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Andrew N. Goldman (AG 1010)
James H. Millar (JM 6091)
WILMER CUTLER PICKERING HALE AND DORR LLP
399 Park Avenue
New York, New York 10022
Telephone: (212) 230-8800
Facsimile: (212) 230-8888

Attorneys for Amici Curiae The Loan Syndications and Trading Association and The Securities Industry and Financial Markets Association

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

- -	x	
	:	
	:	Chapter 11
In re:	:	
	:	Case No. 06-10064 (SMB)
MUSICLAND HOLDINGS CORP., et al.,	:	
	:	(Jointly Administered)
Debtors	:	
- -	x	

BRIEF OF *AMICI CURIAE* THE LOAN SYNDICATIONS AND TRADING ASSOCIATION AND THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN OPPOSITION TO WACHOVIA BANK'S MOTION TO COMPEL THE INFORMAL COMMITTEE OF SECURED TRADE VENDORS TO FILE A VERIFIED STATEMENT PURSUANT TO BANKRUPTCY RULE 2019

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The Loan Syndications and Trading Association (the "LSTA") and the Securities Industry and Financial Markets Association ("SIFMA" and, collectively with LSTA, "*Amici*") respectfully submit this brief in opposition to the Motion Of Wachovia Bank, National Association ("Wachovia"), For Order Compelling The Informal Committee Of Secured Trade Vendors To File A Verified Statement Pursuant To Bankruptcy Rule 2019 (the "Wachovia Motion").

PRELIMINARY STATEMENT

Amici's position is grounded in the views of their collective memberships, parties who regularly participate in *ad hoc* or informal groups of bond and bank debt holders during the pendency of chapter 11 cases filed by issuers of that debt. Were this Court were to grant the Wachovia Motion, sophisticated financial institutions would be discouraged from playing active roles in chapter 11 restructurings, a result antithetical to the goals and design of the Bankruptcy Code. By this submission, *Amici* seek to assist the Court in analyzing these issues with due regard for the proper and efficient functioning of the chapter 11 process and the financial markets for trading bankruptcy claims.

So-called "*ad hoc* or informal committees"—which today act as nothing more than a collection of similarly situated holders of claims or interests represented by a set of advisors — nonetheless play a vital role in chapter 11 restructurings. As typically the largest stakeholders in chapter 11 cases, these parties—whose economic rights and interests lie at the heart of such chapter 11 cases—not only give voice to small holders who, acting separately, would have little say in the debtor's restructuring, but also provide the debtor with negotiating partners with the goal of efficiently and economically fashioning a consensual resolution to a bankruptcy case. And, as here, such groups satisfy any practical disclosure concerns, since they publicly disclose

the quantum of their holdings—information which enables the debtor and other parties in interest to understand how large the group's voice looms in the restructuring process.

The Wachovia Motion, however, goes beyond the practical and seeks public disclosure of a market participant's most confidential and proprietary information: the price at which that institution purchased (and/or sold) its claims. In seeking such information, Wachovia points to no reasoning (rational or otherwise) for such information; rather, it simply seeks Pavlovian application of an inapposite rule, which—due to language crafted decades before the emergence of the secondary markets for debt trading—seeks pricing information wholly irrelevant to the orderly administration of the case and restructuring of the debtors. Respectfully, this Court should deny the Wachovia Motion.

STATEMENT OF INTEREST

The LSTA is the trade association for all segments of the floating rate corporate loan market. With over 220 members, including broker-dealers, commercial banks, investment banks, mutual funds, merchant banks, and other major financial organizations worldwide, the LSTA seeks to foster the development of policies and market practices designed to promote just and equitable marketplace principles and to encourage cooperation and coordination with firms facilitating transactions in loans and related claims.

SIFMA is the organization formed from the 2006 merger of the Bond Market Association and the Securities Industry Association. SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers active in U.S. and foreign markets. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services, and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry.

Collectively, *Amici* are uniquely positioned to address the impact that the resolution of this issue will have on the financial markets for trading bankruptcy claims.

