

Minutes of Proceedings

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
Date: May 10, 2006
-----X

In re
Enron Corp., *et al.*,

Reorganized Debtors.

Case No. 01-16034 (AJG)

-----X
Enron Corp.,

Plaintiff,

Adversary Proceeding
No. 03-92677 (AJG)

v.

J.P. Morgan Securities, Inc., *et al.*

Defendants

-----X
Enron Corp.,

Plaintiff,

Adversary Proceeding
No. 03-92682 (AJG)

v.

MassMutual Life Insurance Co., *et al.*

Defendants

-----X
Present: Hon. Arthur J. Gonzalez
Bankruptcy Judge

Jacqueline De Pierola
Courtroom Deputy

ECRO
Court Reporter

Plaintiff, by counsel

Defendants, by counsel

Proceeding: Defendants' Motion for a Stay of Discovery Pending Leave to Appeal, and Appeal, if Leave is Granted.

Order: For the reasons set forth in the decision attached hereto as Exhibit A, the relief sought is

Granted Denied

FOR THE COURT: Kathleen Farrell, Clerk of the Court

BY THE COURT:

s/Arthur J. Gonzalez
United States Bankruptcy Judge

5/10/2006
Date

Jacqueline De Pierola
Courtroom Deputy

Exhibit A

Before the Court is a Motion for a Stay of Discovery Pending Leave to Appeal, and Appeal, if Leave is Granted (the “Motion”) filed by defendants Lehman Commercial Paper Inc. and Goldman Sachs & Co. (together, the “Defendants”) related to adversary proceedings nos. 03-92677 and 03-92682 (the “Adversary Proceedings”). Various other defendants in the adversary proceedings have joined in the Motion. Currently, the Defendants have filed motions that are pending before the district court for leave to file an interlocutory appeal of this Court’s June 15, 2005 Memorandum Opinion Denying Defendants’ Motions to Dismiss Complaints in the Adversary Proceedings.

The parties have engaged in a number of related disputes concerning the standards by which the Court should judge the Motion. The Defendants have suggested that the Motion can be analyzed under either Rule 8005 of the Federal Rules of Bankruptcy Procedure or Rule 26(c) of the Federal Rules of Civil Procedure. The Plaintiff appears to ultimately agree with this approach to the extent that the Plaintiff does not deny the applicability of Rule 26(c). The Court recognizes that these two rules are analogous in purpose and effect. The Court also recognizes that the standards for applying these two rules are similar.

Under Rule 8005, the Court considers four factors in deciding whether to grant a motion to stay discovery: “(1) whether the movant will suffer irreparable injury absent a stay, (2) whether a party will suffer substantial injury if a stay is issued, (3) whether the movant has demonstrated ‘a substantial possibility, although less than a likelihood, of success’ on appeal, and (4) the public interests that may be affected.” *Hirschfeld v. Board of Elections*, 984 F.2d 35, 39 (2d Cir. 1993). As the parties correctly note, the Second Circuit in *Mohammed v. Reno* recently revised its formulation of the first factor to embrace a more variable approach: ““The

necessary level or degree of possibility of success will vary according to the court's assessment of the other stay factors.” 309 F.3d 95, at 101 (2d Cir. 2002) (citing *Washington Metropolitan Area Transit Commission v. Holiday Tours, Inc.*, 559 F.2d 841, 843 (D.C.Cir. 1977)). Phrased alternatively, “The probability of success that must be demonstrated is inversely proportional to the amount of irreparable injury plaintiff will suffer absent the stay. Simply stated, more of one excuses less of the other.” *Id.* (citing *Michigan Coalition of Radioactive Material Users, Inc. v. Griepentrog*, 945 F.2d 150, 153 (6th Cir. 1991)). The Court should note at this point that the relevant “possibility of success” is the possibility that the District Court will grant the Defendants’ leave to file an interlocutory appeal, not the possibility that the Defendants will succeed on the merits of that appeal.

Rule 26(c) allows courts, in their discretion, to stay discovery upon a showing of “good cause,” which courts have interpreted to require “a showing of facts militating in favor of the stay.” *American Booksellers Assoc. Inc. v. Houghton Miffling Co., Inc.*, 1995 WL 72376, at 1 (S.D.N.Y. Feb. 22, 1995). While no definite list of factors has been developed to guide the Court’s analysis of Rule 26(c), those factors that courts have recognized are similar to the four Rule 8005 factors. The recognized factors include: “(1) whether the defendant has made a strong showing that the plaintiff’s claim is unmeritorious; (2) the breadth of discovery and the burden of responding to it; and (3) the risk of unfair prejudice to the party opposing the stay.” *Chesney v. Valley Stream Union Free School District No. 24*, 2006 WL 842909, at 1 (E.D.N.Y. March 28, 2006).

