Minutes of Proceedings

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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Date: June 21, 2007

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In re

Enron Creditors Recovery Corp., et al., Case No.

Reorganized Debtors. 01-16034 (AJG)

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Enron Creditors Recovery Corp.,

Adv. Pro. No.

Plaintiff, 03- 92682(AJG)

-v -

Mass Mutual Life Insurance Co., et al,

Defendants.

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Present: Hon. Arthur J. Gonzalez _____ ECRO
Bankruptcy Judge Courtroom Deputy Court Reporter

Plaintiff, by counsel

Defendants, by counsel

Proceeding: Opinion on Defendants= Motion, joined by Enron Creditors Recovery Corp., to Compel Production of Documents, to Continue the Depositions of Certain Witnesses, and Request for Expedited Consideration

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

X Granted **G** Denied

FOR THE COURT: Kathleen Farrell, Clerk of the Court

BY THE COURT:

s/ Arthur J. Gonzalez 6/21/2007 s/ Lynda M. Nulty
United States Bankruptcy Judge Date Courtroom Deputy

Exhibit A

This discovery dispute arises in connection with Enron's litigation against various defendants, including Goldman, seeking to recover certain transfers it alleges were preferences or otherwise avoidable. At issue are a series of transactions, commencing on October 26, 2001 and concluding on November 6, 2001, whereby Enron transferred, to defendants, including Goldman, more than 1 billion dollars. According to Enron, these transfers were payments of its commercial paper notes prior to maturity, in violation of their governing terms, at a price significantly higher than market value. Enron contends that the defendants, including Goldman, were aware that these transfers might be subject to avoidance. Goldman's response is that the transfers were "settlement payments" made to complete securities transactions that, as a matter of law, are protected from avoidance under sections 546(e) and 548(d)(2)(B) of the Bankruptcy Code – the "safe harbor" provisions. Additionally, Goldman asserts, among other defenses, that it was an agent or mere conduit for Enron's transfers and is therefore not an "initial transferee" from whom such transfers can be recovered, once avoided. Goldman also asserts that the transfers were not made for its benefit and that it undertook the transactions in good faith.

Before the Court is a motion, brought by certain defendants and joined by Enron, to compel discovery from Goldman of all materials related to a certain "Project Truman" – a financial advisory project between Goldman and Enron that took place from August through December 2001. The parties seek these materials to help determine whether, and to what extent, Goldman and Enron's advisory dealings with each other may have influenced their respective roles in the disputed commercial paper transactions.

For the reasons set forth below, the Court finds the Project Truman materials relevant to the

underlying litigation and therefore grants the motion to compel. Goldman has acknowledged that producing these materials is not burdensome. (The Court notes that Goldman's stated concern is that the instant production could ultimately lead to expansive discovery similar to that in the Newby litigation. However, to the extent such discovery concerns were to materialize, Goldman can seek appropriate relief from the Court at that time). Goldman's objection to the motion is on the basis of relevancy and effectively asks that the Court stop this portion of the discovery process and undertake a dispositive analysis of the underlying issues of the case. Goldman, among other defendants, previously sought dismissal of this case which the Court denied. Goldman's request for leave to file an appeal from that ruling is currently pending before the district court. The parties are far along in the discovery process. Goldman's objection effectively imposes upon the Movants a Rule 56(f) burden in order for them to be entitled to the discovery sought. This is an unwarranted burden in a response to a motion to compel. The Court will not, at this stage of the case within the context of a motion to compel discovery, engage in dispositive motion practice.

Goldman filed a motion to dismiss Enron's case on February 19, 2004. After extensive briefing and a hearing, the Court denied the motion on June 15, 2005 and determined that "whether payments that are made with respect to short-term commercial paper prior to the maturity date, at significantly above market prices and contrary to the offering documents qualify as settlement payments is a factual issue requiring a trial." *In re Enron Corp.*, 325 B.R. 671, 678 (Bankr. S.D.N.Y. 2005). The Court found the record incomplete and discovery and a trial ultimately necessary to determine various issues, including, whether the short-term commercial paper at issue qualifies as a security, whether the transfers were made to retire and extinguish debt or to trade securities, whether the transfers were common in

the securities trade, and whether the transfers were a result of manipulation. *Id.* at 687. Goldman and other defendants sought leave to file an interlocutory appeal of the Court's decision which motions remain pending before the district court. On March 27, 2006, Goldman filed an "emergency" motion for a stay of discovery pending leave to appeal, and appeal if leave is granted. In support of the stay motion Goldman asserted (1) a high probability of success on its motion for leave to appeal, and then on appeal and (2) harm to the marketplace and in terms of cost that would be suffered if discovery were allowed to proceed. The Court denied Goldman's stay motion on May 10, 2006 finding that Goldman had not offered any evidence demonstrating quantifiable harm to the marketplace nor evidence that the cost of discovery represented any unique or irreparable harm. The Court held that "where . . . 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)." "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 purposes of Rule 26(c)." *Enron Docket Entry #1259, Exhibit A to Order* at 6.