ARGUMENT

I. REQUIRING MEMBERS OF INFORMAL GROUPS TO MAKE RULE 2019 DISCLOSURES WOULD HAVE SIGNIFICANT, NEGATIVE CONSEQUENCES

Participants in the postpetition claims trading market consist primarily of financial institutions that make decisions to trade claims or interests based on highly confidential and proprietary methods of valuation analysis. Of critical importance, those participants do not engage in a one-time transaction to buy or sell debt. Rather, each implements its respective investment strategy and manages its risk through a continual evaluation and adjustment to its position in a given credit. As the court-ordered disclosures made in the *Northwest* case demonstrate, that continual process typically gives rise to an extensive series of trades. (*See* Exhibit A, attached hereto.)

Each of these market participants, of course, intends for its investment strategy not only to prove profitable, but also to provide returns that distinguish it from the crowded field of competitors. And each views its strategy as a trade secret to be held in great confidence, not to be shared with its competitors. While a participant will disclose that it has joined a member of an informal group, it will strenuously resist disclosing information concerning its underlying trades for fear that competitors would then have a window into its unique formula for success (and a heightened appreciation for that participant's threshold for risk, upside recognition and downside tolerance).

Approval of the Wachovia Motion—and specifically, Wachovia's request that the Informal Committee of Secured Trade Vendors reveal not only their holdings but the prices at which these entities purchased their securities—will likely have a dramatic effect on the

willingness of financial institutions to participate in the restructuring process. Given the choice between disclosing their highly confidential and proprietary trading strategies, on the one hand, and not participating in informal groups, on the other, most institutions will choose the latter. And that result will threaten serious disruption of the otherwise well balanced mechanisms of the chapter 11 process, since those participants—often the largest true economic stakeholders in a case—will not participate.

First, small stakeholders will suffer the absence of a collective larger economic voice in the case. An institution's willingness to spend the time and energy required to work through often-contentious chapter 11 processes is a function of the price paid for such securities relative to the expected value of the return that such purchase will afford. As one would expect, small stakeholders, if forced to work independently, would not have the financial incentive to expend the time and bear the expense to play a significant role in a debtor's reorganization process. These small stakeholders will thus be left on the sidelines, with no remaining party willing to espouse positions shared by these smaller constituents. Said differently, an informal committee's withdrawal from the restructuring process will leave smaller (but similarly situated) creditors with no practical, cost-effective mechanism to promulgate their views of the restructuring process.

Second and relatedly, the debtor will lose a vital negotiating partner in the restructuring process. In most chapter 11 cases (*i.e.*, cases with complex capital structures), the statutory creditors' committee is comprised of a wide cross-section of creditors, and thus cannot adequately advocate a position on behalf of any one constituency. In those instances, informal groups move to the forefront of the plan restructuring process. While the holders within those informal groups do not divulge to each other their trading histories and strategy, they do

amalgamate into loosely held groups that effectively neutralize any real or perceived conflicts of interest between the various parties in interest. That economical and efficient *ad hoc* process—developed and refined through market forces—provides the best means for organizing suitably cohesive groups of similarly situated holders to negotiate with the debtor over the treatment of their claims or interest and the resolution of the debtor's chapter 11 case. If Rule 2019 is interpreted rotely, it will erect a practical obstacle to a constituent's willingness to participate in that process. Without their participation, the debtor will be forced to endure a time-consuming and intractable series of one-off negotiations with individual stakeholders, thereby substantially interfering with—and dramatically lengthening—the reorganization process.

Third, Wachovia's desired interpretation of Rule 2019 provides no legitimate benefit to this case (or to restructuring processes in general). So long as information concerning the quantum of an informal group's holdings in the aggregate is made available (which is current practice and has been disclosed in this case), the debtor and other parties in interest will have sufficient information to understand how loud that group's voice may loom in the restructuring process. Requiring further disclosure would simply give obstinate parties a bare-knuckled litigation device to use, not for the purpose of obtaining relevant information, but rather to bludgeon an opponent as part of a scorched-earth litigation strategy. Approval of the Wachovia Motion would thus only serve to empower parties to act more litigiously.

II. INFORMAL GROUPS ARE NOT SUBJECT TO RULE 2019

A. Rule 2019 Does Not Apply To Informal Groups Because They Do Not Act As Fiduciaries.

The Wachovia Motion is premised on the assumption that the Informal Committee of Secured Trade Vendors is a true "committee" within the rubric of Rule 2019. In today's environment, that premise is false.

