we try not to use the bankruptcy vehicle, but rather let that go on in the ordinary course in the non-bankruptcy context, with nobody trying to assert stays of anything. Because, really, it's kind of difficult anyway to keep the two going on parallel tracks. And at the end of the day, not only will we have a fully liquidated estate, but also criminal issues, at least as far as the company is concerned, behind them.[4]

Phelan: I'm prejudiced, I guess, because I've had some bad experiences. We represented a corporation one time in a chapter 11, and the criminal authorities had been investigating, apparently, for a couple of years without bothering to tell anybody. And because they were investigating the principal of the corporation, even though we were in a chapter 11, even though I had a plan filed that paid everybody 100 cents on the dollar, even though I was suing what I considered to be the breaching contracting party, they came in with a secret affidavit, and the judge was required to stay my case based on a secret affidavit that I couldn't see and, obviously couldn't contest.

And when we went and looked at the statutes, by golly, they can do that. They put my whole chapter 11 on hold. When it finally got off hold, we found out that one of the ex-employees had, in essence, stolen a Rolodex and was soliciting customers. We wanted to take a 2004 of the guy. Under one of the local rules, you have to notice the party that you're going to take the 2004 of. I had one of my associates call his house and he left a message with his wife.

Next thing I know, I get a call from the Justice Department lawyer accusing me of obstructing justice by tampering with his witness.

I'm concerned, to some degree that we have these statutes, which were designed to keep people from killing witnesses and were designed to keep mafia guys from

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[2] *See id.*, at *1, *6 (claiming defendant breached contract). *See generally* Nathan Vardi, *Paper Trail*, FORBES, Nov. 25, 2002, at 70 (discussing several allegations against American Tissue owners).

[3] FED. R. BANKR. P. 2004. *See In re* Int'l Fibercom, Inc., 283 B.R. 290, 292 (Bankr. D. Ariz. 2002) (opining purpose of 2004 is "to allow the court to a gain clear picture of the condition and the whereabouts of the bankrupt's estate" and to authorize court to "order examination of any entity"); *see also In re* Enron Corp., 281 B.R. 836, 840 (Bankr. S.D.N.Y. 2002) (explaining scope of 2004 examination as discovery device, relating to "acts, conduct, or property, or to the liabilities and financial conditions of the debtor," including any matter affecting administration of bankruptcy estate and used to discover assets, examine transactions and determine if wrongdoing occurred).

[4] *See* U.S. v. Cutter, 313 F.3d 1, 1 (1st Cir. 2002) (ruling defendant guilty of criminal charges after bankruptcy proceedings); U.S. v. Savin, 2002 WL 31520472, No. 00CR45(RWS), at *1 (S.D.N.Y. October 22, 2002) (confirming defendant's guilt for perjury during bankruptcy proceedings).

engaging in violent crimes, and we're using it for differences in accounting opinions.

Jones: Well, I think, Robin, the most difficult problem that I've run across in the American Tissue case, but also in a couple of other cases where we've had criminal charges pending or indictments pending, has been that, in the course of depositions, whether 2004 or non-bankruptcy deposition, everyone takes the fifth.[5] And they have to, because they're so afraid that what they might talk about in the bankruptcy case will affect them in the criminal case.[6]

So from an information gathering perspective from the bankruptcy side, that's probably been the most troubling part of it.

Phelan: The criminal authorities have to do what they've got to do, [7] but on the other hand, when you put a chapter 11 on hold, you kill a business[8] and kill the creditors,[9] because they want to prove a point because they spent two years running around the world tracking evidence and won't back off because it will hurt promotional opportunities.

Judge Case: A similar issue arises when one of the parties may try to use the criminal proceedings as leverage in the bankruptcy case, by taking information that may have arisen in the bankruptcy case and then supplying that to the prosecuting authorities, who then make their own decision whether to prosecute, but would not

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[5] U.S. CONST. amend. V ("[N]o person shall . . . be compelled in any criminal case to be a witness against himself"); *see also* Ohio v. Reiner, 532 U.S. 17, 18–21 (2001) *(*discussing scope of constitutional protection from self-incrimination). *See generally* Ajit V. Pai, Comment, *Should a Grand Jury Subpoena Override a District Court's Protective?*, 64 U. CHI. L. REV. 317, 337 (1997) (discussing problems surrounding self-incrimination in civil suits.).

[6] *See Cutter*, 313 F.3d at 2 (discussing defendant's conviction stemmed from statements made during bankruptcy petition); *Savin*, 2002 WL 31520472, at *3 (noting defendant's perjury in bankruptcy case of pending criminal proceeding).

[7] *See* 28 U.S.C. § 1334 (c)(1) (2000) (stating district court can abstain from hearing proceeding arising in or related to case under title 11); Nelson v. La Crosse County Dist. Att'y (*In re* Nelson), 301 F.3d 820, 824 n.2 (7th Cir. 2002) (applying 28 U.S.C. § 1334(c)(1), which provides "'[n]othing in this section [granting original and exclusive jurisdiction in bankruptcy cases to federal courts] prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.'").

[8] *See* Hon. Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85, 89 (1996) (stating business contacts are less willing to conduct business with chapter 11 debtors because of potential losses, therefore chapter 11 is cloud looming over debtors and creditors). *But see* Steven R. Wirth, *A Uniform Structural Basis for Nationwide Authorization of Bankruptcy Court-Annexed Mediation*, 6 AM. BANKR. INST. L. REV. 213, 229 (1998) (stating debtors usually favor delaying bankruptcy proceedings as long as possible effort to wait for business to increase in value and succeed, particularly where debtor wants to make long-term business changes that take time to implement).

[9] *See* Bufford, *supra* note 8, at 90 (arguing creditors are principal beneficiaries of shorter chapter 11 cases, since they suffer expenses and losses resulting from delayed disposition); Wirth, *supra* note 8, at 229 (stating unsecured and undersecured creditors benefit by early resolution of chapter 11 case because earlier plan is confirmed, earlier assets are distributed to creditors).

have known about it had they not received the information from one of the parties in the bankruptcy case.[10]

And that then complicates the bankruptcy case considerably, because you then have the Fifth Amendment overtones.[11] You have requests to seal documents and hearings. You have all sorts of problems that otherwise wouldn't exist.[12]

Phelan: You know, another thing that relates to these kind of cases, of course, is the pressure from the media.[13] And, in this regard I'm just going to read a little blurb from one of the papers commenting on the WorldCom settlement with the SEC. Basically, it boils down to the editor in this publication criticizing that settlement.

"Can a company that misstates its financial results by nine billion dollars actually escape being fined? It's hard to believe, but it's a real possibility. In the Securities and Exchange Commission settlement with WorldCom, the SEC has settled the WorldCom case without hitting the telecommunications giant with a financial penalty, although they reserve the right to do so later.[14] That's hardly the proper example."

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[10] *See* Gabriel L. Gonzales et al., *Parallel Civil and Criminal Proceedings*, 30 AM. CRIM. L. REV. 1179, 1182 (1993) (arguing inconsonant reach of civil and criminal discovery may tempt both prosecution and accused to utilize broad scope of civil discovery to obtain materials to aid efforts in criminal prosecution); Craig Peyton Gaumer, *Affairs of State: Breaking the Code of Silence*, 17 AM. BANKR. INST. J. 8, 35 (1998) (describing case where information provided by debtor's attorney to U.S. attorney about bankruptcy case was used to successfully prosecute debtor in criminal case); Pamela Griffith, *Bankruptcy System Provides Means to ShutDown Massive Cattle Fraud Case*, 2001 ABI JNL. LEXIS 161 at *6–7 (Sept. 2001) (describing instance where bankruptcy trustee referred and assisted in criminal prosecution of debtor).

[11] *See* Gonzales, *supra* note 10, at 1191 ("The Fifth Amendment problem is particularly serious [in parallel proceedings] since the privilege may be waived if not invoked in the civil action and the evidence may then be used in the criminal proceeding.").

[12] *See, e.g*, Transcript of Proceedings, U.S. v. Arthur Andersen, L.L.P., 2002 Extra LEXIS 448 at *166 (S.D. Tex. May 9, 2002) (No. H-02-121) (acknowledging potential ramifications of not sealing cases or issuing protective orders); U.S. v. Davis, 702 F.2d 418, 419 (2d Cir. 1983) (explaining problems presented by sealing cases and protective orders in cases where both bankruptcy and criminal charges were brought); *see also* Gonzales, *supra* note 10, at 1191 (noting parallel proceedings can present several dangers to defendants, including jeopardizing Fifth Amendment privileges, expanding scope of discovery and exposing basis of one's defense).

[13] How the media is covering the case may also determine whether, when and how you talk to the government on behalf of your client. Media scrutiny and public pressure may make an indictment inevitable, as appears to be the case with the recent indictment of Arthur Andersen, the international accounting firm responsible for auditing the books of Enron. *See* Beth A. Wilkinson & Steven H. Schulman, *When Talk is not Cheap: Communications with the Media, the Government, and Other Parties in High Profile White Collar Criminal Cases*, 39 AM. CRIM. L. REV. 203, 204 (2002). *See generally* U.S. v. Muncy, 526 F.2d 1261, 1263 (5th Cir. 1976) (addressing concern over effect of pretrial publicity on high-profile cases).

[14] *See* Siobhan Kennedy, *WorldCom Makes Deal with SEC; Fines Could Still be in Making Later On*, HOUS. CHRON., November 27, 2002, at 1 (describing settlement requiring WorldCom to refrain from future securities violations and establish new training programs, and acknowledging possibility of SEC imposing fine at some later date); David Rovella, *Judge OK's WorldCom Settlement with SEC*, SEATTLE TIMES, November 27, 2002, at E1 (stating Federal Judge Rakoff will determine next year how much to fine WorldCom; fine may be for hundreds of millions of dollars or nothing at all if WorldCom transforms itself and Judge Rakoff concludes financial penalties would serve no purpose).

I'm sitting there going, do these guys not understand that when you fine a chapter 11 debtor, all you're doing is hurting creditors?[15] From a policy and publicity standpoint, how much effect does that have on the political process and criminal authorities?

Phil and Bill, you guys are Washington type guys. You know what's going on over there. Is the Congress rational? Is the Justice Department rational? Do they understand you can't fine a corporation, that there's nothing there but a piece of paper filed with the Secretary of State's office? You can't punish a piece of paper. All you're doing is taking money out of the estate,[16] to the detriment of the creditors, employees and everybody else that they profess to be trying to protect.[17]

Mr. Philip Corwin: Politicians are rational within the infrastructure of the world they operate in, which is driven by the need to be re-elected.

And Sarbanes-Oxley,[18] a massive bill, can go through the Congress in just a matter of months, and it's still being implemented. But it's certainly a massive change in corporate governance and oversight of the industry, changing the rules for insider loans, stock options, and disclosure to the public.[19]

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[15] *See* Stephen D. Hurd, Note, *Re-reading Reading: "Fairness to All Persons" in the Context of Administrative Expense Priority for Postpetition Punitive Fines in Bankruptcy*, 51 VAND. L. REV. 1459, 1476 (1998) ("In a world where bankruptcy debtors rarely pay all obligations in full, every dollar allocated to pay a punitive fine as an administrative expense takes a dollar away from prepetition creditors (including parties who have suffered compensable tort injuries)."); David Rovella, *WorldCom Near Deal to Avoid Charges, Fines*, HOUS. CHRON., November 23, 2002, at 1 (quoting David M. Becker, former SEC general counsel: "If you have a company in bankruptcy and you fine them, all you've done is taken money away from the creditors. If you care about getting money into people's pockets, then you don't fine them."); Christopher Stern & Brook A. Masters, *WorldCom Agrees to Continuing Oversight; Fine, if Any, Unresolved in Settlement with SEC*, WASHINGTON POST, November 27, 2002, at A01 (noting SEC usually does not seek fines in accounting cases involving public companies because monetary punishments simply inflict more damages on shareholders, who were victimized by fraud in first place).

[16] *See* Susan R. DeSimone, Note & Comment, *The Price of Doing Business: Environmental Criminal Fines and Administrative Expense Solution*, 17 BANKR. DEV. J. 489, 492 (2001) (stating fines have ability to deplete entire estate); Hurd, *supra* note 15, at 1460 (stating entire estate may be exhausted by fines). *See generally In re* Lazar, 207 B.R. 668, 672 (Bankr. C.D. Cal. 1997) (noting bankruptcy estate will have to pay fines).

[17] *See In re Lazar*, 207 B.R. at 685 (stating fines deplete estate, preventing any payment to creditors); DeSimone, *supra* note 16, at 492 (stating fines may leave no monetary compensation for creditors); Hurd, *supra* note 15, at 1459 (stating every dollar allocated to pay fines takes away from creditors).

[18] Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended at 15 U.S.C. § 7201 (2002)).

[19] *See, e.g.*, Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management InvestmentCompanies, Sarbanes-Oxley Act Release Nos. 33-8188, 34-47304, IC-25922, File No. S7-36-02, 2003 SEC LEXIS 284 at *1 (Jan. 31, 2003) (adopting rule requiring management investment companies to provide disclosure about how they vote proxies relating to portfolios held); Disclosure Required by Sections 406 and 407, Sarbanes-Oxley Act Release Nos. 33-8177, 34-47235, File No. S7-40-02, 2003 SEC LEXIS 194 at *1 (Jan. 23, 2003) (adopting rules requiring companies to include two new types of disclosure in annual reports); Conditions for Use of Non-GAAP Financial Measures, Sarbanes-Oxley Act Release Nos. 33-8176, 34-47226, FR-65 File No. S7-43-02, 2003 SEC LEXIS 193, at *1 (Jan. 22, 2003) (adopting new rules to address public companies' disclosure or release of certain financial information).

And that was completely bipartisan. I mean, it was a race in the Congress, with many members of Congress trying to be tougher than the next guy, in terms of pushing this bill through.

There was a shared perception that, if the public was going to base their votes on the corporate debacles — WorldCom, Enron and etc., that they had to do something to show that they were not going to let this happen again.[20] So it was rational.

Now, you know, everybody knows, especially for a law this massive, of course it's going to have unintended consequences. It's going to be read in ways that people never thought of when they drafted it. Just like RICO has been used for lots of things other than targeting organized crime,[21] this bill will have a lot of effects down the road that people didn't contemplate when they were enacting it.[22] But they were driven by the feeling that they had to do something, to restore public confidence.[23]

Phelan: Isn't there somebody in the Justice Department, though, that can understand the economic ramifications of their prosecutions?

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[20] *See* Kathleen Day, *SEC Allows Auditors as Tax Consultants; Agency Abandons Proposed Ban*, WASH. POST, Jan. 23, 2003, at A01 (stating SEC adopted Sarbanes-Oxley Act after financial scandals at Enron and WorldCom); Robert J. McCartney, *Audit Exemptions Relieve Europeans; SEC Move Allays Fear About New Corporate Governance Rules*, WASH. POST, Jan. 25, 2003, at E02 (stating Sarbanes-Oxley Act was drafted and passed in response to uproar over accounting scandals at Enron and WorldCom); Ian McDonald, *Pitt Picks Up Pace in Final Months*, WALL ST. J., Jan. 30, 2003, at D7 (stating Sarbanes-Oxley Act was approved in response to Enron Corp. and WorldCom Inc. accounting scandals).

[21] *See* G. Robert Blakey, *Symposium: Law and the Continuing Enterprise: Perspectives on Rico: Foreword*, 65 NOTRE DAME L. REV. 873, 874 (1990) (discussing wide range of sanctions and remedies available under RICO); Terrence P. Canade, *Civil RICO-Incentive to Litigate: The Court's Rejection of Standing Requirements: Sedima v. Imrex, 105 S. Ct. 3275 (1985)*, 76 J. CRIM. L. & CRIMINOLOGY 1086, 1086 (1985) (stating business entities not associated with organized crime have taken advantage of RICO); Robert K. Rasmussen, *Introductory Remarks and a Comment on Civil RICO's Remedial Provisions*, 43 VAND. L. REV. 623, 624 (1990) (stating RICO has extended far beyond paradigmatic case of organized crime family).

