IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

In re: Winstar Communications, Inc., *et al.*, Debtor.	Chapter 7 Bankr. Case No. 01-01430 (KJC)
Christine C. Shubert, Chapter 7 Trustee, Plaintiff-Appellee, v. Lucent Technologies Inc., Defendant-Appellant.	Civil Action No. 06-147 (JJF) Adv. Proc. No. 01-01063 (KJC)

LUCENT TECHNOLOGIES, INC.'S OPENING BRIEF

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The decision of the bankruptcy court, and the many errors it made, can only be understood against the backdrop of the rapid rise and fall of the telecommunications sector—the bursting of the 1990s telecom bubble. Winstar Communications, Inc. ("Winstar") was one of many telecommunications companies, founded in that decade, that sought to build a global broadband network to provide high-speed telecommunications services to business customers. Following the passage of the Telecommunications Act of 1996, which deregulated the industry, capital flooded into this sector of the economy. At that time, "many companies racked up huge debts laying redundant fiber-optic cables over the same city-to-city routes on the mistaken—and, in retrospect, wildly unrealistic—assumption that demand would keep pace."[1] Because "much of this investment was vendor financed," manufacturers "such as Lucent, Nortel, Motorola, Alcatel and Cisco" lent billions of dollars to the telecom companies that purchased their equipment.[2]

But when the demand for telecom services did not match expectations, "[h]yper competition ensued in various markets across the industry [and] vicious price wars ensued, driving down overall industry and individual company revenues."[3] The results, as FCC Chairman Michael Powell noted, "were devastating." *Id.* at 9. "As some telecom companies began to fail and enter bankruptcy, others resorted to fraud and deception to mask these core fundamental problems facing their companies. Some went so far in their deception to not only mask failure, but to inflate, artificially, revenue growth—to make it look like the dream was real." *Id.*

This case arises from that environment. During the heady days of the telecommunications boom, the debtor, Winstar, and the defendant, Lucent Technologies, Inc. ("Lucent"), entered into agreements intended to create a mutually beneficial strategic relationship. In the course of that relationship, Lucent concededly engaged in some of the

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1 Jonathan E. Nuechterlein and Philip J. Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* 36 (2005).

2 Paul Starr, "The Great Telecom Implosion," *The American Prospect* (Sept. 9, 2002).

3 Michael Powell, Chairman of the Federal Communication Commission, Statement Before Senate Committee on Commerce, Science and Transportation at 8 (July 30, 2002).

misconduct Chairman Powell described. And so too did Winstar. As the telecom sector was collapsing, the parties' relationship deteriorated. When Winstar ultimately filed for bankruptcy, it sued Lucent, claiming (among other things) that Lucent had breached various of the parties' contractual arrangements. Subsequently, the bankruptcy case was converted to chapter 7 and the trustee, Christine Shubert (the "Trustee"), took over the action, adding a new claim, that Lucent had received an improper preferential payment from Winstar prior to the bankruptcy.

The Trustee's case at trial focused heavily on the allegations of corporate misconduct that she leveled against Lucent. Neither the preference statute nor state contract law, however, is intended to provide a remedy for claims of improper accounting or other financial irregularities. Losing sight of that fact, the bankruptcy court made the fundamental error of allowing its distaste for Lucent's conduct to override its obligation to follow governing law. In so doing, the court upset previously settled principles that are critical to commercial lending. Its errors will thus have serious adverse consequences, not only for Lucent, but for any party doing business with companies that may seek bankruptcy protection in Delaware. Faithful application of the correct legal standards requires reversal of the bankruptcy court's judgment.

INTRODUCTION AND SUMMARY OF ARGUMENT

The relationship between Lucent and Winstar began with high expectations all around. In October 1998, the parties entered into a series of agreements under which Winstar would receive financing and Lucent equipment to build its wireless network, and Lucent would grow its customer base by facilitating the success of a large potential customer. Over a period of a little more than two years, Lucent lent Winstar more than a billion dollars, which financed Winstar's purchase both of Lucent equipment, and of equipment and services provided by other vendors.

Two particular events lie at the heart of this case. The first is a financing transaction that took place in December 2000. At that time, just on the eve of the collapse of the telecom sector, and at a time when the once robust relationship between Lucent and Winstar was fraying, Winstar entered into a new strategic relationship with Siemens, a Lucent rival. As part of that relationship, Winstar obtained a new loan of approximately $200 million from Siemens. The net proceeds of the Siemens loan, as the relevant agreements among the various parties all required, immediately went to pay down Winstar's debt to Lucent. This repayment forms the basis of the Trustee's claim that Lucent received an avoidable preference.