Rule 2019 provides that "every entity or *committee* representing more than one creditor" must file a verified statement pursuant to Rule 2019 disclosing "the amounts of claims or interests owned by the entity, the members of the *committee* or the indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof." Fed. R. Bankr. Proc. 2019(a)(4) (emphasis added).

Here, Wachovia assumes that the Informal Committee of Secured Trade Vendors is a true "committee" simply because of the nomenclature used. Wachovia is wrong. The idea that the applicability of Rule 2019 turns on self-labeling makes no sense, as a collection of creditors could simply call themselves a "group" and defeat much of Wachovia's argument. Rather, as used in Rule 2019, the term "committee" has a more exacting definition in furtherance of a specific purpose.

Informal groups of creditors, such as the Informal Committee of Secured Trade Vendors here, do not satisfy the definition of a "committee". Under both the legal and colloquial definitions, a "committee" constitutes a group of people that act on behalf of others. *See Webster's Third New International Dictionary, Unabridged* 458 (2002) ("a body of persons delegated to consider, investigate, or take action upon and usu[ally] to report concerning some matter of business . . . ."); *see also Ballentine's Law Dictionary* 225 (3d ed. 1969) ("A body of persons who have been selected and appointed with authority to perform some public service or duty"). Indeed, the case law surrounding Rule 2019 likewise makes clear that the term "committee" refers only to groups that act in a representative or fiduciary capacity with respect to other creditors or interest holders. *E.g., Certain Underwriters at Lloyd's, London v. Future Asbestos Claim Representative (In re Kaiser Aluminum Corp.)*, 327 B.R. 554, 559 (D. Del. 2005) ("The purpose of Rule 2019 is to ensure that plans of reorganization are negotiated and voted

upon by people who are authorized to act on behalf of the real parties in interest."); *In re CF Holding Corp.*, 145 B.R. 124, 126 (Bankr. D. Conn. 1992) (Rule 2019 "was designed to cover entities which, during the bankruptcy case, act in a fiduciary capacity to those they represent, but are not otherwise subject to control of the court."); *In re Ionosphere Clubs, Inc.*, 101 B.R. 844, 852 (Bankr. S.D.N.Y. 1989) (Rule 2019 "places the burden on the party seeking agency status for several claimants.").

While it is true that informal groups of creditors or interest holders—like the Informal Committee of Secured Trade Vendors here—nominally label themselves as "*ad hoc* or informal committees", it is beyond dispute that the members do not act on behalf of anyone except themselves and do not stand in a representative or fiduciary capacity with respect to others. Under any construct, these groups are not "committees" within the meaning of Rule 2019.

In promulgating the Wachovia Motion, Wachovia demonstrates its fundamental misunderstanding of the role played by "informal committees" in bankruptcy cases. These groups do *not* typically form a separate entity (a general partnership or limited liability company, for example) to act on behalf of their (or others') collective interests. They do *not* have any agreement that binds them together, whereby the majority can impose its will on the minority. And they do *not* require that their members must remain part of the group for the duration of the case.

Recently in the *ScoPac* case, Judge Schmidt —in denying the very relief that Wachovia seeks here—offered the best description of "informal committees" as just a "bunch of creditors".[1] These groups form when circumstances drive them together. In most every instance, these groups are comprised of stakeholders that:

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[1] Transcript of Hearing, at 4-5, *In re Scotia Dev., LLC*, No. 07-20027 (Bankr. S.D. Tex. April 17, 2007), attached hereto as Exhibit B.

- Hold the same (or substantially similar) types of claims or interests in the debtor (such as unsecured bond debt or secured bank debt);
- Choose to exchange ideas and collectively formulate strategies so that each will realize the greatest return on its respective claims or interests;
- Seek to negotiate in lockstep so that the process can result in a global solution; and
- Engage a single law firm to maximize efficiencies and minimize costs.

When they work together as a group, these participants are engaged in an alliance of convenience. Each seeks only to do what is best in its individual economic interest at that particular time. Nothing prevents any participant from dropping out, either because the holder has sold its position or simply no longer wishes to be part of the group. Indeed, should some—even a majority—of an informal group wish to pursue a path that does not meet with unanimous approval, the dissenters remain free to take their own action and, if they choose, oppose the group effort.