[22] *See* Michael L. Hermsen, et al., *Law: Sarbanes-Oxley Act - An Extraordinary Expansion*, ACCOUNTANCY (London), Oct. 2002, at 110 (stating Sarbanes-Oxley Act will dramatically impact US federal securities laws); David M. Stuart & Charles F. Wright, *The Sarbanes-Oxley Act: Advancing the SEC's Ability to Obtain Foreign Audit Documentation in Accounting Fraud Investigations*, 2002 COLUM. BUS. L. REV. 749, 750 (2002) (stating Sarbanes-Oxley Act is far-reaching, thereby affecting accounting, disclosure and corporate governance). *See generally* Joseph A. Grundfest, *Symposium: Enron: Lessons and Implications: Punctuated Equilibria in the Evolution of United States Securities Regulation*, 8 STAN. J. L. BUS. & FIN. 1, 2 (2002) (noting Sarbanes-Oxley Act's sweeping scope).

[23] Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, Release Nos. 33-8185, 34-47276, IC-25929, File No. S7-45-02, 2003 SEC LEXIS 256 at *1 (Jan. 29, 2003) (stating proposed part was intended to protect investors and increase their confidence in public companies); Certification of Management Investment Company Shareholder Report and Designation of Certified Shareholder Reports As Exchange Act Periodic Reporting Forms, Sarbanes-Oxley Act, Release Nos. 34-47262, IC-25914, File Nos. S7-33-02, S7-40-02, 2003 SEC LEXIS 224 at *85 (Jan. 27, 2003) (stating new rules will help enhance investor confidence); Standards Relating to Listed Company Audit Committees, Sarbanes-Oxley Act, Release Nos. 33-8173, 34-47137, IC-25885, File No. S7-02-03, 2003 SEC LEXIS 38 at *114 (January 8, 2003) (stating one of main goals of Act is to improve investor confidence in financial markets).

Mr. William Brandt: Robin, I think if there was, Arthur Andersen would still be with us. I think perhaps the lesson to be learned at Justice from Arthur Andersen is that consequences are both manifest and latent. And while we can agree with the Justice Department that Andersen was already on "double secret probation," so maybe it deserved what it got, the abject dissolution of the corporation, the 5,000 people (or more) out of work, and the running commentary by Lou Dobbs on CNN will probably cause them in the future to reflect on the type of issues you spoke of earlier, such as when they will be inclined to levy massive fines and do other types of strident enforcement actions.

I often see them doing cease and desist orders on something that has already basically "ceased and desisted," and so they are only garnering some level of a public relations victory for their own bureaucratic needs.

With regard to the two problems I see most relevant to what you talked about earlier, you're right, I don't see enough people convicted of theft, or larceny or similar crimes. I see them convicted of conspiracy charges. The reason I see this, I believe, is because the threshold for deposition of a conspiracy charge on an evidentiary basis appears to be much lower[24] than for other actual crimes, and apparently, this exposure often prompts people to cut a deal faster than if they were being put on trial where the evidence is, perhaps, more direct and more difficult to obtain.[25]

The other thing I see that I have a difficult time with is when, just a day or so into a case, the FBI raids the offices and takes all the records. Although I'm not in the National Century[26] case, I see similarities between that matter and Mercury Finance[27] I was involved in. A day into the case, the FBI raids the office and takes all the records.

It is difficult to begin to do bankruptcy schedules and talk about having a meaningful meeting with your creditors when your records are all buried under a grand jury subpoena, and you can't get to them.

One of the things I wish would happen is that the prosecutors would call first. Look, by the time people like us are in the case, we're not, absolutely not, going to

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[24] *See* Peter J. Henning, *Individual Liability for Conduct by Criminal Organizations in the United States*, 44 WAYNE L. REV. 1305, 1317–19 (1998) (stating proof of conspiratorial agreement is not required); Kevin Jon Heller, Note, *Whatever Happened to Proof Beyond a Reasonable Doubt? Of Drug Conspiracies, Overt Acts and United States v. Shabani*, 49 STAN. REV. 111, 112 (1996) (discussing court holding that government need not prove commission of any overt act in furtherance of conspiracy).

[25] *See* Edward D. Cavanagh, *Contribution, Claim Reduction, and Individual Treble Damages Responsibility: Which Paths to Reform of Antitrust Remedies?*, 40 VAND. L. REV. 1277, 1298 (1987) (stating joint and several liability for participants in conspiracy pushes defendants toward settlement); David Waksman, Note, *Causation Concerns in Civil Conspiracy to Violate Rule 10b-5*, 66 N.Y.U. L. REV. 1505, 1525 (1991) (stating parties with little faith in their ability to succeed on merits will attempt to force settlement).

[26] Order on Motion of Debtors Pursuant to Section 105, for entry of Order Preserving Certain Assets of Debtors' Estate, *In re* Nat'l Century Fin. Enter., 2003 Bankr. LEXIS 138 (Bankr. S.D.N.Y. Jan. 15, 2003) (No. 02-65235) (Pleading No. 252).

[27] *In re* Mercury Fin. Co., 240 B.R. 270 (Bankr. N.D. Ill. 1999).

let previous management take any records out or destroy any files, but when you get just a raw seizure with no chance to make copies, well, that leaves the estate unable to do its business.

Phelan: I got a worse one than that. We had a situation where there was an investment company. It boiled down to, a period of over 14 years, they had about a half-billion of investors and only maybe about a quarter-billion dollars in assets. We got involved and convinced them in probably 20 minutes that they shouldn't try to make it up on arbitrage or Brady bonds and that they would have to file. Since the assets were in a Cayman Islands company, and the sales organization was a UK company, we filed liquidation proceedings in the Caymans and UK. We had, at that time, a Big Eight accounting firm appointed as liquidators. There was a paper shuffling function in Texas and a small brokerage firm that had only been used essentially to handle the mechanics of the trades.

We filed a 304 proceeding[28] in Texas. And pursuant to an order in that 304 proceeding, the accounting firm had custody of the books and records. The SEC had been in the company's offices, with full cooperation, for several weeks.

I get up one morning, tried to call the client. Don't get an answer. Five minutes later I get a call from a reporter for the Wall Street Journal. At 8:30 that morning, a dozen armed agents of the FBI and Treasury Department had stormed off the elevators to liberate the books and records from the Big Eight accounting firm.

I got hold of the SEC lawyer. "What are you doing here? All you're doing is destroying value that would otherwise be available to the investors that you're supposed to be protecting."[29]

He said he wanted to make a point--put these guys out of business. It happened that the principals were high profile local guys, in terms of social profile. He admitted to me that was all they wanted to do, was put them out of business, and put them out of business with the most publicity, period. Their job was to deter. They view that as deterrence.[30] They could care less about the economic ramifications.[31]

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[28] *See* 11 U.S.C. § 304 (2000) (referring to ancillary cases); David Costa Levenson, Thesis, *Proposal for Reform of Choice of Avoidance Law in the Context of International Bankruptcies from a U.S. Perspective*, 10 AM. BANKR. INST. L. REV. 291, 321 (2002) (explaining purpose of § 304 is "lending assistance to foreign proceeding and handling U.S. assets under U.S. law.").

[29] *See, e.g.*, Reed Abelson, *Tenet Healthcare says the S.E.C. is Looking Informally into the Fall of Tenet's Share Price*, N.Y. TIMES, Nov. 19, 2002, at C14 (describing how F.B.I. raid was major factor in plummeting share price); *FBI Raids Medi-Hut Headquarters*, Reuters (Nov. 22, 2002), *available at* http://www.forbes.com/markets/newswire/2002/11/22/rtr804635.html (last visited Feb. 5, 2003) (showing stock price dropping over one-third after F.B.I. raided company's office).

[30] *See Corporate Law – Congress Passes Corporate and Accounting Fraud Legislation. – Sarbanes-Oxley Act of 2002*, 116 HARV. L. REV. 728, 732–33 (2002) (showing SEC's limited resources force it to focus on well-known offenders as deterrent). *But see* Charles R.P. Pouncy, *The Rational Rogue: Neoclassical Economic Ideology in the Regulation of the Financial Professional*, 26 VT. L. REV. 263, 284 (2002) ("The law attempts to enhance the individual's preference for law compliance by attaching what are assumed to be prohibitive costs to non-compliance. And still law frequently fails to deter.").

[31] *See* William S. Lerach, *Plundering America: How American Investors Got Taken For Trillions by Corporate Insiders*, 8 STAN. J.L. BUS. & FIN. 69, 93 (2002) (stating SEC and Congress have not looked out

Brandt: Robin, run that back into your Enron issue of earlier. You know, the bigger picture here is America has always favored rehabilitation in its processes for restructuring, and everything you have talked about has been aimed at how these issues impact or cripple any rehabilitative efforts.

If you look at Europe, you recognize that retribution has always been first among their issues. "Let's see first why this happened and prosecute them, and if it works out that we can save something as well, all the better."

The line here in the U.S. between retribution and rehabilitation, in my mind, has never really been clearly defined.[32]

When you look at Enron, that's one of the odder instances in our system. I speak for myself, because I know some others on the panel may be involved in that case. Enron's one of the instances where the European outlook of retribution might have served our system better than our routine emphasis on rehabilitation.[33]

And by that I mean, whatever may come out of the back end of the Enron — and I think Steve Cooper and the others working on that case are wonderfully talented people and something can come out of it — but whatever it is, does it justify leaving all of those same people in control? By that I mean the Boards of Directors and others who were there at the time of the questionable practices, and not subjecting them to proper investigation or retribution. The horror stories you're telling about the SEC and FBI sort of deciding to make examples of people, well Enron is one of those cases that if you were actually trying to make an example, it might have an effect on the rest of the system. The question is whether any rehabilitation effort, and any outcome that might proceed from it, is worth more to the system than would be some type of long-term, involved investigation as to why this all happened.

Phelan: That's a good point, Bill. I think you hit the nail on the head a little while ago when you said that the attitude was Arthur Andersen got what it deserved.

The question is: What is Arthur Andersen and *who* got what they deserved? You know, some secretary in Des Moines that doesn't have a job now or some

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for investors' best interests); Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 937 (1994) (criticizing SEC's effort to maintain its relevance in today's markets rather than looking out for best interests of market participants).

[32] *See* Grogan v. Garner, 498 U.S. 279, 286–87 (1991) (noting "fresh start" in bankruptcy is often overcome by policy decisions); Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (emphasizing fresh start in bankruptcy is for "honest but unfortunate debtor"); William I. Kampf & Jay M. Quam, *The Intersection of Bankruptcy and White Collar Crime*, 97 COM. L.J. 70, 77 (1992) (stating discharges normally not granted when criminal activity is alleged).

[33] *See* Lawrence Friedman, *In Defense of Corporate Criminal Liability*, 23 HARV. J.L. & PUB. POL'Y 833, 857–58 (2000) (emphasizing need for corporate criminal liability as retribution and moral condemnation in addition to deterrence); Jay Lawrence Westbrook, *Local Legal Culture and the Fear of Abuse*, 6 AM. BANKR. INST. L. REV. 25, 31 (1998) (noting most European nations traditionally had no possibility of discharge).

junior auditor in Atlanta? I mean, that's who got punished.[34] There is no such thing as Arthur Andersen and there is no such thing as Enron. You can't punish a legal entity.[35]

Brandt: I don't disagree with you. I suspect if one looked at it dispassionately now, they might agree with your argument, which is I think, that we all would have rather punished Enron than Arthur Andersen. The people at Enron were losing jobs in any case, and there was a need, in my mind, to do the kind of investigation or make examples of the people at Enron that may have an effect on the system.

The Arthur Andersen case seemed to be misdirected, and it seems the outcome was to be misdirected worse than the intended effect.

And I think that speaks to the continuing tension or lack of definition between the two differing aspects of this business. That is, it seems there are areas where retribution efforts probably do need to dominate, and we never define that very well, because we first put a particular emphasis on rehabilitation,[36] and it's served our society and economic structure fairly well in doing so.

Phelan: Just mentioning the employees, that's another one I think, is kind of interesting. There's a lot of media attention on a couple of things involving employees.

Number one was these guys losing their jobs,[37] which is always bad, but, on the other hand, there's a lot of people losing their jobs in K-Mart. A lot more are going to lose their jobs in K-Mart because of the nature of that situation. Many people at Enron had jobs really because the phony deals, or the deals which are allegedly phony, propped up an organization and required, or generated the dollars to hire a lot of these people for a period of time at what were, in Houston, considered to be some of the top jobs running around.[38]

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[34] *See* International Brotherhood of Electrical Workers, *IBEW Members Tell Senate Enron's Collapse Wiped Out Their Savings While Company Brass Profited*, *at* http://www.ibew.org/stories/02journal/0203/Enron.htm (Mar. 2002) (discussing how collapse of Enron wiped out 12,000 employees' retirement savings and left 5,000 workers unemployed); CBS News, *Enron Workers Went Down With Ship*, *at* http://www.cbsnews.com/stories/2002/01/14/national/main324196.shtml (Jan. 14, 2002) (explaining thousands of Enron employees lost investments, retirement portfolios and savings).

[35] *See generally* V.S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 HARV. L. REV. 1477, 1478 (1996) (reiterating rule "corporations cannot be imprisoned").

[36] *See In re* Pac. Gas & Elec. Co., 283 B.R. 41, 54 (Bankr. N.D. Cal. 2002) (explaining paramount goal of chapter 11 is rehabilitation of debtor); *In re* Geriatrics Nursing Home, 187 B.R. 128, 131 (Bankr. D. N.J. 1995) (stating need to facilitate rehabilitation of debtor); *In re* Ionosphere Clubs, Inc., 98 B.R. 174, 175–76 (Bankr. S.D.N.Y. 1989) (noting legislative intent of 11 U.S.C. § 1211 was to facilitate rehabilitation of chapter 11 debtors).

[37] *See Enron's Ex-Treasurer is Subject of Justice Dept. Investigation*, N.Y. TIMES, December 28, 2002, at C14 (noting 5,000 Enron employees lost positions with company).

[38] *See* Bill Murphy, *The Fall of Enron: Lingering Stigma; Reputation Taints Some Jon Prospects*, HOUS. CHRON., Aug. 18, 2002, at A1 (stating other companies viewed Enron employees as being at "top of their game"); Megan Stack, *The Fall of Enron: A Feeling of Disbelief and Betrayal in a City Known for Boom and Bust Enron*, L.A. TIMES, Jan. 26, 2002, at A14 (quoting individuals saying Enron was best company to

The other thing that was interesting is the media attention that was focused on the pension fund, when they switched the pension administrators there was an 11-day window where participants could not trade in the pension funds.[39] What is interesting is, there was a lot of media attention to that. But, as I understand it, during that 11-day window, the stock dropped from something like 12 to something like nine.[40]

I'm sitting here going, how many of those people that didn't sell when it dropped from 80 to 12 would have sold in that 11-day window when it was dropping from 12 to nine? So, to me, that was another situation where the press focused on what amounted to, in my estimation, to be somewhat of a non-issue. Although, what's happening with Durbin-Delahunt, Bill?

Brandt: Durbin-Delahunt isn't going anywhere, at least in this session, anyway, and probably in the next.

But I think — and Phil could probably speak to this as well — on the other matters that are being debated, what you're seeing is that there is, in my mind, some unease in Congress with the difficulty defining the difference between rehabilitation and retribution and where the two should apply.

And Sarbanes-Oxley, I suspect, is Congress' attempt to say, "If the system is having a problem cutting some clear lines, and these kinds of examples are happening, perhaps from a Congressional side, we'll start to impose a series of priorities about what we think is important."[41] Sarbanes-Oxley starts reaches to it from the Board of Directors side.[42]

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work for in Houston). *See generally* Scott Shane, *Enron Alive and Well-Online: Artificats, Remnants of Once-Proud Company Are Preserved on the Internet*, BALT. SUN, Jan. 25, 2002, at 2A (noting Fortune magazine named Enron most innovative company in America for six years consequtively).