The second event took place several months later, in March 2001, just weeks before Winstar filed for bankruptcy. Throughout the parties' strategic relationship, Lucent provided equipment for the building of the Winstar network, and Lucent financed Winstar's purchase of equipment and services necessary to build that network. At the outset, the parties had envisioned that Lucent would itself ultimately play an important role in the actual building of the network. But Winstar never quite permitted Lucent to play the active role Lucent had expected. Instead, at Winstar's request, the parties engaged in a circuitous series of transactions, described by the parties as the "pass-through," under which Lucent was ostensibly building the network, but was subcontracting the actual work to a Winstar subsidiary, Winstar Wireless Inc. ("Wireless"). Through these roundabout arrangements, in essence, Lucent was merely funding Winstar's build-out of its own network, through its Wireless subsidiary. Over time, Lucent grew increasingly disillusioned with the way this "pass-through" practice operated, which was disadvantageous to Lucent, inconsistent with the parties' original understanding, and contrary to the express terms of their agreement. In September 2000, Lucent announced that it was no longer willing to continue to engage in the practice. And in March 2001, Lucent exercised its contractual right to refuse to honor a request made by Winstar seeking to borrow additional funds to pay for services that Winstar said Wireless had performed in building out its network. The Trustee has cast that refusal to make a loan to Winstar as a breach of the "Subcontract" between Lucent and Wireless.

Following a bench trial, the bankruptcy court ruled in favor of the Trustee on each of the counts tried. *First*, the court awarded the Trustee $188.2 million on her preference claim related to the payment of the net Siemens proceeds to Lucent. *Second*, the court found that Lucent breached the "Subcontract" with Wireless, and awarded Wireless $62 million in damages (less an agreed $6.3 million setoff). *Finally*, the court concluded that all of Lucent's claims against the Winstar estate should be equitably subordinated, and that $21 million in liens that Lucent held on Winstar assets should be set aside and transferred to the Trustee for the benefit of the estate.

Preference. In awarding $188.2 million to the Trustee on her preference claim, the bankruptcy court made three separate and independent errors:

First, because Lucent received the Siemens proceeds more than 90 days before Winstar filed for bankruptcy, it could not be held liable for a "preference" unless it was found to be an "insider" of Winstar's. The bankruptcy court's decision, deeming Lucent an insider on the ground that it was a "person in control" over Winstar, represents a dramatic break with prior law. It is settled that a commercial creditor "controls" the debtor for purposes of the preference statute only in the highly unusual circumstance in which the creditor, in accordance with the plain meaning of the statute, actually "controls" the management and business affairs of the debtor.

No evidence in the record permitted the determination that such a circumstance existed here. Indeed, the bankruptcy court made no such determination. Instead, its conclusion that Lucent was an insider rested on its view that some of the transactions between Lucent and Winstar were suspect. That is concededly true. In fact, Lucent, on its own initiative, conducted an internal investigation of certain of the transactions in question, and reported the matter to the SEC. But the record demonstrates at worst that Lucent and Winstar worked together to help each other meet financial targets. As one leading chronicle of the rise and fall of the "fiber barons" put it: "Winstar [followed] a time-tested strategy: You scratch my back and I'll scratch yours."[4] The bankruptcy court simply applied the wrong legal standard. Its conclusion that this type of conduct—absent actual managerial control of the debtor—can render a party an insider amounts to nothing less than a revolution in the world of commercial lending. Indeed, we are unaware of any published opinion in which one public company has been deemed to be an insider of another.

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[4] Om Malik, *Broadbandits: Inside The $750 Billion Telecom Heist* 131 (2003).

This case, without any finding, or even any evidence, of actual managerial control, is a particularly poor candidate to become the first.

Second, the court erred in finding that a transaction in which Lucent simply traded places with Siemens amounted to a transfer of Winstar's property; which is a necessary predicate for a voidable preference. That transaction had no effect on the bankruptcy estate at all. It is a paradigmatic case of "earmarking," in which all parties agreed that Siemens' funds would go to Lucent. It was these funds, not funds belonging to Winstar, that Lucent received in the transfer.