None of these characteristics suggests that any of the members are even empowered to bind other members of the group, much less act on behalf of other creditors generally. They act only for their own benefit, and seek to advance only their own economic interests. Those actions may involve, of course, forming allegiances with others who are similarly situated, but that conduct does not create a fiduciary or representative capacity that gives rise to status as a "committee" for purposes of Rule 2019.

B. The History and Purpose of Rule 2019 Likewise Demonstrate That It Was Intended to Apply to Fiduciaries, Not Informal Groups.

The historical and statutory roots of Rule 2019 confirm that the word "committee", as used therein, does not refer to informal groups (like the one at issue here), but rather refers to committees that act in a fiduciary capacity.

In the 1930s, fiduciary committees were dubbed "protective committees", as they were meant—in theory—to act in "protection of those whose interest they represent". *In re Rosenbaum Brain Co.*, 13 F. Supp. 600, 601 (N.D. Ill. 1935) ("[V]ery frequently large numbers of persons with small means hold bonds in quite small amounts. These creditors have great difficulty protecting their interests"). As the *Rosenbaum Brain* court stated:

> In a great many cases, however, the bondholders' committee is set up by the debtor, itself, or by individuals who promoted the organization of the debtor and the sale of its securities.
>
> * * * * *
>
> As a result of such practices, great public scandal has arisen and there has been much newspaper publicity and many legislative investigations. The public has come to distrust all committees, lumping the good with the bad, though there is no doubt that a very large proportion of the committees are honestly and faithfully performing the duties imposed upon them.

Id.

In the midst of that scandal, the Interstate Commerce Commission received authority to supervise the role of protective committees in railroad reorganizations. *See* Section 77(p) of the Bankruptcy Act of 1935 (11 U.S.C. § 205(p) (Supp. 1938)); *see also* William G. Fennell, *Protective Committees and Deposit Agreements in Railroad Reorganizations*, 49 Yale L.J. 224 (1939). Of critical importance, what are now known as "*ad hoc* or informal committees" were *not* subject to such oversight, as the statute stated, "groups of mutual institutions shall not be prohibited from acting together for their own interests through representatives." 11 U.S.C. § 205(p) (Supp. 1938). This was (and still is) only logical, since only committees that acted in a *fiduciary* capacity—*i.e.*, the *protective* committees—could potentially abuse the power they retained over the stakeholders that they represented. That concern simply did not exist (nor does it today) for institutions acting on their own behalf.

Shortly thereafter, in 1937, the SEC—after undertaking a comprehensive study under the leadership of Commissioner William O. Douglas—issued a report on the widespread abuses of protective committees in bankruptcy reorganizations generally (that is, beyond railroad reorganizations). *See generally Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Parts I-VIII (1937) (the "SEC Report"). Unsurprisingly, the SEC Report "emphasized the need for corrective legislation regulating protective committees", finding that the law should "demand a new and greater measure of assurance that those who act in fiduciary or representative capacities are free from adverse interests and appropriate to themselves only those discretionary powers which are necessary or desirable for the protection of investors." *See* SEC Report, Part II at 528 (1937).

The SEC Report led to the enactment of Chapter X of the Bankruptcy Act (the predecessor to Chapter 11 of the current Bankruptcy Code). *See*, *e.g.*, *Caplin v. Marine Midland Grace Trust Co. of New York*, 406 U.S. 416, 422 (1972) ("Chapter X . . . stemmed from a comprehensive S.E.C. study . . . . In enacting Chapter X, Congress had protection of public investors primarily in mind."); *In re Philadelphia & Reading Coal & Iron Co.*, 105 F.2d 358, 359 (3d Cir. 1939) (the "rules [of Chapter X] were laid down in light of abuses which had become manifest in reorganization proceedings . . . [where] it had appeared that unqualified and unrepresentative committees sought and obtained the right to represent defenseless security holders while actually working in the interests of the debtor or other adverse parties."). The current Rule 2019 can be traced back to Sections 210 and 211 of Chapter X of the Bankruptcy Act of 1938,[2] which later became Bankruptcy Rule 10-211 in 1973.[3] To be sure, the language of the current Rule 2019 is identical to its predecessors in all relevant respects.[4]

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[2] *See* Sections 210 and 211 of Chapter X, enacted as part of the Chandler Act of 1938, 52 Stat. 895.