The scope of permissible discovery is defined by Fed. R. Civ. P. 26(b)(1) which provides that "parties may obtain discovery regarding any matter, not privileged, that is relevant to the claim or defense of any party . . . ". Fed. R. Civ. P. 26(b)(1). The information does not need to be admissible at a trial, provided that it is "reasonably calculated to lead to the discovery of admissible evidence." *Id.* Under Rule 26, "relevance for the purpose of discovery is 'an extremely broad concept.'" *Melendez v. Greiner,* 2003 WL 22434101 at *1 (S.D.N.Y. 2003) (citation omitted), *Eastman Kodak Co. v. Camarata,* 238 F.R.D. 372, 374 (W.D.N.Y. 2006*)* (the relevance standard is necessarily broad in

scope in order "to encompass any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case.") (citation omitted). "Given the liberal discovery rules, relevance is rarely a legitimate basis to withhold discovery." *DeSmeth v. Samsung Am, Inc*., 1998 WL 74297 at *9 (S.D.N.Y. 1998). However, a party must show more than just a speculative theory that information might be relevant to a claim or a defense. *Morden v. Intermec Technologies Corp*., 77 Fed. Appx. 424, 427 (9th Cir. 2003) (district court did not abuse discretion in denying plaintiff's discovery request where plaintiff's affidavit in support of request was "based on nothing more than wild speculation"). Yet, while a party must show more than a speculative theory of relevancy to obtain discovery, a party does not have to first prove that it will succeed on its claim before material has relevance. *Murata Mfg. Co., Ltd. V. Bel Fuse, Inc.*, 2006 WL 687172 at *10 (N.D. Ill. 2006) ("Every case Bel Fuse cites in support of its resistence to discovery is either a case detailing what must be established in a summary judgment proceeding or proven at trial. None of the cases supports Bel Fuse's position that it need not produce admittedly relevant discovery materials until after it has effectively proven liability. It is well to recall that discovery need only be relevant to the subject matter involved in the pending action. Indeed, its scope need not even be confined to 'issues raised in the pleadings' or 'the merits of a case'") (citation omitted).

Section 550(a) of the Bankruptcy Code provides that transfers from a debtor that are avoided may be recovered from (1) the initial transferee or the entity for whose benefit the transfer was made; or (2) any immediate or mediate transferee. 11 USC 550(a). Goldman asserts that because it facilitated Enron's transfers to commercial paper holders as Enron's agent it is not an initial transferee from whom such transfers can be recovered. Goldman also asserts that it is not an entity for whose

benefit the transfer was made and that it acted in good faith in undertaking such transactions.

As Goldman described Project Truman, "they were asked by Enron to explore options for the company in response to declines in its stock price and perceived takeover vulnerability and to consider the company's need to prepare for hostile takeovers and sale transactions that might improve its balance sheet." The Movants describe Project Truman as "discussions of a potential engagement under which Goldman would serve as a consultant to advise Enron on ways to stave off the pending financial debacle." Whether Project Truman was brief and exploratory or more substantial, it is relevant to the transactions at issue. In early September 2001, the Goldman Project Truman team allegedly made a presentation to Enron regarding the company's vulnerability and Goldman's proposed strategy with respect thereto. The parties signed an agreement on September 21, 2001 whereby Enron agreed to furnish Goldman with confidential information in connection with the potential engagement. It appears that at least one large-scale meeting was held by the Project Truman team at Enron's offices in Houston. In October 2001, just prior to signing the Agency Agreement, Ken Lay, the CEO of Enron and Robert Hurst, the vice chairman of Goldman had a meeting. There is evidence that discussions from this meeting were disseminated to others in the firm and elsewhere and that Goldman's commercial paper desk may have been made aware of these discussions. Enron points to conversations, for example, between Gary Hickerson, an Enron employee charged with responsibility for commercial paper and Patricia Bonan, head of JP Morgan's Short-Term Fixed Income desk where Mr. Hickerson indicates that the Ken Lay - Robert Hurst meeting was underway and that commercial paper problems would be discussed. In a conversation between them, one hour later, Hickerson indicated to Bonan that Goldman would be undertaking the commercial paper transactions as an agent.