[39] *See* Jena Heath, *Enron Chief Warned Top US Officials*, MILWAUKEE J. & SENTINEL, Jan. 11, 2002, at 01A (describing how Enron employees saw their 401(k) retirement savings evaporate after corporate officials banned them for period from selling their stocks); Karen Hosler, *Enron Fall Spurs Stock Proposals*, BALT. SUN, Feb. 3, 2002, at 1A (explaining employees were barred from selling stock in their 401(k) during "blackout" period); David Ivanovich, *Labor Probes 401(k) Lockdown, Officials Look Into Time When Enron Blocked Stock Sales*, HOUS. CHRON., Jan. 24, 2002, at 14 (stating employees, ex-employees and retirees were unable to sell their Enron shares from October 28 to November 4, 2001).

[40] *See* Tom Detzel, *Panel Hears PGE Worker Woes*, PORTLAND OREGONIAN, Feb. 6, 2002, at A01 (stating the per share price of Enron stock was $9.98 at the end of the lockout period); David Ivanovich, *SEC Offers Revisions in Wake of Enron*, HOUS. CHRON., Oct. 31, 2002, at 1 (noting shares were priced at $13.81 when freeze began and when it ended price was $9.98); Ellen Schultz, *"Lockdowns" of 401(k) Plans Draw Scrutiny*, WALL ST. J., Jan. 16, 2002, at C1 (describing share prices closed at $15.40 per share on last day employees could trade stock, October 26, 2001, in contrast to end of the lockdown, November 13, 2001, when price was $9.98 per share).

[41] *See* H.R. 3763, 107th Cong. (2002), *available at* http://thomas.loc.gov/home/c107query.html (introducing Corporate and Auditing Accountability, Responsibility and Transparency Act of 2002). *See generally* Stephen Redner, *Thinking of Going Public? Think Twice, Then Read the Sarbanes Oxley Act of 2002*, 6 J. SMALL & EMERGING BUS. L. 521, 523 (2002) (stating Congress enacted Sarbanes-Oxley to respond to financial crisis that cheated millions of corporate shareholders).

[42] *See* Faith Kahn, *What Are the Ways of Achieving Corporate Social Responsibility?*, 76 TUL. L. REV. 1579, 1630 (2002) (noting tougher criminal penalties for executives); *Recent Legislation*: *Corporate Law-Congress Passes Corporate and Accounting Fraud Legislation- Sarbanes Oxley Act of 2002*, 116 HARV. L.

Durbin-Delahunt[43] and similar efforts are now beginning to try and put the employees in the forefront — like other mostly nontraditional players, folks who are not really creditors — who probably do need an actual seat at the table and whose interests do need to be spoken to.[44] The danger is we're crowding the rehabilitative process. And at some point all we're going to need is a handbook, a list of priorities if you will, that we hand to people, and there's no point thereafter in trying to do a reorganization, as it all has been already pre-categorized and pre-prioritized.

Judge Case: I was going to make the same comment. It's Congress' job to legislate, but the more priorities you put in any bankruptcy law, whether wage priorities, stronger tax priorities or personal injury recovery priorities, the more priorities you put in, the less chance you have of ever getting anything to the people who actually funded the cases at the unsecured level.

I think you're right that this leads to a diminution of the rehabilitative process, and tends to turn every case into a liquidation. This takes money directly out of the pockets of the unsecured creditors.

If I understand the math correctly on the Durbin-Delahunt proposal, an employee who has an interest in a 401K that includes company stock would get an administrative claim, not an equity interest, determined by the difference between the price of the stock when it went into the plan and the later value.

Brandt: Essentially what it does, or tried to do, was establish that "yaw" test you have in plaintiffs' cases, the spread between X and Y that the damages create, as well as creating a $13,500 upper-limit claim level for wages, up from the $4,600 or $4,700 currently available under the schedules today.

Phelan: Hey, Phil, tell us about Durbin-Delahunt, because I about half understood what Bill said.

Corwin: Let me say a couple of things about Durbin-Delahunt.

Phlean: Start with what it is.

REV. 728, 730 (2002) (explaining how CEO's and CFO's must now certify financial statements filed with SEC).

[43] *See* H.R. 5221, 107th Cong. (2002), *available at* http://thomas.loc.gov/home/c107query.html (designing bill to protect employees from corporate practices depriving them of their earnings when business files bankruptcy under title 11); *see also* G. Ray Warner, *Legislative Update*, 11 AM. BANKR. INST. J. 6, 6 (2002) (explaining Durbin-Delahunt will allow employees to recover when "excessive compensation" is paid from company to officers and directors within 90 days of declaring bankruptcy).

[44] *See* Nathalie D. Martin, *Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In*, 59 OHIO ST. L. J. 429, 477 (1998) (proposing employees should have right to be heard on issues affecting their future employment during chapter 11 case); *see also* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 502 (vol. 1 2000) (quoting Commissioner Babette Ceccotti, stating participation by employees in reorganization process should be encouraged).

Corwin: Durbin-Delahunt is a proposal that was made in the 107th Congress that really went nowhere beyond the proposal stage, and it was framed as "real" bankruptcy reform for America's workers.

There was a perception of some political motivation, particularly on the part of Senator Durbin, to get a quicky hearing and offer pieces of it as a kind of poison pill plan add-on to the bankruptcy reform bill, which was going through, and try to use it to stop or change that bill.

I don't think Senator Durbin was in any way prepared for the breadth and strength of the opposition to it from all quarters, including a wide variety of legal practitioners and law professors who didn't favor the reform bill, but thought that this proposal was just way over the top and was going to have all kinds of negative, unintended effects.

And, as a result, he cancelled the hearing he was going to have in the Senate Judiciary Committee that Committee Chairman Leahy was going to let him chair. Senator Leahy never rescheduled it.

I don't think that Durbin-Delahunt will be proposed again in its original form. This doesn't mean that some of it may not show up down the line as separate bills, or offered as amendments to other Judiciary vehicles that go through.

But, I think the great harm of Durbin-Delahunt would have been that it would have driven more companies into bankruptcy.[45] The best way to save jobs is to keep companies from going into bankruptcy in the first place, and that requires they have liquidity and access to capital.[46] And in just about every way you could cut off liquidity, very broadly defined, the bill would have made it just about impossible stay to liquid or securitize any kind of asset.[47]

Though Enron gave a bad name to securitization, most are a very legitimate way for companies to obtain low cost credit and remain liquid. The bill would have

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[45] *See* Jaret Seiberg, *Bankruptcy Bill to Face Opposition*, NAT'L L.J., Aug. 12, 2002, at A15, (stating legal and banking industry opposition to bill based on belief that asset securitizations and pension claims provisions "would trigger more corporate bankruptcies and force viable businesses to liquidate rather than reorganize").

[46] *See In re* Western Pac. Airlines, Inc., 223 B.R. 567, 568 (Bankr. D. Colo. 1997) (finding liquidity and ability to obtain working capital is essential to debtor); Royce de R. Barondes, *Fiduciary Duties of Officers and Directors of Distressed Corporations*, 7 GEO. MASON L. REV. 45, 61 n.45 (1998) ("Virtually any insolvency could be prevented with an increase in cash flow or greater access to capital."); George G. Triantis, *Financial Slack Policy and the Laws of Secured Transactions*, 29 J. LEGAL STUD. 35, 38 (1990) (discussing correlation between combination of liquidity and cash flow and insolvency).

[47] S. 2798, 107th Cong. § 102 (2002), *available at* http://thomas.loc.gov/home/c107query.html (providing for possible recharacterization of certain secured transactions, which would place the assets involved back into the bankruptcy estate Lenders' concern of such recharacterization often lead them to avoid securitization transactions); *see* REGULATORY DEVELOPMENTS IN SECURITIZATION 758 (Practicing Law Institute 2002) ("Section 102 could substantially limit or even eliminate the ability of companies to continue to securitize assets because of perceived risk of recharacterization."); THE EMERGED AND EMERGING NEW UNIFORM COMMERCIAL CODE 576 (American Law Institute-American Bar Association 2002) ("[The Act] would create substantial and undesirable uncertainty for securitization transactions . . . and other transactions in which sales of financial assets take place, thereby reducing availability and increasing the cost of credit and funding").

made it impossible for legal counsel to give "true sale" opinions.[48] And that, in turn, would have made it impossible for the credit rating agencies to offer investment quality ratings.[49]

The bill also would have given all kinds of people who are really unsecured creditors and even equity holder's claims superior to those of the secured creditors,[50] which would have made secured credit more difficult to obtain. It also placed people with pension fund interests, unsecured claimants, ahead of a lot of other unsecured claims.[51]

If you had a company getting in trouble, and all these different people providing liquidity — broadly defined as money and goods and services — would have said, hey, wait a minute, this is scrambling the under and value of the priorities, and we're not going to get anything if this company goes under if they've got large employee claims.

Here's what it would have done on employee claims, it would have converted any employee interest held in a pension plan into an interest to a claim entitled to enhanced priority, with the value set at the market value of the stock at the time it was contributed to or purchased by the pension plan![52]

So, if a company that bought highly inflated stock because of a lack of adequate financial disclosure about its own stock, that would have boosted these equity claims into claims that elevate — employee pension stock interests would have gone from lowest priority common stock to a fourth level priority.

Phelan: Wouldn't that just mean, Phil, that the company's pension plans would not be buying their own stock, and buy the stock of Amalgamated Widgets instead?

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[48] *See* Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance Between the Obligation of Client Loyalty and Market Gatekeeper*, 16 GEO. J. LEGAL ETHICS 91, 97 (2002) (stating true sale opinions are issued by corporation counsel to assure outside investors that funds, assets and liabilities were in fact sold as reported.). Lawyers have been traditionally reluctant to issue true sale opinions due to the uncertainty involved in securitization transactions, and by allowing for further recharacterization under section 102, lawyers might have been even further disinclined to issue these opinions seeing them as futile, if not impossible. *See* Lois R. Lupica, *Revised Article 9, The Proposed Bankruptcy Amendments and Securitizing Debtors and Their Creditors*, 7 FORDHAM J. CORP. & FIN. L. 321, 331 (2002) (relating historical reluctance of lawyers to provide true sale opinions based on difficulty of defining true sales and explaining that nature of certain transactions make it impossible to issue opinion).

[49] *See* Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061, 1068 n.34 (1996) (regarding true sale opinions: "such an opinion is necessary to the rating agencies rating the transaction"); Edward J. Janger, *Muddy Rules for Securitizations*, 7 FORDHAM J. CORP. & FIN. L. 301, 316 (2002) (describing nature of rating agencies reliance on attorneys' true sale opinions).

[50] *See* S. 2798, § 103.

[51] *See id.* §§ 201, 203; *see also* G. Ray Warner, *Employee Abuse Prevent Bill Would Change Venue Rules and Elevate Employee Claims*, ABI World, *at* http://www.abiworld.org/legis/newlegfront.html ("The effect of these changes would be to elevate covered employee pension plan stock interest from the lowest priority common stock level to a fourth level priority ahead of general unsecured claims").

[52] *See id*. at § 201. The bill would amend the section 101(5) definition of "claim" to include securities held in ERISA pension plan if the employee was forced to invest the pension assets in equity securities of the debtor or an affiliate of the debtor. The claims thus created would be entitled to priority under § 507(a)(4) "employee benefit plan" contribution provision. Warner, *supra* note 51.

Brandt: I agree with Phil on a lot of what he said. The Bill was, in my mind, a reaction to the Enron issue, and a lot of the provisions in there were designed to protect the employee pension plans at the expense of the lenders. Perhaps far too much so.

Congressman Delahunt's people really wrote the Bill, and Congressman Delahunt and Senator Durbin are roommates, as they share living facilities in Washington. Congressman Delahunt asked Senator Durbin to serve as a Senate sponsor of the Bill. I think Senator Durbin had not got fully behind some of the issues Congressman Delahunt put in there.

It certainly would have made DIP lending far more difficult as well as creating a vast new category of expenses, possibly to the point where Phil's right. And I think once people began to look at it, it died.

But what I do see the surrounding debate doing is cementing an embryonic trend towards more employee favoritism. Heretofore, the typical employees had his or her claim maximum, on a priority basis, of $4,000 or $4,600, and that was basically it, with not much more in the way of upside to fight over now, I suspect what may be happening, when the AFL-CIO and Jesse Jackson separately stand up for the Enron employees and get them $13,500, for example, a figure that "coincidentally" gets used in both Durbin-Delahunt and Senator Jean Carnahan's reform bill, is that we are going to see greater attention in Congress paid to employee concerns in the future.

There's a sense in Congress, at least on the Democratic side, that there needs to be some redress in terms of the small people, as you said earlier, Robin, who lost jobs in the process and appear to have not had a place at the table.[53]

Phelan: That's an interesting point you made. The Enron settlement, it has not been explored, I think, on a detailed basis.

What happened there, as I understand it, is Enron was filed in the Second Circuit. The Second Circuit has a case called Strauss-Duparquet.[54] Strauss-Duparquet is the only circuit court opinion that I know of that says, if you fire someone post-petition, the severance obligation is an administrative claim.[55] And some of the other circuits say now it's a per rata type of deal.[56]

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[53] *See* S. 2798. "To protect employees and retirees from corporate practices that deprive them of their earnings and retirement savings when a business files for bankruptcy under title 11, United States Code." *Id.*

[54] Strauss-Duparquet, Inc. v. Local Union No.3, 386 F.2d 649, 651 (2d Cir. 1967).

[55] *Id*. at 651 ("Since severance pay is compensation for termination of employment and since the employment of these claimants was terminated as an incident of the administration of the bankrupt's estate, severance pay was an expense of administration and is entitled to priority as such an expense."); s*ee* Rodman v. Rinier (*In re* W. T. Grant Co.), 620 F.2d 319, 321 (2d Cir. 1980) (following reasoning and conclusion of *Strauss* that severance pay claims are entitled to first priority as expenses of administration and stating that it remains law in Second Circuit); *see also In re* Spectrum Info. Techs., Inc., 193 B.R. 400, 405–07 (Bankr. E.D.N.Y. 1996) (discussing differing opinions throughout circuits on how to deal with issue and ultimately deciding to follow Second Circuit precedent).

[56] *See* Roth Am. Inc v. Int'l Brotherhood of Teamsters, Local 401 (*In re* Roth Am., Inc.), 975 F.2d 949, 957–58 (3d Cir. 1992) (stating severance pay claims made incident to bankruptcy filing only have administrative priority based on portion of services provided to bankrupt entity post-petition); Health Maint.

The employees at Enron were fired post-petition, so they had an argument that there was an administrative claim. So the U.S. Trustee formed a committee, and Jesse Jackson and John Sweeney did a bunch of demonstrations, but the important thing was there was a legitimate debate over the precedent and case authority, the binding precedent in the Second Circuit, which has been heavily criticized,[57] but there is a legal opinion that these guys are entitled to more than the statutory $4,600.

Brandt: You've got to blend that in with the fact that the media were sitting outside the Enron building in Houston as people were leaving with their final, miserly pay packets, and Jesse Jackson and John Sweeney led a whole cadre in the chant: "Give them what they're due."

The recognition of that lousy exit treatment and the public sympathy engendered for those employees created a window of opportunity, in my opinion, to fundamentally change and alter the public perception of how employees are treated in the bankruptcy process.

Phelan: In WorldCom, the people were fired pre-petition,[58] about four months pre-petition, as I understand it. And the prior policy of WorldCom had been that you get your check or your severance at that point in time when you're terminated. But since they were running into a cash squeeze, for that round of terminations, roughly four months prior to the filing, they said they're going to pay out over time.