Third, after the alleged preferential transfer, Lucent provided approximately $90 million in unsecured loans and other new value to Winstar. Under the Bankruptcy Code, any preference judgment must be reduced by the amount of that new value. But the bankruptcy court literally failed to address Lucent's arguments relating to more than $60 million of such new value. And the court rejected the only new value argument it did address on bases that are unsupportable: it found the loan to be secured when in fact it was not, and it held that Lucent failed to prove that it provided the new value *after* it had received the alleged preference, when the timing of that new value was neither disputed nor disputable.

Subcontract. The bankruptcy court also held for the Trustee on the so-called "Subcontract" claim, awarding $62 million in damages—notwithstanding that the express terms of the contract were utterly inconsistent with the Trustee's claim. The court reasoned that the Subcontract, which would not obligate Lucent to pay Wireless for services unless Lucent issued a "Task Order" specifically ordering the services for which Wireless sought payment, had been modified by the conduct of the parties. That reasoning incorrectly treats Lucent's temporary, quarter-by-quarter *waiver* of compliance with the "Task Order" procedure as an implicit, unwritten agreement to *modify* the Subcontract to abolish that requirement permanently, despite the Subcontract's express provision that it could be modified *only* in writing and controlling New York law that enforces such a contractual prohibition on non-written modifications. In any event, even if the Subcontract had been modified, Lucent could not have breached it. The record is clear that no exchange of purchase orders and invoices—the conduct that allegedly replaced the requirement of a formal Task Order—occurred in March 2001. The evidence on which the bankruptcy court relied was simply a request by *Winstar* (which was not a party to the Subcontract) that Lucent *lend* it money under their credit agreement. This draw request cannot constitute a demand by *Wireless* that Lucent *pay* it for services under even the allegedly modified terms of the Subcontract, and hence cannot support a claim of breach of contract.

Equitable subordination. Finally, the bankruptcy court erroneously subordinated Lucent's claims against Winstar's bankruptcy estate, ignoring the well-established principle that equitable subordination is a remedial rather than a punitive doctrine, and without making any effort to tailor the subordination to any identifiable harm to creditors caused by the alleged improper conduct, as the law requires. Further, the bankruptcy court went so far as to subordinate Lucent's debt claims to the interests of certain equity holders, in plain contravention of the unambiguous text of the Bankruptcy Code.

The law allows for none of this. The bankruptcy court's decision is replete with legal error, and its judgment must be reversed.

STATEMENT OF THE BASIS FOR THIS COURT'S JURISDICTION

The bankruptcy court entered judgment on December 28, 2005. Lucent timely appealed on January 11, 2006. This court has jurisdiction pursuant to 28 U.S.C. § 158(a)(1).

STATEMENT OF ISSUES PRESENTED ON APPEAL

This appeal presents the following issues:

I. PREFERENCE CLAIM

A. Was Lucent an insider of Winstar on December 7, 2000?

B. Does the earmarking doctrine apply to the alleged preference because Winstar did not transfer an interest in property to Lucent?

C. Was Lucent entitled to the "new value" affirmative defense pursuant to 11 U.S.C. § 547(c)(4)?

II. SUBCONTRACT CLAIM

Did Lucent breach a contract with Wireless?[5]

III. EQUITABLE SUBORDINATION CLAIM

Did the bankruptcy court err by subordinating Lucent's claims to the claims of all other creditors, and to the interests of preferred shareholders, and by transferring Lucent's security interests to the Trustee for the benefit of the estate?

STANDARD OF REVIEW

The bankruptcy court's conclusions of law are reviewed *de novo*. *Centennial & Allegheny Univ. Hosps.-East Tenet Healthsys. Phila., Inc. v. Nat'l Union of Hosp. & Health Care Employees (In re Allegheny Health, Educ. & Research Found.)*, 383 F.3d 169, 175 (3d Cir. 2004). With respect to core matters, the bankruptcy court's findings of fact are reviewed for clear error. *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 208 (3d Cir. 2000). Lucent contends, however, that the Trustee's Subcontract claim is non-core. If Lucent prevails on that point, the findings of fact related to that claim would be subject to *de novo* review. *In re Allegheny Health*, 383 F.3d at 175. *See infra* at 54-55 n.56.

NATURE AND STAGE OF THE PROCEEDINGS

Winstar and Wireless filed chapter 11 bankruptcy petitions on April 18, 2001. That same day, they brought this adversary proceeding. The bankruptcy court held a bench trial in the spring of 2005, the parties submitted proposed findings and conclusions, and the court heard oral argument in June 2005. The bankruptcy court issued its Memorandum of Decision on December 21, 2005, and on December 28, 2005, entered final judgment in favor of the Trustee. This is an appeal from that final judgment.[6]

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[5] Lucent contends that the Subcontract claim is a non-core matter pursuant to 28 U.S.C. § 157 and that it has not consented to the entry of judgment by the bankruptcy court. *See infra* at 54-55 n.56.