It is not unreasonable for Movants to infer from such conversations that Goldman's Project Truman team, aware of Enron's condition, discussed the agency role Goldman would undertake with Enron on or around the day the payments commenced. Further, any examination of Goldman witnesses that were involved in Project Truman, including Robert Hurst, would likely be informed by documents related to such project. Based on these facts, among others, the Court finds the discovery sought regarding Project Truman may lead to admissible evidence.

Goldman asserts that it was an agent or mere conduit through which Enron paid its commercial paper. Goldman points to the Agency Agreement it signed with Enron on October 28th, October 29th and again on November 9th 2001. An analysis of agency "is a fact-intensive one, requiring consideration of 'the extent of control'" by a principal over its purported agent. *See, e.g., Doe v. Torres*, 2006 WL 290480 at *6 (S.D.N.Y. 2006) *(quoting Leone v. U.S.*, 910 F.2d 46, 50 (2d Cir. 1990)) and *Morales v. Cozy Brokerage, Inc.*, 170 A.D. 2d 201, 202 (1st Dept. 1991) *(*granting motion to compel discovery of defendant on "the nature and term of its agency relationship"). A full examination of the relationships, duties and responsibilities of the parties is required to determine the validity and scope of a purported agency agreement. *Am. Centennial Ins. v. Seguros La Republica, S.A.*, 1995 WL 731630 (S.D.N.Y. 1995). The Court finds that discovery of the Project Truman materials may illuminate the circumstances surrounding the parties entry into the Agency Agreement and may provide the reasons and purpose for such agreement, the intended role of the parties and the timing of its execution. Movants have suggested that transfers may have occurred before the agreement was in place and that certain customers were not aware of Goldman's agency status when selling commercial paper back to Enron. The Court finds that what transpired between Enron and the Project

Truman team leading up to the negotiation and execution of the Agency Agreement is relevant to Goldman's claim of agency. Goldman's argument is effectively that discovery to date has not produced evidence that would challenge the integrity of the Agency Agreement and that nothing in Project Truman could resurrect that challenge. However, whether anything to date puts agency at issue is an open question.

Good faith is not defined in the Bankruptcy Code but courts have found it to include not only "honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage' but also 'freedom from knowledge of circumstances which ought to put the holder on inquiry.'" *In re Manhattan Inv. Fund Ltd.*, 359 B.R. 510, 523 (Bankr. S.D.N.Y. 2007) (citation omitted). "A transferee does not act in good faith when he has sufficient knowledge to place him on inquiry notice of the debtor's possible insolvency." *Id.* at 524 *citing In re Sherman*, 67 F.3d 1348, 1355 (8th Cir. 1995). Good faith is evaluated on a case by case basis and courts look to what a transferee objectively knew or should have known. 359 B.R. at 524. Information concerning what Goldman learned about Enron's financial condition as a result of Project Truman is relevant to the issue of whether Goldman acted in good faith in connection with the transfers. Despite Goldman's assertion that the Project Truman team was institutionally separated from its commercial paper desk, Movants are entitled to see for themselves what Project Truman information was generated, learned or disseminated. Such information is relevant to whether Goldman is a good faith transferee. Further, Andrew Fastow's testimony setting forth his recollection of what transpired does not close the door on an inquiry as to the accuracy of his recollection.

Movants assert that Project Truman is also relevant to the issue of whether Goldman benefitted

from the commercial paper transfers and could thus be liable to disgorgement. Their argument, among others, is that if Enron defaulted on its commercial paper, Goldman would have faced potential liability from its customers. The transfers, therefore, benefitted Goldman by eliminating the risk of exposure to its clients. Movants point to *Franklin Savings Bank v. Levy*, 406 F. Supp. 40 (S.D.N.Y. 1975) which found Goldman liable to its customers for the value of defaulted Penn Central commercial paper. Movants suggest that the Penn Central experience – which resulted in, among other things, an SEC consent decree enjoining the firm from selling commercial paper without regard to creditworthiness and an internal policy manual pointing out the same risks – is evidence of Goldman's awareness of the risks associated with holding commercial paper of a troubled company. Movants also point to the fact that Goldman carried Enron's commercial paper on its books as a "contingent liability." Goldman, on the other hand, argues that it did not receive a disgorgeable benefit, no one at the firm believed there was a possibility of liability based on a potential default by Enron, and Enron did not intend to benefit Goldman when it transferred funds to investors. While Goldman's statement that there was no internal concern over liability may well be accurate, it appears inconsistent with their listing of Enron's commercial paper as such on an internal risk committee Enron exposure sheet. Further, the Court recognizes that there are certainly legal challenges to Enron's benefit theory. Regardless, the Court does not need to reach these issues having found the Project Truman materials to be relevant in terms of understanding Goldman's alleged agency and good faith in this case.