Then the cash problems got worse. They filed the bankruptcy.[59] These were clearly pre-petition claims. There wasn't any legitimate legal argument here. The debtor went ahead and, because of the media publicity and the heat it was getting, filed a motion that said we want to pay these severance obligations because it's fair and because it'll be bad for the morale of our continuing workers if we don't.[60]

Found. v. Sys. Bd. of Adjustment (*In re* Health Maint. Found.), 680 F.2d 619, 621–22 (9th Cir. 1982) (following views of First and Third Circuits holding portion of severance pay earned during period of reorganization is entitled to first priority, but not portion earned pre-petition); Cramer v. Mammoth Mart, Inc. (*In re* Mammoth Mart), 536 F.2d 950, 953 (1st Cir. 1976) (explaining severance claims are entitled to priority to extent they can be apportioned to services performed after filing of bankruptcy and deciding claims for additional severance pay for services occurring pre-petition are not entitled to priority).

[57] *See In re Mammoth Mart*, 536 F.2d at 955 (criticizing *Strauss* conclusion); *see also In re* Cincinnati Cordage & Paper Co., 271 B.R. 264, 268 (Bankr. S.D. Ohio 2001) (noting *Strauss* is not binding in Sixth Circuit and further that its logic has been seriously questioned within Second Circuit); *In re* Jamesway Corp., 199 B.R. 836, 840 (Bankr. S.D.N.Y. 1996) (questioning strength of *Strauss* in certain situations, but ultimately not considering its applicability).

[58] *See* Andrew Backover, *WorldCom files for Chapter 11 Protection*, U.S.A. TODAY, July 22, 2002, at 1A (noting WorldCom had laid off 17,000 workers months before bankruptcy filing was expected to occur); Amy Joyce, *Laid-Off Workers Lose Severance*, WASH. POST, July 26, 2002, at E01 (relating some hardships suffered by laid-off employees fired before any bankruptcy filing).

[59] *See* Simon Romero & Riva D. Atlas, *WorldCom's Collapse: The Overview; WorldCom Files for Bankruptcy; Largest U.S. Case*, N.Y. TIMES, July 22, 2002, at A1 (outlining the bankruptcy filing of WorldCom and its implications).

[60] *See* Washington Post Staff Writer, *Severance Increase for WorldCom Employees Approved*, WASH. POST, Oct. 02, 2002, at E03 (announcing federal judges decision to increase certain severance payments of

No opposition. They didn't bother mentioning, by the way, the Robins versus Piccinin case[61] in the Fourth Circuit which says you can't.[62] If there ever was a case where a pre-petition should be paid, it was that case, because it was the Dalkon shield case. I'm certainly no medical expert, but my understanding was there was a window of opportunity where these woman who had been injured by the Dalkon Shield could have some type of procedure done that would help it or fix it. But if they couldn't get it done by a certain age, then the possibilities of success deteriorate significantly.[63] So, there was an interim distribution proposed and the Fourth Circuit said you can't do it, that the Bankruptcy Code said no. In WorldCom, the judge signs off on the order, and these guys get paid on pre-petition claims.

Brandt: The $13,500 number, which became the embodiment of what the figure should be, was then picked up by Missouri Senator Jean Carnahan. That figure was included in her Bill wound up in the Durbin-Delahunt proposal. These are my friends. At their invitation, when we sat down with them and their staff members in Washington during the initial feedback process, I mentioned that I thought the $13,500 figure was kind of high. I suggested that we halve it, to maybe $8,000, or so. However, there was then a close Senate race in Missouri, and Senator Carnahan had already, in the context of that race, committed "hard" to $13,500 figure for employees in the future.

So that number was going to stay in the Bill. I then ask, "Could we fix it or approach it in some other way? Does it have to be cumulative, for example, could it not be done only on an individual attribution basis, let's say?" I said this because there has been a practice in some bankruptcy cases of multiplying the number of workers by the amount of the cap, rather than doing an individual cap for each worker. Applying only an individual cap might be a way to at least bring the total number back into a form of reality, at least mathematically.

But that was unacceptable to the House side, the Delahunt side, who had originally inserted this provision.

And that's when I recognized, as Phil was similarly saying about the Sarbanes-Oxley Bill, this legislation was also rushing through without a great deal of debate. The unintended consequences, in my opinion, would have been substantial.

The other aspect of it that catches the eye and is worth ten seconds of explanation is it also foisted some new liabilities on employee benefit plan trustees. For example, if it turned out the employees who had owned shares in the company, such shares being held in the plan, lost value there, and ultimately there were

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former WorldCom employees and describing how WorldCom viewed this as necessary to pump up morale of those employees still with WorldCom).

[61] A.H. Robins Co. v. Piccinin, 788 F.2d 994 (4th Cir. 1986).

[62] *Id.* at 1013 (aggregating plaintiffs suits against debtor and staying actions because of potential to deplete debtors assets).

[63] *See generally* Morton Mintz, *Study Says Contraceptive Device Carried High Risk of Infection*, WASH. POST, March 17, 1983, at A9 (noting risks associated with Dalkon Shield worsen over time due to deterioration of removal device).

insufficient funds to make these losses while from the bankruptcy estate, then under this Bill the personal liability for the plan trustees, which is normally a ministerial-type role, could become substantial.[64]

Phelan: That's not necessarily bad, because the result, as you indicated —

Brandt: But it's not provided for in ERISA. That's truly a wholesale change in the responsibilities under ERISA in terms of what the plan trustees do and what their liabilities could be. And I suspect what you do is set off an argument between those trustees and administrators on the company side, and the professionals running the bankruptcy case. Right now, these roles are almost ministerial in duties.

And arising, again, out of Enron, this would seem to impose a series of punitive changes on how these plans are run, and for that reason legislation of this type should be watched.

Phelan: The net effect of that would have been, in essence, the same thing if you said pension plans can't invest in the stock of the employer.

Brandt: Well, you know then, Robin, they should just say that. It's an easy issue to identify. I don't have a problem with that. But if you're not going to simply say that, then what you're trying to do is nibble at the margin hoping for essentially the same effect. What happens when they do this, and it doesn't turn out well?

Judge Case: My comment was about what you said earlier. How is it really any different from a critical vendor motion, where an unsecured creditor gets paid in full because it's essential to continue to operate the business; how is paying employees under these circumstances really any different than that? Because on a principled statutory basis, there really isn't any basis for either one.

Brandt: It's not. That's the point. We're moving the employees arguably into what would be critical vendor status. In doing so, some of the legitimate vendors, who could be terribly important in the success of the process, have been overlooked as Congress tries to balance the inequities they see in the evolution of the process.

Phelan: One of the things mentioned was securitization. As I recall, the Durbin-Delahunt bill basically said, just because you call it a securitization doesn't mean the bankruptcy judge can't make a determination that it really was a loan.[65] What's wrong with that? If it really is a loan, why can't the bankruptcy court make

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[64] *See* S. 2798, 107th Cong. § 203 (2002) *available at* http://thomas.loc.gov/home/c107query.html (elevating status of claims arising from failure to meet fiduciary obligations: "claims arising out of the breach of any fiduciary duty under part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1101 et seq.) or State law" shall be treated as administrative expenses).

[65] *See* S. 2798, at § 102 (reinforcing court authority to look beyond terminology).

that determination? And the capital markets have to do something with their money. If there's a higher risk in securitization, aren't they still going to have to put that money somewhere? Is it just going to increase the cost of capital? But isn't the cost of capital really more driven by supply and demand than by true sale opinions?

Corwin: Well, you can't have securitization —

Brandt: You know, I think that I disagree with Phil on one point, and that is, I don't think this was meant to be an amendment that would have ultimately sealed the coffin on the existing bankruptcy reform act. Their thinking was that corporate responsibility, and specifically corporate responsibility towards employees, was going to be a real catchword in the Fall elections in 2002.[66] So this was both Senator Durbin and Congressman Delahunt's, as well as others' idea as to how to catch that wave and ride it in on the back of the bankruptcy issues.

And, yes, there's no doubt Phil's right. They were tweaking other people in the Senate whose perspective was different, but they truly had a different agenda, rather than just offering an amendment designed to block the pending reform legislation.

The problem was that the Delahunt Bill was really shaped by only one or two people, who all of us in this group know, as well as being introduced without a great deal of vetting. Additionally, it was framed in such a way that it basically adopted, as Phil points out, a number of positions absolutely contrary to the issues argued out and disposed of in the debate surrounding the bankruptcy reform act. These people had come back with the Durbin-Delahunt bill which had not had time to be vetted.

I believe if they would have introduced it with a little more preparation, for example, if they would have allowed for securitization to be dealt with in an evolving fashion rather than just a black and white fashion, there might have been room for compromise. But some of the Bill's supporters acted like bulls in a china shops.

Corwin: Well, we'll never know what the ultimate political motivation was because the thing never got going. But certainly there was a perception among a lot of folks in Washington, due to the rhetoric that accompanied the bill, was that this was being used to set up with a Senate Democratic demand that, for the other bankruptcy bill to go through, we'll filibuster it unless we get pieces of this. If it had been a more credible, more narrowly focused proposal that might have happened. It's just speculation now, and we'll never know.

You know, asset securitization has been a long-standing subject of debate in the legal community,[67] whether these are truly separate securitizations that deserve the

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[66] *See New Bill Takes on New York, Delaware, Corporate Execs*, 39 BCD NEWS AND COMMENT No. 21, August 15, 2002 (claiming provisions "would be wonderful election-year 'feel good' acts that some members of Congress may push aggressively.").

[67] *See generally* Alan Axelrod, et al., *Law School Deans, Professors Ask Congress to Reconsider Securitization Provision*, 21 AM. BANKR. INST. J. 6, 36 (2002) (identifying expansive amount of case law on issue).

treatment they get or whether they're disguised loans. Something fishy's going on here, and the asset should be recaptured when the company is in bankruptcy.

But the reality is that asset securitization is a low cost and efficient way for all kinds of companies,[68] including smaller companies, to get low cost capital. And if you cut that off, it's more difficult for them to get capital, and they're going to pay more for it.[69] So you have this negative liquidity effect.

And the bill proposed such vague standards and basically overrode state law.[70] We've always looked to state law to determine what the legal status of the securitizations are. And it just said that if any bankruptcy judge thinks it has material characteristics of or is substantially similar of a secured loan, he recaptures it. And that's such a vague standard, totally judge-dependent, that no lawyer would have been able to get a solid "true sale" opinion, and thus no rating agency could give an investment grade rating.

That doesn't mean to say that a more narrowly focused proposal, which gives a higher, more specific standard, which targets some specific state law that people think goes too far, might not be worthy of discussion. But this thing was so broad, it basically said it depends on the judge. If the judge wants to say it's a loan, it's a loan. And the investors in the securities are wiped out, including many pension funds!

Phelan: Judge Case, isn't that the same standard that you operate under now, except in Texas, where they say if it's called a true sale, it's a true sale?

Judge Case: I don't think it's quite the same, because there are characteristics and factors that you need to look at under applicable state law in making those kind of true sale determinations.[71] I don't think existing law is quite as vague or quite as broadly brushed as that.

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[68] *See* Letter from Dwight Jenkins, Executive Director of American Securitization Forum, to Richard Durbin, United States Senate (September 16, 2002) *available at* www.americansecuritization.com/docs/DurbinDelahuntCommentLtr.pdf (explaining benefits of securitizations to corporate finance).

[69] *See* Letter from Thomas J. Welsh, Connecticut Congressional Delegation, to Senator or Representative (September 3, 2002), *available at* www.brownwelsh.com/TJWcases/107-2798_Durbin-Delahunt_Bill_Letter.pdf (explaining negative impact of Durbin-Delahunt on lenders reliance on collateral); s*ee also* Letter from K. King Burnett, President, National Conference of Commissioners on Uniform State Laws, to Richard Durbin (August 30, 2002), *available at* www.abiworld.org/ulccresponse.pdf (stating bill would undermine availability of secured financing in America).

[70] Report on Avoidance, Subordination, Super Priority and Recharacterization Provisions of the Proposed Employee Abuse Prevention Act of 2002 (September 3, 2002), *available at* http://www.hewm.com/use/articles/durbin-delahunt.pdf.

[71] *See* Robert D. Aicher & William J. Fellerkoff, *Characterization of a Transfer of Receivables as a Sale or Secured Loan Upon Bankruptcy of the Transferor*, 65 AM. BANKR. L.J. 181, 185 (1991) (noting Article 9 does not eliminate application of state law in determining whether particular assignment constitutes true sale); Jeffrey E. Bjork, *Seeking Predictability in Bankruptcy: An Alternative to Judicial Recharacterization in Structural Financing*, 14 BANKR. DEV. J. 119, 129 (1997) (stating UCC "provides no guidance in distinguishing true sale from security sale."); Lupica, *supra* note 48, 296 n.49 (specifying factors for true sale determination).

Part of the problem is that people do now look at transactions under the applicable state law. Lawyers look at them that way, opinions are issued and the financings are done on that basis. That wouldn't be possible under this standard.

Phelan: Let me ask you this. One of the things you mentioned, Judge Case, was layering priorities: You mentioned the employees, but you also mentioned tort claimants.

Can't a pretty legitimate argument be constructed that some poor guy walking down the street, just going down for a beer, and a moose falls out of the moose factory and lands on him, and he's got a claim against the moose factory, that that guy should come ahead of the secured creditors, the unsecured creditors, everybody that dealt on a voluntary and consensual basis with the Moose Factory and stood to make a profit or, you know, for whatever reason, entered into a contractual relationship with that debtor? Why shouldn't the tort guy come ahead of them? He was just walking done to the corner to get a beer, and a moose fell on him.

Judge Case: It's a policy decision. What are the underlying goals of your bankruptcy system?

If the underlying goal is to encourage commerce, by having a system that gives some reasonable return to unsecured creditors, then you're going to want to minimize the number of priorities.

If, on the other hand, your focus is on making sure that particular people with particular kinds of claims are treated in a certain way, then you go the other way.

Now, I think our law is more the latter than the former. We have more priorities for more bizarre things than most countries of the world, and we keep adding more.

So I wouldn't be surprised, frankly, if Congress were to put in another priority like that.

Phelan: Aren't half of those priorities governmental priorities?

Judge Case: That's right. A number of them are. Some developing countries, when they write new bankruptcy laws, don't give any priority to tax claims, for example, because they know, by giving that priority, particularly in a former controlled economy where the state is the primary creditor, that's going to wipe out everybody else.

I'm not sure that the drafters of these Bills, or any of us, for that matter, have taken a sufficient step back and actually looked at what kind of policy we are furthering by layering on these priorities and what impact such actions may have upon the overall financial environment in which business transactions take place.

Corwin: Responding to some things Robin brought up--in terms of the emphasis switching from rehabilitation to retribution, that's driven by the media and

the political atmosphere. And I think one would hope that, absent further debacles, and I think we've already seen the bursting of the stock market bubble, we've seen the really gross cases of false financial disclosure hiding financial truth in Enron, WorldCom, et cetera, unless other shoes are going to drop, and I think they've all pretty much dropped by now, one would hope that that emphasis would recede.

Politically, the big Congressional response to what happened in the financial markets and with these particular companies was Sarbanes-Oxley.[72] This is a bill that had unanimous votes for provisions that members knew were questionable, might even be counterproductive, but not one of those politicians wanted to have the task of explaining why he or she voted against it, no matter how good the explanation might have been. So it's the law now.

Chairman Shelby of the Banking Committee gave a speech saying one of his top priorities for the new Congress is strong oversight of the implementation of Sarbanes-Oxley.[73] It's just being implemented. Regulations will be rolled out during the next year, year and a half.

We're going to still need a chairman for this new public accounting standards board. This is a massive law, and it's going to take really two, three years to shake out and start being implemented to see the real market effects going forward.

I don't know what else there will be in relation to this. I hear Bill Brandt talking about Jesse Jackson and Sweeney, who were out their pushing their agenda. They don't carry a lot of sway with a Republican dominated congress. Not to say that's right or wrong, just a political reality.