[6] With respect to non-core claims, the bankruptcy court lacked the authority to enter judgment, but rather had the authority only to enter proposed findings and conclusions that would be subject to *de novo* review by the district court. *See* 28 U.S.C. § 157(c)(1); *infra* at 54-55 n.56. Because the bankruptcy court's order is styled as a "judgment," however, Lucent filed a notice of appeal and is herein pursuing this appeal from that purported judgment. In addition, out of an abundance of caution, Lucent also filed, on January 3, 2006, an objection to proposed findings

STATEMENT OF FACTS

Winstar was a telecommunications carrier seeking to create a global broadband network to provide services to business customers. DX 211 at Part 1, ROA 689.[7] It developed an innovative wireless platform that allowed it to offer broadband services without the cost of laying fiber at each customer site.[8] Instead, Winstar installed a dish at a business site (a "B site") and transmitted data via a wireless platform to a "hub," from which fiber cable transmitted the data to a network. *See id.*

Wireless was a wholly-owned subsidiary of Winstar, serving as the engineering arm of the company. Wireless's primary business was the design, construction, and build-out of the network. Jt. Stip. at ¶¶ 1, 2, ROA 327.

Lucent, a 1990s spin-off of the AT&T systems and technology unit, is a global leader in the business of designing and delivering telecommunications products, systems, and services to telecommunications carriers.

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and conclusions per Fed. R. Bankr. P. 9033(b). Appellant's Designation of Items to be Included in the Record on Appeal, Tab 353 ("ROA 353").

7 At trial, exhibits were designated as "PX" (plaintiff's exhibits), "DX" (defendant's exhibits), or "JX" (joint exhibits). Trial exhibits are thus cited herein by exhibit number, and document number in the record on appeal ("ROA"). Each deposition transcript that was admitted into evidence bears a "JX" designation. They are cited by reference to the JX number, the location in the ROA, followed by the witness name and page number (*e.g.*, "Kantor Dir. at __"). Trial transcripts are cited by the transcript volume number, followed by the page number. For example, testimony found at pages 29-30 of the transcript of day 16 of the trial is cited as "16-29-30 (Wilson Tr.)."

The Memorandum of Decision Including Findings of Fact and Conclusions of Law with Respects to Count VII and X, and XI of the Second Amended Complaint and Counts 5 and 6 of the Second Amended Answer and Counterclaims (Dec. 21, 2005) is cited as "Op." The Renumbered Joint Stipulation as to Uncontested Facts is cited as "Jt. Stip."

For the Court's convenience, Lucent's Appendix contains the parties' designations for the ROA, and the principal documents cited herein (or excerpts thereof), numbered to correspond with the ROA.

8 Prior to the telecom boom, telecommunications transmission relied primarily on copper wires. With the boom, companies began laying fiberoptic cable for high volume broadband uses that copper could not accommodate, such as video-streaming, teleconferencing, and other internet-based services.

A. The Parties Begin A Strategic Relationship Intended For Mutual Benefit.

On October 21, 1998, Lucent and Winstar entered into a strategic relationship whereby Lucent agreed to collaborate with Winstar in the financing and build-out of its network. PX 331, ROA 1573. At that time, each party believed that its own success would be furthered by the success of the other. Lucent hoped to facilitate the development of Winstar's business, thereby fostering the growth of a large potential customer and creating a new market for its products. Winstar benefited from Lucent's established industry presence and its agreement to finance Winstar's network build-out. *See id.*; *see also* DX 699 at 14, ROA 1178 (Ackerman SEC Tr.).

The parties initially structured their relationship around two key agreements: the Supply Agreement and the First Credit Agreement.

The Supply Agreement. The Supply Agreement, entered into in October 1998, described the parties' respective obligations for the build-out of Winstar's network and provided that Lucent would supply Winstar with products and certain services for the network build-out. Jt. Stip. at ¶6, ROA 327. As regards products, Lucent was obligated to provide "best of breed" equipment. DX 28 at § 2.3(a), ROA 506 (Supply Agreement). In instances where Lucent itself could not provide best of breed equipment, it agreed to finance Winstar's purchases of such equipment from other vendors. *Id.* at § 11.3(c). Winstar in turn agreed to buy from Lucent a set proportion of the equipment and services it purchased using funds it borrowed under the Lucent credit agreement: 65% Lucent content during the first year, and 70% thereafter. *Id.* at § 11.3(b)(i).