The Court does not find Goldman's suggestion for an *in camera* review of the materials warranted or appropriate. Such review is more appropriate in circumstances involving privileged or confidential information. The Court agrees with the Movants that a court's *in camera* inspection "is no

substitute to full disclosure to, and review of the disputed materials, by a litigant's counsel, who is best positioned to know the party's strategy and assess the relevance *vel non* of the information contained within the disputed materials." *Smith v. Goord*, 222 F.R. D. 238, 242 (N.D.N.Y. 2004). The fact that Goldman offered to make the materials available to the Court and the suggestion by Movants that such materials were previously compiled for a government entity, suggests to the Court that they can be promptly made available. Further, Goldman has acknowledged there is no burden in turning over these materials. And, as the Court noted above, in the event Goldman's concern that expansive, Newby-style discovery should result from this production, Goldman can seek appropriate relief from the Court at that time.

At the hearing, Goldman pointed to several cases in support of its argument that irrelevant evidence is not discoverable. The Court finds the cases distinguishable, however, from the instant facts. In *Heidelberg Americas, Inc. v. Tokyo Kikai Seisakusho, Ltd.*, 333 F.3d 38 (1st Cir. 2003), the 1st Circuit upheld a district court's quashing of a subpoena as unduly burdensome, not on relevancy grounds. The plaintiff was seeking from a non-party, a decade's worth of materials including "any and all documents received, reviewed or generated . . . relating to any type of business affiliation" between the plaintiff and the non-party. The court noted that "some considerable question exists as to how discovery of the materials would lead to admissible evidence . . . [i]n other words, the documents are not obviously, and perhaps not even reasonably, calculated to lead to other discoverable materials. The burden on the non-party . . . by contrast appears to be significant." 333 F.3d at 41. The court cited *Cusumano v. Microsoft Corp.*, 162 F.2d 708, 717 (1st Cir. 1998) where the court held that "concern for the unwanted burden thrust upon non-parties is a factor entitled to special weight in

evaluating the balance of competitive needs." 333 F.3d at 41-42. The case of *Micro Motion v. Kane Steel Co.*, 894 F.2d 1318 (Fed Cir. 1990) is also distinguishable. Unlike here, the case involved a dispute where discovery on damages had been completed and the patent infringement case had been tried once. *Id. at 1323*. Thereafter, following the court's order for a new trial and after the parties had agreed to allow for only "updated" discovery in the underlying patent infringement suit, *id. at 1320-21*, the plaintiff served notices of deposition and accompanying subpoenas on five non-party competitors. *Id. at 1320-23*. One of the stated reasons the plaintiff in *Micro Motion* requested extensive discovery was to *first* determine whether any of the products of the "wholly uninvolved non-parties," infringed on the plaintiff's patent, in addition to enabling the plaintiff "to determine which version or versions of the various lost profits damage theories to pursue." *Id at 1322-23*. Here, Enron is seeking, in the discovery stages of its case, four months of material in order to help disprove defenses asserted by Goldman, a party to the case. In *Malletier v. Dooney & Bourke, Inc.*, 2007 WL 187692 (S.D.N.Y.), the plaintiff moved to enforce a subpoena against Brooks Brothers, a non-party. The subpoena sought all documents concerning the manufacturer of a certain lock Brooks Brothers used on its products which was similar to the plaintiff's trademarked lock. Brooks Brothers challenged the relevance of the information sought. The court held that the plaintiff had failed to demonstrate how the information sought from Brooks Brothers was relevant to any issue in its lawsuit against the defendant, Dooney & Bourke. *Id.* at *1. "Indeed, the principal potential utility to [plaintiff] of this information . . . would be for use in a lawsuit against Brooks Brothers for infringement, but this is not that lawsuit." *Id.*

In light of (1) the discovery posture of this case following a denial of a motion to dismiss and motion to stay discovery; (2) the broad definition of relevance articulated in Fed. R. Civ. P. 26, (3) the

overall relevance of the Project Truman materials to the issues of Goldman's agency and good faith, and (4) the acknowledged lack of burden on Goldman to produce such material, the Court finds that the motion to compel is warranted. As such, the Motion to Compel is granted and the Movant's request to continue the depositions of, among others, Robert Hurst and Scott Gieselman, who were involved in Project Truman, for 30 days following production is also granted.