Thus, the disclosure requirements of Rule 2019—just like that of its predecessors—are intended to prevent abuses by "committee" members whose supposed function is to "protect" other stakeholders as their fiduciary. That is certainly not the function of informal groups, such as the ones at issue here. Indeed, the representatives of the Informal Committee of Secured Trade Vendors cannot abuse their fiduciary duties to other creditors because *they have no fiduciary duties*. As the historical underpinnings of the rule demonstrate, the contention that this Court should force the Informal Committee of Secured Trade Vendors to make Rule 2019 disclosures has no legal or historical footing.

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[3] *See In re Northwest Airlines Corp.*, No. 05-17930, 2007 WL 724977, at *2 (Bankr. S.D.N.Y. Mar. 9, 2007) (Explaining that Rule 10-211 is the "direct antecedent of Rule 2019").

[4] *See* Section 211 of Chapter X, 52 Stat. 895 ("Every person or committee, representing more than twelve creditors or stockholders, and every indenture trustee who appears in this proceeding shall file with the court a statement, under oath, which shall include—(1) a copy of the instrument, if any, whereby such person, committee, or indenture trustee is empowered to act on behalf of creditors or stockholders; (2) a recital of the pertinent facts and circumstances in connection with the employment of such person or indenture trustee, and, in the case of a committee, the name or names of the person or persons at whose instance, directly or indirectly, such employment was arranged or the committee was organized or formed or agreed to act; (3) with reference to the time of the employment of such person, of the organization or formation of such committee, or the appearance in the proceeding of any indenture trustee, a showing of the amounts of claims or stock owned by such person or persons at whose instance, directly or indirectly, such employment was arranged or the committee was organized or formed or agreed to act; and (4) a showing of the claims or stock represented by such person or committee and the respective amounts thereof, with an averment that each holder of such claims or stock acquired them at least one year before the filing of the petition or with a showing of the times of acquisition thereof"); *see also* Rule 10-211 of Chapter X (enacted in 1973) ("Every person or committee representing more than one creditor or stockholder, and every indenture trustee, shall file a signed statement with the court setting forth (1) the names and addresses of such creditors or stockholder; (2) the nature and amounts of their claims or stock and the time of acquisition thereof unless they are alleged to have been acquired more than one year prior to the filing of the petition; (3) a recital of the pertinent facts and circumstances in connection with the employment of such person or indenture trustee, and, in the case of a committee, the name or names of the person or persons at those instance, directly or indirectly, such employment was arranged or the committee was organized or agreed to act; and (4) with reference to the time of employment of such person, or the organization or formation of such committee, or the appearance in the case of any indenture trustee, a showing of the amounts of claims or stock owned by such person, the members of such committee or such indenture trustee, the times when acquired, the amounts paid therefor, and any sales or other disposition thereof.").

III. WACHOVIA'S POINTS LACK MERIT

A. Rule 2019 Does Not Seek To Protect Those Entities To Which No Fiduciary Duties Are Owed.

Wachovia's argument concerning application of Rule 2019 fails, as discussed above, because informal groups are not fiduciaries and are not otherwise "represent[ing]" in any way anyone else's interests. They thus have no obligation to make any such disclosures. But Wachovia's argument also fails for other reasons.

First, Wachovia claims that "full disclosure is particularly necessary in this case because the composition of the Informal Committee has changed during the bankruptcy proceedings." (Wachovia Motion, at 9.) But the Informal Committee *has* disclosed its aggregate holdings. No legitimate purpose is served by requiring this informal group to tell the world the dates and prices at which each member acquired its respective position.