In addition, the Supply Agreement also addressed how the network build-out would be managed. Because Lucent did not yet have all of the necessary experience or capabilities required to build out a global communications systems network,[9] the Supply Agreement gave Lucent up to five years to collaborate with Winstar and develop certain capabilities. *Id.* at § 3.1

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[9] ROA 371 at 16-22-23 (Wilson Tr.); JX 1, ROA 460 (Kantor Cr. at 52-53).

and at Schedule A § 3.3(b). The parties specifically agreed that Lucent "would work together with Winstar on how to transition those services and those capabilities to Lucent as Lucent acquired those core competencies and both parties were comfortable that [Lucent] was able to assume them."[10] The Supply Agreement thus contained an agreement between the parties to agree on a "Transition Plan," defining Lucent's role in managing the network build-out. The Supply Agreement obligated Lucent to perform only those services specifically ordered by Winstar, "subject to the Transition Plan." *Id.* at §§ 1.1(kk) & 6.1(a); *see also* DX 390, ROA 869.

The First Credit Agreement. To set the parameters of Lucent's obligation to finance the build-out of the Winstar network, the parties executed, contemporaneous with the Supply Agreement, a credit agreement (the "First Credit Agreement"). Under the First Credit Agreement, Lucent became the primary secured lender to Winstar and provided a $2 billion line of credit (with a $500 million limit on outstanding borrowings at any one time). To secure the financing, Winstar gave Lucent a lien on virtually all of its assets. Op. at ¶ 27, ROA 347.

B. The Parties Execute The "Subcontract" And Thereafter Engage In "Pass-Through" Transactions To Finance The Build-Out Of Winstar's Network.

In the months following the execution of the Supply Agreement and the First Credit Agreement, Lucent and Winstar failed to agree on a Transition Plan. Even before the execution of the principal agreements, there was reason to believe that reaching an agreement on a Transition Plan would be an on-going source of dispute. After Lucent provided Winstar a draft "Winstar/Lucent Partnership Concept," Nate Kantor, President and COO of Winstar, sent an internal email to Winstar's Chairman and CEO to say that he doubted that Lucent had "all the skills in place to actually make this happen." DX 695, ROA 1174. Instead, he suggested the creation of a separate Winstar subsidiary (which ultimately became Wireless) "that does Engineering, Program Management, Construction, etc. . . . I want Lucent to actually buy services from us as part of the deal and wrap it all under this agreement." *Id.*

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[10] ROA 371 at 16-23 (Wilson Tr.); *see also* JX 1 at 52-53, ROA 460 (Kantor Cr.).

At Winstar's request, the parties settled on an arrangement that was similar to what Kantor had earlier suggested in his internal email. In March 1999, Lucent and Wireless entered into an "Agreement For Network Build-Out Services," which they referred to as the "Subcontract," made effective as of January 4, 1999. DX 117, ROA 595. Under the Subcontract, the parties agreed that insofar as Lucent sought to request services from Wireless, it would send Wireless a "Task Order." Wireless would then perform the ordered services. *See id.* at § 1.1; *see also* DX 141, ROA 619. Lucent would in turn pay Wireless in accordance with the agreed-upon Task Order. *Id.* at § 4.1. The Task Order requirement thus served to permit Lucent, insofar as it took on responsibility to build out the Winstar network, to determine which services it would provide, and which services to subcontract to Wireless or to another third party.

In fact, however, the only Task Order that Lucent issued Wireless was for the first quarter of 1999. Thereafter, between March 1999 and September 2000, the parties engaged in the following roundabout exchange of paperwork: (1) Winstar sent a purchase order to Lucent for services performed by Wireless in building out Winstar's network; (2) Lucent, in turn, sent a purchase order to Wireless for those services; (3) Wireless invoiced Lucent for the services performed, as described in the purchase order it had received; (4) Lucent invoiced Winstar in the same amount for the same services; (5) Winstar drew on the Credit Agreement and used the funds it borrowed to pay Lucent's invoice; and, finally (6) Lucent used the funds it had just received from Winstar to pay Wireless's invoice.[11] The purchase orders, invoices and funds were all exchanged on the same day, to avoid any accounts receivable issue. DX 274, ROA 753; DX 239, ROA 718. The net effect was that Winstar built out its own network, through its subsidiary Wireless, and borrowed the money to pay for the build-out by drawing on its credit line from Lucent.