The Defendants focus their arguments on two factors: the probability that they will succeed in their motion for leave to appeal, and then on appeal; and the harm they would suffer if discovery proceeds. The Defendants allege in particular that they will suffer two definite

injuries if discovery is allowed to proceed here. First, the Defendants argue that the marketplace is irreparably harmed by the uncertainty induced, among other ways, by this Court's denial of the motions to dismiss in the Adversary Proceedings. Second, the Defendants allege that the costs of discovery would represent a substantial and irreparable injury, as discovery in the Adversary Proceedings can be expected to be resource-intensive. The Defendants further highlight the inequity of these injuries by asserting what they characterize as the substantial possibility that they will succeed on their motion for leave to appeal and, ultimately, on the merits of their appeal.

The Court concludes that the Motion must be denied under either Rule 8005 or Rule 26(c) because the Defendants have not demonstrated that they would suffer the requisite level of injury if the stay were not granted. Regarding the alleged injury to the marketplace, the Court notes that the Defendants first raised this issue in connection with their motions to dismiss the complaint, which were filed on February 19, 2004, and argued before the Court on September 21, 2004. The Defendants argued at that time that the pendency of the actions challenging the safe harbor provision as applied to the questioned transfers creates uncertainty in the marketplace to the detriment of the marketplace itself as well as market participants, and they have extended that argument to their motion here. As an initial matter, the Court is not clear as to what aspects of discovery would create any additional uncertainty that could be recognized as an injury under Rule 8005.

More importantly, even assuming that injury to the marketplace would, under both Rule 26(c) and Rule 8005, be considered as injury to market participants as defendants, the Defendants have simply offered no evidence to demonstrate any quantifiable injury. The Court notes that this alleged injury has been ongoing for over two years and presumably crystallized

following this Court's denial of the Defendants' motions to dismiss in June 2005. Nonetheless, though the Defendants continue to repeat their allegations that the marketplace has been injured, they have not translated those allegations into empirical evidence. One possible explanation for this lack of evidence is the irregular characteristics of the transactions at issue. It is possible that, due to the unique circumstances surrounding those transactions, the marketplace did not regard the Adversary Proceedings as representing a threat to the continued vitality of the safe harbor provision. Thus, one could hypothesize, market expectations and common business practices were not disturbed when the transactions came under scrutiny as to their bone fides as security transactions and settlements payments. This is, of course, speculation, but the Court is left to speculate given the noted absence of any evidence of quantifiable harm; moreover, this speculation is at least consistent with the lack of evidence presented regarding negative market effects. Nonetheless, regardless of why the Defendants have not presented definite evidence in support of their allegations, Rule 8005 and Rule 26(c) require that they offer such evidence, and not simply allegations, in order to justify upsetting the normal processes of the courts. This the Defendants have not done. The Court notes moreover that the costs of discovery are generally not a recognizable injury under Rule 8005, which requires "irreparable injury," and nothing herein warrants the opposite result.

This conclusion suffices for the Rule 8005 analysis. A showing of irreparable harm is a necessary threshold for a Rule 8005 motion. *See In re Adelpia Communications Corp.*, 333 B.R. 649, 659 (Bankr. S.D.N.Y. 2005) ("All four criteria must be satisfied to some extent before a stay is granted.") (citing *Turner v. Citizens Nat'l Bank of Hammond*, 207 B.R. 373, 375 (2d Cir. BAP 1997)). As the Defendants have not introduced evidence showing irreparable harm, the Motion must be denied under Rule 8005.

The costs of discovery, the second injury the Defendants identify, is however a recognizable injury under Rule 26(c). As the Defendants note, the court in *In re Currency Conversion Fee Antitrust Litigation* rested its holding in favor of the motion to stay on the movant's costs of discovery. 2002 WL 88278, at 3 (S.D.N.Y. Jan. 22, 2002). Similarly, the court in *American Booksellers* held that "[t]he discovery sought by the plaintiffs is very broad and to require defendants to respond to it at this juncture, when their motion to dismiss may be granted, would be extremely burdensome." 1995 WL 72376 at 1. The Defendants do not necessarily assert that substantial discovery costs are alone sufficient to justify a finding of "good cause." Rather, they tie the costs of discovery to, what they characterize as, the substantial possibility that they will succeed on the motion for leave to appeal, and ultimately, on the merits of their appeal, and the purpose of the statute at issue in the motions to dismiss.

Regarding the latter factor, the Defendants argue that the statute at issue, the safe harbor provision, serves not only to protect a transfer from the operation of other provisions of the Bankruptcy Code; they argue that it also prevents the Plaintiff from challenging, save on grounds of fraud, the application of the safe harbor provision to the questioned transfer. The Defendants suggest that Congress, in enacting the safe harbor, intended to protect the marketplace from scrutiny as to whether a security transaction was present or whether the payment at issue was a settlement payment. Stated simply, the Defendants suggest that if financial institutions characterize a transaction as a security transaction, and if those institutions label a payment as a settlement payment, those characterizations and labels have effectively binding legal consequence. By implication, this argument would also hold that the safe harbor protects financial institutions from facial challenges to those characterizations and labels. The Defendants are thus arguing that the costs of discovery represent a unique and irreparable harm

because they had a legitimate expectation that their transactions would be subject only to challenges on grounds of fraud.