Brandt: I'll take issue when you say you don't see any more shoes ready to drop. I will tell you that I think the asset securitization market is going to be roiled by this medical funding group in Columbus, Ohio, National Century Funding,[74] which many of you have seen.

And from what I've seen doing a couple of panels with a bunch of Wall Street folks, they are now beginning to wonder just how far behind these transactions we should look with regard to the efficacy of securitizations.

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[72] *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (2002) (codified as amended at 15 U.S.C. § 7201 (2002)); s*ee also In re* JDS Uniphase Corp. Secs. Litig., No. C-02-1486CW, 2002 U.S. Dist. LEXIS 24242, at *27 (N.D. Cal. Oct. 18, 2002) (identifying Sarbanes-Oxley as prohibiting companies from "discriminating against employees because of any lawful act by the employee to assist in an investigation of securities fraud.").

[73] Senator Richard C. Shelby, Speech to Consumer Federations of America Conference, *at* http://www.butera-andrews.com/legislative-updates/directory/new-developments/SEN-SHELBY-SPEECH.pdf. (December 5, 2002).

[74] *See* Jenny Wiggins, *Health Financier Makes Filing for Protection*, FIN. TIMES (London), Nov. 19, 2002, at 28 (noting National Century as one of largest acquirers of healthcare receivables in United States and inevitable struggle healthcare providers which relied on National Century will face as result); *National Century Files for Bankruptcy*, N.Y. TIMES, Nov. 19, 2002, at C4 (reporting health care financing company's filing for chapter 11 subsequent to F.B.I raid of its offices in Dublin, Ohio).

I think National Century has a direct possibility of really ruining many health care operators in this country in the next six months, and in many ways will be a mini Enron.

So I don't agree that the last shoe has dropped. There's always something new. I think part of the problem with securitizations is that the market may have gotten ahead of the regulation. And with a couple more scandals, I suspect that there are going to be further revisitations, even in a Republican Congress, on the securitization markets, as well as the level of disclosure and other issues.

Corwin: I hope there aren't, but there may be more. If there are, there may be further reaction. I hope the political atmosphere is a little calmer than it was over the past year, and we don't throw the baby out with the bath water.

I think asset securitization can be a very useful, legitimate tool for companies to stay liquid and raise financial capital in a very efficient and low cost way.[75] If we go too far and wipe it out, the overall effect to the economy — I mean, if the aim of the rhetoric is to protect workers, the best way to do that is to keep companies going and protect jobs. And if you make capital more expensive, it's going to have a negative impact.[76] Finding the right balance is always a challenge. You would hope the atmosphere's a little calmer than it has been.

Phelan: Let's move to another lesson that we may have learned from the Enron case, and I'd be particularly interested in hearing what Laura and Larry have to say about this, because in Enron there was a venue transfer motion filed.[77] The case was filed in New York, because there was one subsidiary that had a few employees sitting in New York. And I know I have heard from people outside New York City that have read the venue opinion, that they've read it to say New York is the only place where you can handle a really sophisticated case.

And just to kind of set the stage on that, when you look at the opinion, there's some quotes in there that I think are really interesting. New York is one of the world's most accessible locations. Now, I have heard from people who have to get to Kennedy at rush hour that that may be subject to some debate.

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[75] *See* Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. L. BUS. & FIN. 133, 137 (1994) [hereinafter Schwarcz I] ("A securitization transaction can provide obvious cost savings by permitting an originator whose debt securities are rated less than investment grade or whose securities are unrated to obtain funding through and SPV whose debt securities have an investment grade rating."). Schwarcz defines "SPV" as "special purpose vehicle" established for purposes of asset securitization. *Id.* at 135. *See generally* Steven L. Schwarcz, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (2d ed. 1993) [hereinafter Schwarcz II] (giving broad overview of asset securitization).

[76] *See* Schwarcz I, *supra* note 75, at 134 (explaining asset securitization allows companies to raise funds in capital markets at low cost, which generates savings and greater opportunity than if funds were raised by issuing increasing amounts of debt or equity); *see also* Schwarcz II, *supra* note 75, at 1–2 (noting when company engages in asset securitization, such assets are no longer owned by company, but separate entity, which enables funds to be raised less expensively than if raised directly through securities).

[77] *See* Supplement To Joint Motion For Change Of Venue And Response To Oppositions *In re*: Enron, 2002 Extra LEXIS 67, at *11 (Bankr. S.D.N.Y Jan. 7, 2002) (No. 01-16034) (granting venue transfer from New York to Houston in interest of justice and convenience of parties).

The court also found the executives would not be required to attend hearings and could participate by telephone and video conferencing. Even though he recognized that the executives were all in Houston, he said they really weren't necessary, because the professionals would handle the case.

Now, I know that there's some judges in the hinterlands that require the CEO or executives to show up in court because they want to assess credibility when you're talking about what this debtor's going to do in the future, and they don't necessarily rely on financial advisors.

Larry, how does it work out there in Middle America when you're talking about having executives show up at hearings?

Mr. Larry Frazen: Sitting in the hinterlands, I can tell you that we've got three very good, just judges, for example, here in the western district, and we are always frustrated when we see a large case go to either New York or Delaware under the guise of having no ability to handle an unsophisticated case here in the Midwest.

We've got large cases here. We're handling a very large case right now here in the Western District, you know, a multi-billion dollar case.

The judges here, don't demand to see the CEO at every hearing, but I think it's of great benefit to have them sitting with you at counsel table. I think it says something to the court and creditors, in terms of the importance of commitment, depending on the issue that's in front of the judge.

I think there's been a little bit of a backlash in terms of where debtors are going. I think people are not quite as in a hurry to go to the Southern District or Delaware. I think that the debtors that I speak to and the different advisors realize there may be some real benefit in getting into some of the other districts, into the courts that are as accessible and have a real interest to see the local companies and employees protected.

Phelan: Laura, I suspect that Delaware's close enough to New York that it does have the financial resources the judge in the Enron case mentioned. He stated New York is a world financial center and, as such, has the resources required to address the debtor's financial issues. You're in a little state and little town, but it's close to New York, so maybe —

Brandt: But Judge Gonzalez has maybe never been to Dallas, Robin, and if he went he'd surely be enlightened as to where the true center of real financial power is.

Jones: I like to think that Delaware has the financial and expertise resources to handle the cases in front of it.

I think a couple of things. I'm involved with cases in about six districts right now. A lot of the courts are trying to be more accommodating in terms of video

conferencing and teleconferencing.[78] I know that Judge Folvent sitting in Chicago actively encouraged video conferencing here in Delaware.

We're not as progressive in terms of the video conferencing or the testimony by phone. Judge Walsh has spoken many times, that if an officer were going to take the stand, he wants to see them. And Judge Walrath has shown some leniency on that, but she, likewise, wants the witness there, or the affiant, or whatever the case maybe.

I think it's a line that people are trying to juggle between trying to be accommodating, knowing that firms, lawyers and financial companies have cases all over the country and can't always be in the courtroom, but at the same time I know our judges here agree that they really want to see the witness or the affiant has to be in the courtroom.

The only other thing I was going to add was, like Larry is saying, there is not a requirement that an executive be in the courtroom every time there is a hearing, but for me personally, when I'm running cases, I often try to have a representative here who is at least knowledgeable on the issue that is before the court. It may not be the chief executive officer, but it might be one of the financial officers.

Phelan: Another thing that the judge pointed out was that the books and records were in Houston, but that doesn't matter, since everything's electronic anyway. Does that mean the location of the books and records, in essence, is going to be written out of the standards for transfers of venue? Judge Case, I want you to comment on that.

Judge Case: I don't think it's being written out, Robin. I can tell you in petitions that I've seen here, in the cases where venue has been transferred out of here, oftentimes what I see, in areas that the people and/or the records are elsewhere and not just that they're elsewhere but that they are concentrated elsewhere, if you will —

Brandt: I can add something, a little known statistic about Delaware is that over 70 percent of the motions to change venue that are brought are granted, and yet people just sometimes don't bring the motions.[79]

Corwin: You know, I see it time and again, and not just with bankruptcy but all kinds of issues, that people with a specific interest in either defeating or preserving a provision of the law defeat a much broader group of people who have a general interest in seeing that change enacted, but aren't as strongly motivated to push for it.

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[78] *See* Jessica M. Natale, *Exploring Virtual Legal Presence: The Present and the Promise*, 1 HIGH TECH. L.J. 157, 178 (2002) (explaining video conferencing is becoming more prevalent in courts).

[79] *See, e.g.*, Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 1000 (1999) (revealing eighteen of twenty-seven motions to change venue were granted, suggesting infrequent requests account for lack of successful motions).

And it's well known that when the Bankruptcy Commission recommended change in the venue rules, and in Durbin-Delahunt which recommended changes in venue, that would have stripped out the ways that some debtors get to New York and Delaware.[80] Now, that would harm the New York and Delaware bankruptcy bars, and so they have a very strong interest in preserving the current rule. Senators Biden and Schumer sit on the Judiciary Committee, and none of these proposals have ever made it out of the Committee because of this tendency for the specific overcoming the general.[81]

It has little to do with merits, and I've heard the merits argued on both sides of the issue. It has to do with the realities of the political world. The Senators from New York and Delaware are strongly motivated by the input from their bar associations to block any change.

Judge Case: I have two comments on venue change. It is very useful to have the physical presence of corporate officers because of a pesky thing called evidence. Often people in bankruptcy court forget that judges have to make findings based upon evidence, and that counsel telling you what is going on is not itself evidence. So I like ready access corporate officers for that reason.

Although I'm happy to see somebody on video conference, I don't like testimony over the telephone, unless it's a witness that I've already seen and I know and have had the chance to get to know. For example, if the CEO has been there two or three times and testified, and I've seen him, then I'll hear him over the phone, because I know who he is.

It's not that I distrust people, but I don't know who's on the other end of the telephone line. I don't know what they're looking at, who's whispering in their ear or what they're doing. My view is that if I am worrying about those things, it's not good for the person putting that evidence on, because they're hurting their witnesses' credibility by doing it that way. The lawyer is hurting the credibility of their own witness.

The second thing I think about venue is that I look at who are the people who are affected by this bankruptcy case, whether it's the employees or the creditors, particularly creditors who arise out of some local operations.

Part of what we need to do is to think about what the impact of bankruptcy is upon folks who thought they were entering into a commercial transaction that was going to be good for them and have now been sorely disappointed. If they are not physically present, not able to come to court, not able to see the proceedings, not able to hire a local lawyer, not able to have a personal sense of what's going on locally, I think it undermines the confidence of the public in the bankruptcy

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[80] *See* 28 U.S.C. § 1408(1) (2000) (allowing venue in bankruptcy cases to be based solely on state of incorporation).

[81] *See* Robert K. Rasmussen & Randall S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 NW. U. L. REV. 1357, 1381 (2000) (stating Senator Biden's distaste for bill).

system.[82] So, to me, having venue close to the folks most impacted is an important thing.

In a huge multi-state case or multi-national case, with creditors spread far and wide, and several hundred million dollars in bond debt and secured debt, it's hard to identify who those people are, and it's harder to focus on the little guy.

I'm talking more about the middle size case, and whether it should be handled somewhere for the convenience of the lawyers or the convenience of those affected by what is going to happen in the case.

Phelan: One of the things you mentioned, Judge, is evidence. Something that has been noted in these mega cases that have been filed in New York, particularly recently, is that, because of the very size of them, and in particular some of the judges have two or more of these size of cases, there just isn't a lot of time to have hearings where you can put on much in the way of evidence.[83] You've got a 15-minute window to present evidence in a case where there are tens of millions of dollars in transactions.

Does that create a problem, in your mind, in terms of the actual process? And what is the solution to that type of situation?

Judge Case: It does create a problem in the process and, to some degree, may be unavoidable. We have to do the best with what we are given in bankruptcy cases, because time is important. Sometimes you can't have the luxury that you have in ordinary civil litigation.

But I've found that if you tell people we're going to have a regular hearing here, we're going to have discovery, what we're going to set aside this day for and it's your job to get ready for it, they figure out how to do it, and they cooperate. They do exchange documents, they do have multiple lawyers in different places taking depositions, and they do then give me a record upon which I can make principled decision, rather than wondering what the real facts are.

Sometimes the exigencies of the moment make it difficult, but I do believe that, whenever possible, parties ought to have the opportunity to discover and present the facts, and I need to have the opportunity to see and hear those facts.

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[82] *See* Marcus Cole, *'Delaware Is Not a State': Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845, 1866–68 (2002) (indicating Delaware filings are driven by secured creditors and attorneys with large stakes); Rasmussen & Thomas, *supra* note 81, at 1380 (stating forum shopping is unfair to small creditors).

[83] *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 789 (2002) (questioning results of forcing bankruptcy judges to work quickly); Cole, *supra* note 82, at 1860 (citing speed of decisions for frequency of Delaware filings); Harvey Tepner, *Turnarounds, Transparency and Accountability*, 21 AM. BANKR. INST. J. 10, 10 (2002) (indicating New York and Delaware confirm plans seven times faster than other jurisdictions).

Phelan: Well, Larry, you're handling a billion dollar case out in the Corn Belt. Are you required to put on evidence, or do you do everything by agreement and declaration and proffer?

Frazen: Well, we have the occasion where we do put on evidence and, in fact, I think there's been a renewed emphasis by the bench out here. We recently had a roundtable discussion with the local bar, where the judges re-enforced the notion that Judge Case was just emphasizing: When we go to court, and we're asking for findings, we ought to be prepared to put on evidence.

Now, we still do a lot of things by affidavit, but we'll have a witness in the courtroom, and a lot of times we present things with a proffer, but we're certainly prepared to put on evidence. And if people want to cross-examine the witness, they're given the opportunity to cross-examine.

These days, when we go to court on a motion, if it's of any size or contested at all, we have evidence ready to go. It can be presented in various forms, but we never go in assuming we're going to be able to testify from the podium.

Judge Case: The recent changes to Rule 9014[84] underscore that. The changes represent a clear directive from the rules committee and the Supreme Court that evidence is important in contested matters and the parties need to be on notice as to whether or not they are going to have to present it.[85]

Phelan: Okay. Take this case I'm involved with. They come in with a critical vendor motion that got approved, and got approved very rapidly. I wasn't there, but my understanding was there wasn't a lot in the way of an evidentiary presentation.

Do you consider that to be a contested matter, when essentially there has been very limited notice, but you're going to let $70 million go out the door, which even in the context of a billion dollar case ain't chump change.

Frazen: Separate issues. Notice issue, which is separate from the evidentiary issue. We had the same issue in the Farmland case.[86] We ended up paring down our critical vendor to somewhere around 40 million. We went in with a detailed affidavit from the CFO and various operations detailing why certain categories of vendors were critical. We had them in court, ready to testify. We also had committees up and running the first day, so they were testing our argument. So there was at least enough notice to get the creditors there and asking the right questions.

I think the critical vendor question is one we've created for ourselves in these cases, and I don't think there's any way to put the toothpaste back in the tube. They

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[84] FED. R. BANKR. P. 9014.

[85] *See* FED. R. BANKR. P. 9014(d) ("[T]estimony of witnesses with respect to disputed material factual issues shall be taken in the same manner as testimony in an adversary proceeding."); FED. R. BANKR. P. 9014(e) (establishing reasonable notice requirements).

[86] *In re* Farmland Indus., 284 B.R. 111 (Bankr. W.D. Mo. 2002).

expect to be on the critical vendor list, and they know how to play the game. The client is telling you if they don't pay the vendor, they're out of business or the business will be damaged, so you try to manage it the best you can.

Judge Case: Credibility is important. You can't throw everything into the kitchen sink. You have to be sure that you actually can make a case for those vendors that you're talking about.

But I also agree with Larry that the deposition or affidavit route is perfectly acceptable, so long as the party is there, able to testify, to fill in any blanks and answer any questions I may have and of course, be subject to cross-examination.