Second, Wachovia's construction of the rule purportedly seeks to protect those that choose *not* to incur the time and expense of participating in the chapter 11 process: the so-called "free-riders." That position, however, runs counter to established bankruptcy policy. Without question, bankruptcy provides a forum where all parties in interest have an opportunity to participate in a process that seeks a fair and equitable resolution and maximizes value for all. But the bankruptcy process encourages parties in interest to vigilantly protect their rights, and does not look favorably on those that sit on their hands. *See, e.g.*, *In re Andersen*, 179 F.3d 1253, 1257 (10th Cir. 1999) ("A creditor cannot simply sit on its rights and expect that the bankruptcy court or trustee will assume the duty of protecting its interests."); *Am. Bank and Trust Co. v. Jardine Ins. Servs. Texas, Inc.*, 104 F.3d 1241, 1246 (10th Cir. 1997) (creditors are obligated to take an active role in protecting their claims); *In re Szostek*, 886 F.2d 1405, 1414 (3d

Cir. 1989) (same). So, too, here. Rule 2019 should not be construed to reward those that choose not to participate.

Third, Wachovia does not explain why Rule 2019 (as it construes that rule) would require a collection of smaller holders acting together to make disclosures for the benefit of other stakeholders, but would *not* require the same disclosures by a single, large and active holder. Stakeholders that follow the lead of others in a chapter 11 case—one could, of course, question the wisdom of uncritically following those that owe no fiduciary duty—would seemingly ascribe the same weight to a single, large holder's strategy as they would to that of a collection of smaller holders that, in the aggregate, hold an equal stake. If Rule 2019 really sought to protect those that do not take an active role, then it would not distinguish between an active group of stakeholders, on the one hand, and a single, active holder, on the other. Because Rule 2019 unquestionably is not applicable to a single, active holder, however, one must conclude that the rule was not intended to protect those that had not ceded control of their claims to a fiduciary and who otherwise remain free to protect their own interests.

B. Even Though Claims Are Sold At Less than Face Value, the Economics of the Debtor's Obligation Does Not Change.

Wachovia might suggest, as it did in its objection to plan confirmation, that members of the Informal Committee of Secured Trade Vendors purchased their claims at a discount, and the other bankruptcy parties in interest know that discounted price. (*See* Wachovia's plan objection, docket no. 1600, at 6.) But that argument misunderstands a fundamental principle of the market for trading in the securities of bankrupt companies: the value of a claim or interest is determined by the nature of the debtor's obligation under the instrument, not by the price paid for that instrument. It is well established law that the consideration paid for a claim or interest is irrelevant to the treatment of such claim or interest in bankruptcy. *Texas Hotel Secs. Corp. v.*

Waco Dev. Co., 87 F.2d 395, 399 (5th Cir. 1936) (transfer of claim during bankruptcy "usually does not deprive the claim of any of its incidents"); *Resurgent Capital Servs. v. Burnett (In re Burnett)*, 306 B.R. 313, 319 (B.A.P. 9th Cir. 2004) (claim filed in bankruptcy case by an assignee may not, in absence of evidence of breach of some specialized duty of assignee, be disallowed solely because assignee does not reveal consideration it paid to assignor) ("[T]he consideration paid by [the assignee] is, as a matter of law, irrelevant to the allowance of [its] claims"), *aff'd*, 435 F.3d 971 (9th Cir. 2006). *See also* Hon. Robert D. Drain, *Are Bankruptcy Claims Subject to the Federal Securities Laws*, 10 Am Bankr. Inst. L. Rev. 569, 575 n.31 (2002) ("[A] discounted purchase price is irrelevant to the ability to enforce the claim in full."). Wachovia's argument is simply wrong.

C. Plan Issues Are Not the Province of Rule 2019.

At bottom, Wachovia obviously has objections to the proposed plan. While *Amici* takes no position on the confirmability of any proposed plan of reorganization, the reality is that if Wachovia seeks to challenge plan confirmation, it should seek whatever information it wishes through typical discovery procedures. Using Rule 2019 as a weapon in a confirmation battle is both inappropriate and abusive. Such tactics cannot be countenanced.

CONCLUSION

For the foregoing reasons, the Court should deny the Wachovia Motion.

August 7, 2007

Respectfully submitted,

/s/ *Andrew N. Goldman*

Andrew N. Goldman (AG 1010)
James H. Millar (JM 6091)
WILMER CUTLER PICKERING
HALE and DORR LLP
399 Park Avenue
New York, NY 10022
Telephone: (212) 230-8800
Facsimile: (212) 230-8888

Attorneys for Amici Curiae The Loan Syndications and Trading Association And The Securities Industry and Financial Markets Association