The Court finds this argument to be of doubtful validity. Regardless of the outcome of the appellate process, it does not appear to the Court that the protection afforded by the safe harbor was intended to immunize a party from a facial challenge to the characterizations and labels referenced previously. However, the Court need not address the argument on its merits as the Court concludes that the Defendants have otherwise failed to show “good cause.” While Rule 26(c) may be applied even where a motion to dismiss is not currently pending, the Court finds that where, as here, the motion to dismiss was denied and leave to appeal that decision is currently pending, the costs of discovery are not a factor to be analyzed under Rule 26(c). The purpose of Rule 26(c) is to prevent a plaintiff from leveraging the costs of discovery in settlement negotiations where the defendant has filed a meritorious motion to dismiss. In applying Rule 26(c), the courts thus assume that, in those circumstances, the costs of discovery represent a degree of irreparable harm to the movant. However, where the motion to dismiss has been denied, the same presumption cannot be made. Simply, the Defendants have had their opportunity to challenge the complaint and have failed in their attempt to dismiss the complaint; discovery is the natural next step and therefore the costs of discovery cannot be considered an injury for the purposes of Rule 26(c).

Similarly, the “possibility of success” factor must be evaluated in light of these considerations. As noted previously, the “possibility of success” the Court must consider relates to the motion for leave to appeal. These type of motions are, as a general matter, seldom granted, and the Court finds that there is nothing herein that would indicate that this factor would weigh in favor of Defendants. As the Defendants have thus not established that either of these

two factors militate in favor of a stay of discovery, the Court may arguably conclude on that ground alone that the Defendants have not shown “good cause” under Rule 26(c). However, even if the Court must still balance the various factors previously identified, a cursory review of the harms the estate would suffer if discovery were stayed (detailed more fully below) is sufficient for the Court to conclude that, on balance, the Defendants have not shown “good cause.”

The Court’s conclusions to this point rest upon a direct analysis of the Defendants’ arguments and evidence. However, for the sake of completeness, the Court will also analyze the Motion under the assumption that the Defendants have introduced evidence that could be properly considered under either Rule 8005 or Rule 26(c), which thus requires the Court to apply a balancing test. Nonetheless, even with that assumption, the Court concludes that application of a balancing test similarly requires the Court to deny the Motion. The Plaintiff has noted a number of injuries the estate would suffer if discovery was stayed at this stage of the litigation, including: (1) additional administrative costs if the Adversary Proceedings are unnecessarily prolonged; (2) the spoliation of evidence and the unavailability of witnesses; (3) the delay in recovery if the estate is ultimately successful in the Adversary Proceedings; and (4) the delay in distributions to creditors of the estate. These considerations all favor allowing discovery to proceed.

Furthermore, consideration of the public interest does not favor granting the stay. Most obviously, the public interest favors quick resolution of these adversarial actions as well as the broader bankruptcy proceeding, and to that extent, a stay in discovery pending leave to appeal would frustrate the public interest. The Defendants counter that the marketplace, and by extension, the public, has an interest in the underlying substantive issues presented in the

motions to dismiss, and thus, the Defendants argue, the marketplace has an interest in ensuring that the Defendants do not have to bear the costs of discovery. The Court has already expressed its doubt concerning this argument and reiterates its view that this connection is tenuous at best. However, the Defendants also note that two government entities, the Securities and Exchange Commission and the Treasury Department, as well as a member of the Federal Reserve Board, have supported the Defendants' motion for leave to appeal. The Defendants suggest that this fact demonstrates conclusively that the public interest favors a stay in discovery.

The Court notes, however, that those governmental entities did not participate in the proceedings before this Court even though they had ample opportunity to do so. As well, the Court notes that those entities' views are not binding, even had they been presented here. More fundamentally, though, the District Court recently considered a motion for leave to appeal, in which the same governmental entities also supported the relief sought, in another Enron proceeding and held that "these agencies have [not] offered any examples of any adverse impact on the securities markets caused by the decisions below. *See Enron Corp. v. Credit Suisse First Boston Int'l, et al.*, No. M-47 (S.D.N.Y. May 2, 2006) (order denying motion for leave to appeal). The Court does not deny that those entities may represent the public interest, but such would not excuse them from providing evidence supporting their allegations.

Second, while this Court believes that the alleged injury to the marketplace should be considered, the Court finds that, even assuming this alleged injury is real, this public interest consideration is outweighed by the public interest in a quick resolution of the issues. The public interest the Defendants identify is in the eventual resolution of the substantive issues presented in the motions to dismiss, and only to a limited extent by implication is that public interest affected by the process and procedures of the litigation. The Court thus finds that, on balance,

the harm to the estate outweighs the alleged harm to the Defendants under either Rule 8005 or Rule 26(c).

This ruling is without prejudice to Defendants seeking similar relief, as requested herein, if their motion for leave to file an interlocutory appeal is granted.

Based upon the foregoing, the Motion is DENIED.