That's a much quicker way to deal with it. I'll often take a break, and read a declaration or deposition and make sure everybody else reads it, so that we then have a common basis upon which we're operating. That can still be evidence, even though it's not given directly.

Phelan: What happened to the concept of leading the witness?[87] I mean, isn't there any — isn't a declaration the embodiment of leading the witness? And if I'm the opposing party, you know, how mad are you going to get at me and how mad is Larry going to get at me, and how mad is the judge in the cornbelt going to get at me when I say: "gee, Judge, I don't like this declaration stuff." I know that it was drafted by the lawyer, and maybe the witnesses looked at it and said it's right, but I'd like you to hear him testify on direct about that without me being required to cross-examine whatever, with whatever constraints there are with respect to that, but I want him to put on a foundation. I want him to be able to prove up his documents. I want the regular evidentiary rules I'm entitled to in a federal court. I don't have enough guts personally to do that.

Judge Case: You don't?

Phelan: I generally don't, because a court is going to get real unhappy with me. Judge Case, how do you get around that or reconcile those concepts?

Judge Case: I think it's a good point. One way to do that is to make sure the declaration is available for everyone to see either a day ahead of time or take a break.

If somebody has the kind of foundational objection that you're talking about, they should say: "Wait a minute, Judge. There's inadequate foundation for this testimony, I object to paragraphs 6 through 20." I'll say, "Fine, let's put the witness on and hear what he has to say."

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[87] *See* BLACK'S LAW DICTIONARY 888 (6th ed., 1990) (defining "leading question" as one which "instructs witness how to answer or puts into his mouth words to be echoed back"); *see also* FED. R. EVID. 611(c) (barring leading questions on direct examination "except as necessary to develop the witness' testimony" or "[w]hen a party calls a hostile witness, an adverse party, or a witness identified with an adverse party"); FED. R. BANKR. P. 9017 (incorporating Federal Rules of Evidence to cases under Bankruptcy Code).

Frazen: Rule 9017[88] says you can present evidence on motion with respect to affidavit if the court can then direct it be whole or partly heard on testimony.[89] So it's up to the judge if he wants to consider the affidavit or have parties cross-examine the affiant.[90]

Phelan: I agree, it's an efficient system. When I'm the opposing counsel, I like to see the declaration prior to the hearing. It gives me time to prepare for it. I know, however, there have been a lot of circumstances where you're handed it as you walk into the courtroom.

Judge Case: My view of this is that if that's the way the proponent of the motion handles it, then he or she is taking the risk that the judge will say: "I'm sorry, the other side needs an opportunity to review this, make comments, prepare their cross-examination, so you have to come back in two days." And when they say: "We can't, that's too late, we need a ruling today." To me, that's an emergency of their own making.

They need to think about, in advance, how they're going to expedite and make efficient their presentation of the case, which includes getting as much information to their potential opponents as possible.

Phelan: Another thing that's coming up in the Enron case is the issue of conflicts on committee and committee counsel.[91] Because Enron has hundreds of affiliates.[92] There's one creditors' committee,[93] although certainly there's been a very active group of creditors of Enron North America who have contended that Enron North America is a more solvent subsidiary—whether that is true or not may be a different issue—and have been active in the case in attempting to separate that out.

Judge Case: Which led, I think, to the appointment of a separate examiner.[94]

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[88] FED. R. BANKR. P. 9017.

[89] *See id*. (incorporating Federal Rule of Civil Procedure 43 to cases under Bankruptcy Code); FED. R. CIV. P. 43(e) (allowing court to hear on affidavits motions based on facts not of record, but permitting court to "direct that the matter be heard . . . on oral testimony or deposition").

[90] *See* FED. R. BANKR. P. 9017 (giving court discretion to hear matter solely on affidavits or additionally on testimony or depositions).

[91] *See generally* Carl A. Eklund & Lynn W. Roberts, *The Problem With Creditors' Committees in Chapter 11: How to Manage the Inherent Conflicts Without Loss of Function*, 5 AM. BANKR. INST. L. REV. 129, 133 (discussing issue of conflicts between creditors on creditors' committees).

[92] *See* John R. Emshwiller & Rebecca Smith, *Murky Waters: A Primer on the Enron Partnerships*, WALL ST. J., Jan. 21, 2002, at C1 ("In all, Enron had about 3,500 subsidiaries and affiliates . . . .").

[93] *See* Walter Hamilton, *The Fall of Enron; Ex-Employee Groups Seek Voice in Bankruptcy Proceedings*, L.A. TIMES, Jan. 10, 2002, at B1 ("The Bankruptcy Court has named one creditor committee so far in the Enron case."); s*ee also In re* Enron Corp., 279 B.R. 671, 694–95 (Bankr. S.D.N.Y. 2002) (denying creditors of subsidiary Enron North America's motions to form separate creditor's committees).

[94] *See In re Enron Corp*., 279 B.R. at 678–79 (reviewing appointment, investigatory duties, and interim conclusions of Enron North America examiner).

Phelan: It did in Enron North America, and it also led to an objection to the committee counsel under the circumstances.[95] And apparently the committee counsel represented some of the debtors in connection with some of the off-balance sheet transactions that have been criticized and represented a non-debtor subsidiary, Enron Wind, after the chapter 11 had been filed by Enron and, in fact, while they were representing the committee.[96]

This wasn't a disclosure issue, because they filed a disclosure document under Rule 2014[97] the size of a telephone book. But one of the creditors, one of the Enron North American creditors, filed an objection, and the court ruled that there wasn't a problem.[98]

Now, by that time, the committee had retained conflicts counsel, and they also raised the issue of the fact that the committee counsel had, in fact, been paid for their work for the debtor, or for some of the debtors, within the 90 days prior to filing and that there might be a preference action.[99]

The objecting creditor contended that for the structured transaction the counsel for the committee was investigating, it would have a conflict with other clients that have similar transactions.[100]

The judge stated that since the conflicts counsel and the examiner were investigating similar structures, that the failure on the part of the committee counsel would be brought to light.[101] The judge concluded that any problem regarding the representation by the committee counsel of Enron Wind should have been raised at

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[95] *See* Objection of Exco Resources, Inc. To Monthly Fee Statement of Milbank, Tweed, Hadley & McCloy LLP For Services Rendered and Expenses Incurred From December 12, 2001 Through December 31, 2001, And Motion To Disqualify Milbank, Tweed, Hadley & McCloy LLP As Council For The Official Committee of Unsecured Creditors at *1, *In re* Enron Corp., 2002 Extra LEXIS 349, at *1 (Bankr. S.D.N.Y. March 19, 2002) (No. 01-16034) (motioning court to disqualify creditor committee counsel).

[96] *See, e.g., Enron Briefs*, HOUS. CHRON., May 24, 2002, at B3 (illustrating bankruptcy court judge's ruling allowing creditor's committee to continue use of law firm even though conflicts may have been present).

[97] FED. BANKR. R. P. 2014(a) (requiring applicants for employment to submit various documents which show facts surrounding employment, necessity for such, while also showing interests in being hired by debtor).

[98] *See The Practice*, CONN. L. TRIB., April 1, 2002, Vol. 28, No. 13, at 11 (noting creditor Exco Resources objected to Milbank's representation of Enron because of reported structured finance deals previously completed for Enron). *But see Milbank's Enron Conflict*, LEGAL TIMES, March 25, 2002 (showing creditors' failure to raise objection after Milbank's disclosure of possible conflicts of interest).

[99] *See* Jonathan P. Friedland & Sven T. Nylen, *Accounts Receivable and Retainer Management: Lessons from Pillotex*, 2002 ABI JNL. LEXIS 188, *5–6 (December 2002) (stating bankruptcy court "made no factual finding" on whether payments made to Milbank constituted preferences requiring disqualification).

[100] *See* Objection of Exco Resources, Inc., *supra* note 95, at *21 (arguing Milbank conducted several structured finance deals which would preclude them from representing creditor's committee); *see also* James V. Grimaldi, *Role-Players Move Into the Spotlight of the Enron Drama*, WASH. POST, February 11, 2002, at 11 (noting Milbank had previously structured deals with Donaldson, Lufkin, and Jenerette, of which proceeds financed Enron deals).

[101] *In re* Enron Corp., 279 B.R. 671, 676 n.5 (Bank. S.D.N.Y. 2002) (stating court appointed examiner to oversee bankrupt estate); *In re* Enron Corp., 281 B.R. 836, 843 (Bankr. S.D.N.Y. 2002) (suggesting between court, committee counsel, examiner, appropriate action would be taken).

the time of the Enron Wind sale,[102] which was earlier in the case, and the judge approved the retention of the committee counsel.[103]

Would that analysis work in courts out there in Middle America, Larry, that rationale where you can represent the subsidiaries of the debtor post-petition, where you can have represented the debtor in connection with some of the transactions that are being investigated and where you received a payment that, at least allegedly was a preference?

Now, this was prior to the Pillowtex decision[104] that's recently come down with Jones Day where the court said that issue had to be dealt with on the front end.[105]

Frazen: I think that it may just be. Because we do not get certainly as many of the mega cases, we don't have to come up with some of the practical solutions that they have come up with.

Our U.S. Trustee's office here would not take that position. They would have taken the position there was a conflict.[106] I think they would have taken it to the court and asked counsel be disqualified.

We deal with those similar issues more in the context of, where you've got one committee, various subsidiaries and levels of debt, in the consolidation area. I think the committee has conflict issues, not arising out of the prior representation, but due to the fact that they represent one committee that may have varying interests.[107]

One of the practical things we've done from the debtor's standpoint on consolidation issues, for example is that we and the debtor, will do a substantive consolidation analysis and issue a report to the committees and other constituents and act as, somewhat, the objective analytic for that issue.

But on the other issues, I think our U.S. Trustee takes a much harder position, and I think the judges here would take a much harder line on those kinds of issues.

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[102] *See* Douglas G. Baird & Robert K. Rassmussen, *Four (or Five) Easy Lessons From Enron*, 55 VAND. L. REV. 1787, 1808 (2002) (discussing sale of Enron Wind to General Electric).

[103] *See* Eric Berger, *GE Gets Wind Turbine Unit*, HOUS. CHRON., April 12, 2002, at B2 (illustrating all parties agreed to sale of Enron Wind, even all creditors).

[104] *In re* Pillowtex, Inc., 304 F.3d 246 (3d Cir. 2002).

[105] *See id*. at 255 (holding if facially plausible claim of substantial preference exists, district court or bankruptcy court cannot avoid clear mandate of statute by approving of retention conditional on later determination of preference issue).

[106] *See* United States Trustee v. First Jersey Sec., Inc. (*In re* First Jersey Sec., Inc.), 180 F.3d 504, 509 (3d Cir. 1999) (discussing how actual conflict of interest is per se disqualification; potential disqualification is discretionary in terms of whether court will disqualify attorney; and court may not disqualify attorney on appearance of conflict alone (citing *In re* Marvel Entertainment Group, Inc., 140 F.3d 463, 476 (3d Cir. 1998))).

[107] *See In re Pillowtex*, 304 F.3d at 251 ("[A] conflict is actual, and hence per se disqualifying, if it is likely that a professional will be placed in position permitting it to favor one interest over an impermissibly conflicting interest."); *In re* Fas Mart Convenience Stores, Inc., 265 B.R. 427, 432 (Bankr. E.D. Va. 2001) (noting creditor serving on committee may have impermissible conflict of interest which may give rise to breach of fiduciary duty to all creditors represented by committee).

Phelan: Let me ask you this. When you have one committee for multiple subsidiaries, and I know they do that as well in Delaware, Laura, how do you handle substantive consolidation?

You've got people on your committee that are creditors of subsidiaries and creditors of the parent, and the interests conflict. How, as counsel for the committee, can you handle that?

Jones: Well, I think I've seen it done two ways here, Robin. And in most cases, the committee counsel will assure that they can give an objective memo, kind of what Larry is talking about, that they circulate to debtor's side and to, obviously, folks on the committee. And usually the debtor and the committee will agree on what is the best way to go, whether this should be substantive consolidation or not.

The only time I've seen kind of a separate situation happen is where the committee itself has just felt so conflicted, and they've ended up kind of with a subcommittee and sometimes have brought in special litigation counsel to deal with that issue for the committee.[108]

Phelan: There's one case floating around where the court appointed an examiner to handle that for the very reason that the committee did have conflicts. You have creditors of the rich subsidiaries, the parent, the poor subsidiaries. How can they be voting totally against their own interest and the interests of the people that are similarly situated creditors that, at least theoretically, they're supposed to represent on the committee?[109] Is that grounds for an appointment of an examiner? What do you think, Judge?

Judge Case: I think that's a good example. I don't think they can. It seems to me you don't want to put people on the committee in that kind of position. You don't want to create unforeseen liability, and you want to get input from the committee that's meaningful.[110] And if it is subject to all of these various conflicts, it's difficult to make it meaningful.[111]

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[108] *See, e.g., In re* Best Prods. Co., 173 B.R. 862, 863–64 (Bankr. S.D.N.Y. 1994) (explaining how committee with different goals appointed subcommittee).

[109] *See In re Fas Mart*, 265 B.R. at 432 (explaining how conflicting viewpoints are common when committee members attempt to protect their individual interests); *In re* Rick Pierce, 237 B.R. 748, 758 (Bankr. E.D. Cal. 1999) ("[C]ommittee members often have varying interests, and creditor disagreement over strategy or objectives on a committee does not by itself amount to type of conflict of interest mandating removal.").

[110] *See In re* PWS Holding Corp. Bruno's, Inc., 228 F.3d 224, 246 (3d Cir. 2000) (discussing limited immunity granted to committee members for actions within scope of their duties); *In re* L.F. Rothschild Holdings, Inc. 163 B.R. 45, 49 (S.D.N.Y. 1994) (stating immunity granted to committee members does not extend to willful misconduct); *In re* Tucker Freight Lines, Inc., 62 B.R. 213, 216 (Bankr. W.D. Mich. 1986) (explaining creditors' committee which urges rejection of plan for reasons they knew or would have known but for their recklessness deprives members of immunity).

[111] *See* Eklund & Roberts, *supra* note 91, at 131 (explaining impairment of committee functioning results from members' lack of balancing self-interest with fiduciary obligations); *see also In re* Hill Stores Co., 137 B.R. 4, 6 (Bankr. S.D.N.Y. 1992) (suggesting single creditors' committee is insufficient for large and

People can recuse themselves from a particular decision if it has a direct impact on them, but if you're talking about a substantive consolidation, everybody would be recused.[112] So I think that's a useful place for an examiner to come in and make a report.[113] These are difficult issues. Everyone should be aware of the work of the Select Advisory Committee on Business Reorganization ("SABRE") of the ABA Section of Business Law Business Bankruptcy Committee. That group is grappling with these issues and has made a number of thoughtful and provocative recommendations on reform of the roles of committees and examiners in chapter 11 cases.

Jones: Robin, I generally see this more on people more concerned about the debtor and whether counsel representing mogul affiliated debtors can really be the appropriate one to give a neutral opinion, if you will, in substantive consolidation. Usually I don't see the committees pointing at themselves, saying that they think they have conflicts, but will raise the issue with the debtor, who's represented by counsel; and there's six or seven affiliates, and each one may be in a different solvency situation, if you will.

Phelan: That's a good point, because focus is a lot of times on counsel for the debtor. Counsel takes instructions from the client, and you have the same board of directors and the same management for the parent and the rich and poor subsidiaries. They're sitting right there with a problem.

And it's really not counsel's issue. I can sit there and write a memo on substantive consolidation and look at the facts, but the decision whether to do it or not do it is not mine. It's the board of directors of the debtor.[114] And I don't know how to get around that problem.

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complex cases where creditors have diverse and conflicting interests); *In re* Chile B. Lee and Hae Sook Lee, 94 B.R. 172, 180 (Bankr. C.D. Cal. 1988) (adopting presumption that single creditors' committee is improper where there is "substantial overlap" of creditors or where "affairs of the respective debtors . . . appear to be substantially entangled"); *In re* Parkway Calabasas Ltd., 89 B.R. 832, 835 (Bankr. C.D. Cal. 1988) (stating same).

[112] *See generally* 11 U.S.C. § 1103(b) (2000) (forbidding attorneys representing committees from representing any entity having interests adverse to committee); Kenneth N. Klee & K. John Shaffer, *Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 44 S.C. L. REV 995, 1031–32 (1993) (recommending adoption of recusal rules as one way to address committee conflict "among the estates").

[113] *See* Barry L. Zaretsky, *Trustees and Examiners in Chapter 11*, 44 S.C. L. REV. 907, 910 (1993) (indicating appointment of examiner is instrumental "to protect the interests of various constituencies"). *See generally* 11 U.S.C. § 1104 (2000) (providing for appointment of examiner to conduct investigations).

[114] *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.2 (2002) (placing duty on lawyers to abide by client's decisions); *see also In re* Spanjer Bros., Inc., 191 B.R. 738, 751 (Bankr. N.D. Ill. 1996) (refusing to hold debtor's lawyer breached fiduciary duty to estate because he opposed and lost motion for appointment of trustee when he was merely following directions of managing officers and directors).

Frazen: One thing I can say, counsel can make a report that applies the facts as they find it to the law and make a recommendation on whether or not there are grounds for substantive consolidation.[115]

Phelan: Let's talk for just a couple of seconds about what Enron's doing. One of the things that they did, if they needed to get an asset off their books, they would set up, for example, a special purpose entity, sell that asset to the special purpose entity at an inflated price and book a profit. But, in fact, the special purpose entity was funded through the back door by Enron.

Another thing they did, same as WorldCom, they had dark fiber someplace, and said: "I'll trade you the dark fiber in Boise to, say, WorldCom for its dark fiber in Atlanta," then I would be able to book what I sold to you as a sale, boost my revenues and earnings, and then I would capitalize what I bought from you. So there were these kinds of trades.

There was another trick they called monetizing.[116] In that situation what they would do is just sell something off the balance sheet, again, to a special purpose entity.[117] Then the special purpose entity would enter into a hedge contract effectively with Enron itself.[118] So it was hedging with itself in connection with that transaction.[119] They use the term monetizing for that.

There was also the infamous Raptor transactions;[120] sell to a special purpose entity and then have another one of their subsidiaries later on buy it back.[121]

In the meantime, the guys setting up these entities, at least allegedly, according to the documentation and according to the lawsuits that have been filed, were raking off a piece for their participation, like Fastow and Kopper.[122]

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[115] *See In re* Optical Technologies., Inc. 221 B.R. 909, 913 (Bankr. M.D. Fla. 1998) ("It is agreed that the basic criterion by which to evaluate a proposed substantive consolidation is whether 'the economic prejudice of continued debtor separateness' outweighs 'the economic prejudice of consolidation.'" (quoting Eastgroup Props. v. S. Motel Assoc., Ltd., 935 F.2d 245, 249 (11th Cir. 1991))); *In re* Lease-A-Fleet, Inc., 141 B.R. 869, 871–72 (Bankr. E.D. Pa. 1992) (outlining seven factors relevant to consideration of substantive consolidation).

[116] *See The Allegations*, 26 ANDREWS ENRON LITIG. REP. 1, *available at* http://www.westlaw.com (explaining meaning of "monetizing") (Jan. 13, 2003).

[117] *See Confidential-Material Order Allows Disclosure of Factual Information*, 22 ANDREWS ENRON LITIG. REP. 3, *at* http://www.westlaw.com (Nov. 18, 2002) (explaining role of special purpose entities).

[118] *See Three British Bankers Face Criminal Charges in Enron Hedging Scam*, 12 ANDREWS ENRON LITIG. REP. 8, *at* http://www.westlaw.com (July 15, 2002) (offering illustration of Enron's hedging practice).

[119] *See Enron Report Exposes Phony Hedges, Self-Dealing and Shady* Rewards, 2 ANDREWS ENRON LITIG. REP. 11, *at* http://www.westlaw.com (Feb. 22, 2002) (showing how hedging transactions allowed Enron to avoid risk of loss because it received its collateral back).

[120] *See generally* Peter Behr & April Witt, *Visionary's Dream Led to Risky Business: Opaque Deals, Accounting Sleight of Hand Built Energy Giant and Ensured its Demise*, WASH. POST, July 28, 2002, at A1 (explaining role of Raptors).

[121] *See, e.g.*, Criminal Complaint, United States v. Fastow, 2002 Extra LEXIS 553, at *9–10 (S.D. Tex. Oct. 1, 2002) (No. H-02-889-M) (explaining ways special purpose entities were used to scheme Enron and shareholders).

[122] *See, e.g.*, Indictment, United Stated v. Fastow, 2002 Extra LEXIS 573, at *9 (S.D. Tex. October 31, 2002) (describing overview of how Kopper and Fastow defrauded Enron and its shareholders); Criminal Complaint, *supra* note 121, at *9–13.

The SEC settled with Mr. Kopper,[123] and he was to pay a bunch of money back.[124] He admitted, as I understand it, that he had been taking that money from Enron.[125] He didn't borrow it.[126] It belonged to Enron.[127] As I understand it, the creditors thought it should come back into the estate rather than going to defrauded investors, and there was a deal cut where it would go to bond holders,[128] and it would be a credit against their claims distributions.[129]

How do you think this happened? Why did it happen, and why didn't anybody do anything about it while it was happening? What causes the kind of culture that was apparent in Enron, the type of arrogance that we've seen in connection with their explanations?

They dotted the "i"s, crossed the "t"s, when you look at each individual transaction, in most instances, with exception of the Chewco transaction. If you look at any of them in isolation, on the face, a lot of them look okay. It's just, when you put them together, you see the money ran around in a circle. And how did this happen and what is being done to prevent this type of thing from happening again? Phil, why don't you comment on that?

Corwin: Well, without commenting on any specific company, what generally seems to be going on with some of these companies, which have now very publicly imploded and collapsed, you have, one, they were drinking their own Kool-aid, believing their own press releases. There supposedly was a new alchemy of finance where they could make money out of thin air, and the old rules didn't apply.

Number two, basically you had — and you'll see some of this with the new laws, as every reform seems to breed a new set of problems.[130] The whole reform of compensating major corporate officials with stock options was a reform that was

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[123] Accounting and Auditing, SEC v. Kopper, Litigation Release No. 17692, 2002 SEC LEXIS 2159 at *1 (Aug. 21, 2002) (announcing settlement between Kopper and SEC after SEC charged Kopper with fraud).

[124] *See id.* (stating Kopper was to pay approximately $12 million).

[125] *See id.* (declaring Kopper plead guilty to fraud charges and agreed to cooperate with government's investigation).

[126] *See id.* at 2 (citing commission's complaint alleging complex schemes to "misappropriate millions of dollars representing undisclosed fees and other illegal profits").

[127] *See id.* (showing funds were transferred off Enron's balance sheets when they should have been included in Enron's financial statements).

[128] *See* Jeff St. Onge, *Enron Bondholders to Get $8 Mln Kopper Paid to SEC, Judge Rules*, BLOOMBERG NEWS, *available at* http://www. lexis.com (Oct. 17, 2002) (reporting ruling of Bankruptcy Judge Arthur Gonzalez that federal securities regulators may distribute to Enron's bondholders $8 million surrendered by former Enron executive Michael Kopper).

[129] *Id.* (stating Enron owes senior bondholders more than $5 billion and creditors more than $50 billion).

[130] *See* Marissa P. Viccaro, *Can Regulation Fair Disclosure Survive the Aftermath of Enron?*, 40 DUQ. L. REV. 695, 712 n.92 (2002) (noting extended involvement in securities reform will "'set a dangerous precedent and lead to a Balkanization of securities laws . . .'" (citing Charles Gasparino, *Wall Street Has an Unlikely New Cop: Spitzer*, WALL ST. J., Apr. 25, 2002, at C1)); *see also* Mike Allen, *Bush Urges Crackdown on Business Corruption: More Resources for Regulators, Increased Jail Terms Proposed*, WASH. POST, July 10, 2002, at A01 (describing imposition of too much regulation due to massive accounting irregularities, may result in overreaction and creation of new sets of problems).

supposed to align their interests with those of the shareholders, and it was supposed to be good for shareholders.[131]

What it wound up doing in extreme situations was to give management huge incentives — with the extraordinary types of compensation that could be achieved in the late '90s with the stock market bubble — to keep the stock price going up, up, up, so those options could be exercised,[132] and they could cash in for tens of millions of dollars on an annual basis.[133]

To keep the stock market price going up, you had to keep booking extraordinary gains in revenues.[134] So to keep those kind of revenue numbers, when real profits weren't producing them, you had to create transactions which would give the illusion of creating those levels of revenues.[135]

And then I think at a certain point they built this house of cards, and it got out of control. And I think, as you see in most financial scams, the people who created it thought they could control it and keep it hidden. At a certain point, it's driving them, they have to keep it going. They know if they don't, the whole house of cards will fall in, the company will collapse. They'll be prosecuted, shamed, et cetera, et cetera.

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[131] *See* Linda Barrett, *Unsharing the Wealth: Recent Economic Volatility Has Greatly Impacted Executive Compensation*, 54 RUTGERS L. REV. 293, 316 (2001) (providing one reason why companies offer stock-based plans to executives is to help align interests of shareholders with executive interests); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1173 (1999) (explaining ideas that incentive compensation plans purporting to align manger and shareholder interests are more myth than truth); Jonathan R. Macey, *Agency Theory and the Criminal Liability of Organizations*, 71 B.U. L. REV. 315, 333 (1991) (explaining while executive compensation plans including stock options and bonuses serve to align interests of managers and shareholders, these devices are costly); Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97, 119 (2000) (stating institutional shareholders in 1980's promoted notions of paying executives in stock options as ways of aligning manager's interests with shareholder's interests).

[132] *See* Cunningham, *supra* note 131, at 1174 ("If economic performance improves and the stock price rises above the exercise price, they will exercise the option and share in the increase with shareholders."); *see also* Mara Der Hovanesian, *The Buyback Boomerang*, BUS. WK., Sept. 23, 2002, at 98 (stating issuance of options and offsetting shares once options are exercised pushes share prices higher feeding stock market bubble); Charles Murdock, *Corporate Leaders Lied to Themselves*, CHI. TRIB., Oct. 13, 2002, at C1 ("The stock market bubble created a tremendous incentive to manipulate the price of stock upward and then get out before the true earnings were disclosed."); David Wessel, *The Stock Bubble Magnified Shifts in the Business Mores While Watchdogs Napped. Galbraith Explains the 'Bezzle*,' WALL ST. J., June 20, 2002, at A1 (explaining stock options give executives huge incentives to boost near-term share prices regardless of long-term consequences).

[133] *See* Lerach, *supra* note 31, at 96 (explaining increase in stock prices causes exercises in stock options and ultimately these stocks are sold at high prices). *See, e.g., Ex-Media Tycoon is in a Sales Mood; Owing $20 Million, He Puts Homes on the Market*, NEWSDAY, Dec. 24, 2002, at A52 (discussing former AOL Time Warner chief executive, Gerald Levin, missed opportunity to reap hundreds of millions of dollars by not exercising his stock options).

[134] *See* Neil H. Aronson, *Preventing Future Enrons: Implementing the Sarbanes-Oxley Act of 2002*, 8 STAN. J. L. BUS. & FIN. 127, 129 (2002) (noting stock value depends upon ever increasing earnings and rapidly growing revenue).

[135] *See, e.g.*, Dave Sterman, *How to Avoid the Next Enron Bomb*, REGISTERED REP., Apr. 2002, at 4 (expressing Global Crossing's bankruptcy resulted from attempts to create illusions of revenue).

These types of transactions, which were not producing any real economic value, in fact creating phony revenues to book, were a perversion of the whole purpose of asset securitization.[136] It was not, I think, the typical enterprise in that area, but it certainly has become very bad "horror story."[137]

And what has happened, a lot of what is Sarbanes-Oxley's purpose was to require, certainly, honest financial disclosure to the public so you can't have this type of phony bookkeeping,[138] which, in turn, involves a lot of new controls on the accountants who were — there were so many kinds of co-conspirators for what was going on here in terms of chief financial officers, accountants, attorneys, investment bankers. Everybody was in on the game, and everybody might have been, within their own little world, not doing anything wrong, but it became a very bad thing with very bad results.[139]

And Sarbanes-Oxley was designed to prevent a lot of this from occurring. And other proposals are out there which I think are going to be implemented, whether by law or by New York Stock Exchange regulation,[140] such as restrictions on options, which are going to try to deal with all the factors that drove this type of conduct and that permitted this type of phony bookkeeping to take place and the real truth to be hidden from the public.

Phelan: The Glass-Steagall Act[141] was repealed a while back. And although Enron had some really smart guys in constructing all these things, the investment banks, other financial participants, these are also really smart guys.

Do you think there was a problem because you have the investment bankers making piles and piles of fees, and their guys, their affiliates in the banks, were

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[136] *See* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 29 (1996) (explaining unlike business securitizations, asset securitizations "'eliminat[es] the risk of bankruptcy to investors.'" (quoting Schwarcz I, *supra* note 75, at 151)); Nikiforos Matthews, *Circuit Court Erie Errors and the District Court's Dilemma: From Roto-lith and the Mirror Image Rule to Octagon Gas and Asset Securitization*, 17 CARDOZO L. REV. 739, 745 (1996) ("When a company wishes to raise money, asset securitizations are often designed so that a security holder's investment decision is based not on the creditworthiness of the company, but rather, in specified assets of the company.").

[137] *See* Alex Berenson, *Tweaking Numbers to Meet Goals Comes Back to Haunt Executives*, N.Y. TIMES, June 29, 2002, at A1 (discussing Enron's collapse prompted investors to scrutinize corporate accounting more carefully thereby causing scores of public companies to admit to overstated earnings); Christian Millman, *Don't Cheat on This Exam: The Topic is Business Ethics*, MORNING CALL, Nov. 17, 2002, at D1 (explaining securities fraud, flagrant conflicts of interest, and phony bookkeeping is similar to 1920's widespread abuses).

[138] *See* Andrew Margulis, *The Sarbanes-Oxley Act and D&O Insurance – Who Bears the Cost of Corporate Responsibility*, CORP. OFFICERS & DIR. LIAB. LITIG. REP., Dec. 30, 2002, at 18 (explaining Sarbanes-Oxley Act protects investors by improving accuracy and reliability of corporate disclosures made pursuant to securities laws).

[139] *See generally* Stephen Labaton, *Downturn and Shift in Population Feed Boom in White Collar Crime*, N.Y. TIMES, June 2, 2002, at 1 (noting marked increases in accounting and corporate infractions, fraud in health care, government procurement and bankruptcy, identity theft, illegal corporate espionage and intellectual property piracy).

[140] *See* 15 U.S.C. § 78s(b) (2000) (permitting self-regulated organizations to propose rule changes to Commission).

[141] 12 U.S.C. § 78, *repealed by* Pub. L. 106-102, § 101(b), 113 Stat. 1341 (1999).

funding these specialty purpose entities? Did that create a problem? Did that exacerbate the situation? You don't want to act like a real banker in loaning money because you're getting investment banker fees on the other side.

It's the same type of problem — the same type of alleged conflict that is being raised in connection with the accounting firms. Their consultants get piles of fees, and their auditors are at least subject to the public perception that they're not being totally independent.

Corwin: Well, I think you have to look at specific situations, I don't think Glass-Steagall had much, if anything, to do with this. I think investment bankers are driven by what makes their numbers and drives their revenues, and commercial bankers the same thing.[142]

Phelan: They're all working for the same holding companies. Don't they have similar interests?

Corwin: I think there would have been funding for these entities even with Glass-Steagall still in place. It looked good, but I think there was always some fraud going on here, where the truth was being hidden from some of the people providing financing.

It certainly wasn't good for these banks, in general, even where they were on both sides as lenders and investment bankers, because they've lost a huge amount of money.[143] They're in lawsuits with insurance companies.[144] They're in class action lawsuits with stockholders.[145] This was a very short-term gain with a lot of long-term pain associated with it.

Phelan: Let me ask you this — I lost my train of thought there.

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[142] *See* Inv. Co. Inst. v. Camp, 401 U.S. 617, 630–31 (1971) (explaining bankers holding securities affiliates may be tempted to shore up affiliates through unsound loans to prevent damage to public confidence in banks); Jonathan Zubrow Cohen, Comment, *The Mellon Bank Order: An Unjustifiable Expansion of Banking Powers,* 8 ADMIN. L.J. AM. U. 335, 360 (1994) (stating judicial opinions "reflect an unwarranted acceptance of the changing financial services marketplace and a willingness to risk potential reductions in public perception of bank safety provided that safeguards are in place against actual danger").

[143] *See, e.g.*, Patrick McGeehan, *FleetBoston Settles Inquiry By Regulators*, N.Y. TIMES, Jan. 10, 2003, at C1 ("The FleetBoston Financial Corporation said . . . it would pay $28 million to securities regulators to settle charges that Robertson Stephens, its investment banking unit is now closed, illegally shared in the profits of customers from trading hot new stocks.").

[144] *See* Jeffrey H. Birnbaum, *A Weaselly Way to Pay*, FORTUNE, Feb. 3, 2003, at 32 (discussing dispute between banks and insurance companies over settlement payments to New York State); Kenneth N. Gilpin, *DataBank; If Only a Week Could Last a Whole Year*, N.Y. TIMES, Jan 5, 2003, at 13 (noting settlement of suit by J.P. Morgan and insurers).

[145] *See* Simon Romero, *Adding to Claims Against Global Crossing*, N.Y. TIMES, Jan. 30, 2003, at C4 (describing consolidation of class action suits involving investment banks involved in Global Crossing IPO); Emily Thornton, *Investment Banks Have A Bad Case Of Immunity*, BUS. WK., Feb. 3, 2003, at 82 (noting recent dismissal of class action suits against investment banks).

Brandt: Hey, I don't know that I would agree with Phil. I'm not sure that anybody knew it was going to be a long-term pain when they were going for the short-term gain. More importantly, I think I agree with you. I had dinner with Senator John Kerry about four or five years ago, and he asked me what I thought of the efforts to repeal Glass-Steagall. I said, "You made us rich when you loosened the S&L restrictions in the late '80s. You will do the same with this."

I have no doubt that people will say, "You want a loan from me, I want your investment banking business," or, "I've got your investment banking business, somehow I'm going to tie it into your loan structure."

I think it was a terrible mistake, to get rid of Glass-Steagall. Granted, it was a 50 year-old law, but as I think you're seeing in Enron, people are testing the limits that no longer are so evident, that represent ethical rather than legislative boundaries as were contained in Glass-Steagall.

Phelan: We talked about public syndications with true sale opinions and special purpose entities and everything like that, but there's also been a trend in the last several years for syndications, loans among the bank syndicates. It used to be you had your bank. The debtor and bank were in a chapter 11. Now even in places like Kansas City and Dallas, you get the debtor and the bank syndicate. And there's anywhere from five to one case I've got right now, representing a bank syndicate, I've got 225 lenders in it.

And I heard the other day — for example, there's this one credit facility, and I don't remember how big it was, but the upfront fees for the agent were $20 million, and the agent was going to keep $50 million of the facility. Well, from the standpoint of that lender, that's a no-brainer: you're going to make the loan.

Then all the little participants in a facility, the Bank of West Gibralter, or whatever, they're taking their five or $15 million slice, and it's some guy sitting in a cubicle and looking at financial statements.

It seems that the argument can be made that, because of that risk spreading that's being done by these lenders, where they just buy into bunches of syndicates, the risk gets spread all over the place, nobody's really watching — the agent that's supposed to be watching the store, he's driven by — the guy actually doing it is driven by his quarterly bonus and upfront fees.

Banks used to make money by borrowing at one rate and loaning at another rate. Now they make money on their fees.

Because we've gone to a fee generated profit model for these lending institutions, nobody's watching the stores and making loans based on their ultimate collectibility. Is that an idealistic type viewpoint, or is there reality to that?

Brandt: I think the syndications reflect the maturation of the derivative markets.[146] That's a function of the other side of the way this debt is paid off now as well as the ready markets for the reselling of it, both at discounts, depending on how the risk is rated, and with respect to laying it off on other participants. It's not just that banks decided fees are where the income is and forgot lending, it is reflective of the change in the derivative market, and we're never going back to the old days.

Phelan: Is there some type of control that needs to be placed on that? Should anything be done to make banks a little more careful and less fee oriented?

Brandt: Well, you know, by saying this I'll probably get guffaws all around the table. If these were equities being traded, there would be a whole host of disclosure requirements governed by the SEC and 50 years worth of case and regulatory law. There is no such regulatory law for the debtor market, other than for public bonds, but I'm talking about trade credit debts and the rest of it.

I think, frankly, we're just waiting for the next scandal to appear where a number of people are trading debt derivatives in the market with perhaps better knowledge, because they sit on the creditors' committee, than the folks that are buying it. It's those kinds of ethical issues I see as one of the things we could be facing next.

There is talk about this issue. Is there a mechanism, perhaps employing the Internet and its instant reporting, where we can get a better handle on disclosure as well as understand the dynamics that speak to the marketing of debt and its impact on the bankruptcy system?

Jones: Robin, the one thing I would add to echo Bill's point, I participated recently in a seminar that went on for a half day just on the issue of the information that banks have to trade as compared to bonds. And we had representatives of both sides, if you will, and it's amazing, just the point that Bill made, that, you know either the banks have access because they are a lender that didn't go through, or because they're sitting on the committee, the amount of information they have compared to the bondholders, who are restricted. That's a fascinating issue itself, but I think something we're going to have to get a handle on.

In terms of trying to get control of the fees, the only thing I see, in terms of actual day-to-day practice in this huge system, what I'm seeing is, the commitment

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[146] *See Camp*, 401 U.S. at 630–31 (1971):

> [P]ressures are created because the bank and the affiliate are closely associated in the public mind, and should the affiliate fare badly, public confidence in the bank might be impaired. And since public confidence is essential to the solvency of a bank, there might exist a natural temptation to shore up the affiliate through unsound loans or other aid.

Id.; Cohen, *supra* note 142, at 360 (1994) (suggesting changes in regulation reduce public perception of bank safety).

fees, the facility fees, those types of things, the courts are trying to ratchet down when those fees are deemed earned.[147]

Ten, fifteen years ago, you walk in with these huge individual loans, the lender would say, "I need all these fees approved at the interim fee hearing," and now they're pushing them more toward final, or actually certain thresholds are drawn down or what have you. I think the bankruptcy judges are trying to get a handle on that.

But with respect to individual loans, in these cases or in the larger cases, trying to at least spread out the fees, not have them deemed earned at the beginning, much to the lender not being happy about that, or otherwise trying to control them.

Phelan: Let me mention one other thing. Do you all remember when aggressive accounting was good and when off balance sheet financing was good? I mean, I can't tell you the number of times a few years ago when my transactional guys would say, "We have a client, they want to do some off-balance sheet financing. Look at this deal, give us your true sale opinion, whatever."

As I understand it, one of Andy Fastow's defenses may be he was hired to do this, he dotted his "i"s and crossed his "t"s; he was very, very good at it, and why is everybody mad at him now?

It seems the reaction to that is to replace accounting and some — and an accountant told me this. The reaction is to replace accounting principles by definitive rules. And Professor Jack Ayers once told me that rules are all nice and dandy, but that's not ethics. Ethics is what you do when you don't have rules to go by. That's what you abide by when you don't have rules, people telling you what to do.

And it's been mentioned that the same might be able to be said for accounting principles, and that Enron is a good example of people that were following the rules, in terms of dotting "i"s and crossing "t"s, but ignoring the principles. And a lot of this was the result of unrealistic expectations. And it wasn't caught, for example, by Arthur Andersen, because of the tremendous fee generation that was required to keep that engine going.

Remember that Andersen Consulting split off from Arthur Andersen because those guys were making piles more money than the auditors, and they didn't want to share it with the auditors.

Judge Case: There is a theme here to what you've been talking about all afternoon, Robin. The executives who boost earnings because that helps their stock options, or the lenders who take the big fees, or the accountants and the consultants who are looking for large fees, or the lawyers who have conflicts and end up representing entities they shouldn't all have something in common: when there's a

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[147] *See, e.g., In re* Graham Square, Inc., 224 B.R. 614, 617 (Bankr. N.D. Ohio 1998) (finding The Mutual Life Insurance Company of New York ("MONY") entitled to commitment fee when ready and willing to make loan).

lot of money around people's judgment gets impaired.[148] And, we are now seeing that in spades.

That's what happened back in the '80s in the savings and loan crisis. Everybody saw the values going up, and they were making buckets of money, and lenders started making stupid loans. They made loans that were at best ill-advised and, at worst, illegal, because when there's a big pot of gold around, it impairs people's judgment.

Brandt: There's one other thing, Judge. Robin, you talk about when aggressive accounting was good, and I remember when junk bonds were bad back in the early '90s, with Milken.[149] Everything has its cycle, and our use of and our comfort with certain products changes and falls as the market shakes out those products and gives us both a scheme of regulations and a sense of ethics as to how they're supposed to be used.

Right now people are crying that there isn't much of a junk bond market,[150] even though it's three to four times what it was during the period of reported sins of Milken.[151]

The instruments will find their own level of use. And I suspect that the current prohibition on aggressive accounting will slide back, and probably fairly soon, leaving us with yet more inevitable changes to face in the future.

Phelan: Is Sarbanes and the Public Accounting Oversight Board[152] going to fix all this stuff?

Brandt: No.

Judge Case: Are you going to be the Chairman of the Board?

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[148] *See, e.g.*, Vincent DiLorenzo, *Public Confidence and the Banking System: The Policy Basis for Continued Separation of Commercial and Investment Banking*, 35 AM. U. L. REV. 647, 679 (1986) ("[I]mpaired judgment in loan transactions may, and has taken the form of an increased willingness to extend credit to a corporation in which the bank or its nonblank affiliate has a profit interest in the nature if underwriting fees for equity and debt securities.").

[149] *See* Kurt Eichenwald, *White-Collar Defense Stance: The Criminal-less Crime*, N.Y. TIMES, Mar. 3, 2002, at 4 (describing Michael Milken's involvement in stock-market fraud); *Junked*, ECONOMIST, Nov. 24, 1990, at 90 (noting Michael Milken's obstruction of government investigation).

[150] *See Holed*, ECONOMIST, Nov. 11, 2000, at 96 (describing fall in prices of junk bonds in 2000). *See generally* Suzanne Kapner, *Global Slump is Blurring Line at Bank Units for Junk Bond*, N.Y. TIMES, Nov. 6, 2001, at W1 ("The junk bond market . . . affords companies with shakier credit profiles a way to raise money by paying higher returns to investors willing to assume higher risks.").

[151] *See generally* Riva D. Atlas, *Will He Star Again In a Buyout Revival?*, N.Y. TIMES, Jan. 26, 2003, at 3 (commenting on resurgence of junk bond market).

[152] *See* Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745, 750 (2002) (codified as amended at 15 U.S.C. § 7211 (2002)) (codifying establishment of "Public Company Accounting Oversight Board"); *see also* Stuart & Wright, *supra* note 22, at 771 n.73 (noting "Public Company Accounting Oversight Board" is core element of Sarbanes-Oxley).

Phelan: My understanding, you guys tell me if I'm wrong, is that the — you cannot have more than two members of the accounting oversight board under Sarbanes-Oxley that are CPAs. If one of those guys is the Chairman, he cannot have been a practicing CPA for the last five years. I notice that the five guys appointed initially are all lawyers. It seems to me that's like setting up a brain surgery procedures board and not having any doctors on it.

Brandt: Robin, I'll go one further with you. If you look at what Sarbanes-Oxley says, who would want to be the audit committee chairman? This new law requires you to have a skilled financial person serve as the chairman of your audit committee.[153] Try as I might, I don't read that any other way than that you have to have your audit committee chaired by an accountant. And with respect to the liability one would undertake in connection with that, why would you do that?

Phelan: I agree. Also, I'd like to know how the CEO of Amalgamated Department Stores who is the CEO because he is an expert in fashion trends and because he — came up the operation side and doesn't know a debit from a credit is going to certify that he's looking at the accounting controls.

Brandt: That doesn't bother me. You and I sign the bottom of our 1040's every April, and we sign them under oath. You sign your pleadings under oath. I sign the bankruptcy schedules under oath. There is so much we routinely sign under oath, right down to our driver's license application.

Granted, it gives the regulators another shot at these guys, but the fact of the matter is that this particular part of Sarbanes-Oxley bothers me least, mostly because of everything else in our lives and our professions we're required to sign under oath.

However, the idea that the CEO and/or CFO are down streaming that liability by taking a number of people within the organization and requesting them to sign also, thus spreading the risk, does seem to be getting a bit bizarre.

Phelan: What do you think the cost on a macro basis is going to be as a result of something like Sarbanes-Oxley, just the legal costs and accounting costs? You think that it will outweigh the benefit?

Corwin: Even if it does, it's going to be a long time before anybody proposes paring it back. I think what's important now is to get a good strong chairman in charge of that Public Accounting Oversight Board. And as incoming Committee Chairman Shelby has stated — you know, Congress is very good at passing laws but not as good at oversight, in really seeing how those laws are implemented —

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[153] *See* Joel Seligman, *No One Can Serve Two Masters: Corporate and Securities Law After ENRON*, 80 WASH. U. L.Q. 449, 495 n.111 (2002) (recommending to NYSE Board of Directors that chair of audit committee have "accounting or related financial expertise").

and he's promised strong oversight of the implementation of this new law, and that's good.

Speaking more generally, to some of the points you raised, Robin, maybe there is nostalgia for a world that doesn't exist anymore, where we had commercial banks separate from investment banks. We had national, in fact, regional capital markets, not global, where everybody stayed in their own bailiwick, and commercial banks lent and made money and kept the portfolio and made the profit on the spread.

But the fact is that one of the reasons that Congress finally repealed Glass-Steagall is because they saw the capital markets had changed.[154] And not to say it's all unalloyed good, and we've seen some bad come out of this, but the fact is that technology, computer technology and international capital markets created the new world of finance. It's taken down the old walls. We've decided that the benefits of liquidity and efficiency outweigh the deficits.

But we're going to have to focus on eliminating the negatives, which is going to take criminal charges, more oversight and honest disclosure to the public.

Phelan: Banks are not going to be close to their customers like they were in the old days. But they now have regulations that say they have to know the borrowers and have to file suspicious activity reports.[155] Isn't that somewhat inconsistent?

Corwin: They're going to have to do both, walk and chew gum at the same time. One hopes that they can do that. You know, there's plenty of contradictory laws on the books, and you have to live with all of them.

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[154] *See generally* George Steven Swan, *Legal Education and Financial Planning: Preparation for the Multidisciplinary Practice Future*, 23 CAMPBELL L. REV. 1, 3 (2000) (noting repeal of Glass-Steagall Act).

[155] *See* Sarbanes-Oxley Act, 116 Stat. at 784 ("[R]equiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof . . . ."); *see also* Michael L. Fox, *To Tell or Not To Tell: Legal Ethics and Disclosure After Enron*, 2002 COLUM. BUS. L. REV. 867, 895 (2002) (observing of attorneys limited discretion under Sarbanes-Oxley to report "misdeeds, wrongdoings and illegalities"); William H. Simon, *Whom (or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict*, 91 CALIF. L. REV. 57, 81 n.64 (2003) (asserting counsel must report material violations and breaches of fiduciary duty).