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11 *See* DX 274, ROA 753; DX 714, ROA 1193; *see also* ROA 371 at 16-44-45 (Wilson Tr.).

The pass-through transactions were structured to allow Winstar to obtain favorable accounting treatment. DX 141, ROA 619; DX 125, ROA 603. Specifically, the inspiration for structuring the pass-through this way stemmed from Winstar's desire to capitalize otherwise non-capitalizable costs associated with the build-out, and thus improve its stated financial position.[12] Lucent agreed to the pass-through arrangement for the first quarter of 1999. DX 117, ROA 595. But Lucent soon discovered that the transactions yielded it no benefit, and indeed imposed administrative costs to process, track, and manage. DX 163, ROA 641; *see also* ROA 371 at 16-30 (Wilson Tr.). In addition, because financing the cost of services performed by Wireless did not increase Lucent's collateral, this arrangement diluted Lucent's collateral base, thereby weakening Lucent's protection in the event of bankruptcy and interfering with its ability to market the Winstar loans. *See* DX 155, ROA 633. The arrangement also deprived Lucent of the revenues it anticipated receiving in connection with its building of the Winstar network. Lucent thus announced its objection to the practice in early June 1999, *see* DX 155, ROA 633; DX 163, ROA 641, but nevertheless agreed to pass through Wireless-performed services in the second quarter of 1999, on the understanding that the parties would thereafter work to discontinue the practice by developing a Transition Plan. ROA 371 at 16-54 (Wilson Tr.).

In July 1999, Lucent and Winstar began negotiating toward a relationship that would have Lucent managing as much of the build-out as possible. DX 164, ROA 642; DX 168, ROA 646. In August 1999, Lucent provided Winstar with a document outlining a proposed "turnkey" approach, under which Lucent would provide overall management of the build-out. DX 168, ROA 646. Winstar, however, was unwilling at that point to allow Lucent to play such an active role in the building of its network. DX 169, ROA 647. Rather than say so, Winstar dragged out the negotiations over the turnkey proposal through the end of 1999. *See* DX 195, ROA 673. Lucent—believing that the parties were still negotiating towards a turnkey relationship—

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12 ROA 371 at 16-29-30 (Wilson Tr.); *see* DX 125, ROA 603.

continued to perform the pass-through transactions that Winstar had first proposed. *See* ROA 371 at 16-61-62 (Wilson Tr.); *see also* DX 214, ROA 692.

C. Winstar Assists Lucent In Meeting Revenue Targets; Lucent Provides Winstar Reciprocal Benefits.

Nevertheless, Lucent obtained advantages from the parties' business relationship. Because of its ambitious network build-out plans, Winstar was a substantial customer for Lucent equipment. *See* DX 28 at § 2.3, ROA 506 (conferring preferred supplier status). And Winstar did purchase equipment on a timetable that helped Lucent achieve revenue targets. But the record is replete with evidence that these benefits ran in both directions.

Winstar took full advantage of Lucent's desire to meet market expectations, and used that as leverage to bargain for favorable terms. At times, Winstar would use this leverage to demand favorable pricing, as in December 1999, when Winstar negotiated a 30 percent price reduction on Lucent's prices on long-haul optical products and services. ROA 371 at 16-69-70 (Wilson Tr.). On other occasions, Winstar would ask for reciprocal help from Lucent, as the end of a fiscal quarter approached, in meeting its revenue targets. For example, in December 1999, Winstar prevailed on Lucent to purchase $10 million in radios links from Wireless. DX 201, ROA 679; ROA 371 at 16-73 (Wilson Tr.). And in March 2000, Winstar persuaded Lucent to buy $35 million in equipment and services from Wireless. *Id.* at 16-93-94. Winstar also took an aggressive position with respect to the "best of breed" equipment requirement, rejecting products that it believed did not meet that standard—and instead buying equipment from Lucent's competitors. *See* DX 699 at 15-16, ROA 1178 (Ackerman SEC Tr.).[13]

[13] For example, Winstar rejected Lucent's digital cross-connects and routers in favor of equipment from TellLabs and Cisco. Winstar similarly rejected Lucent's AnyMediaFast solution in favor of equipment from a company called AFC. *See* JX 6 at 427-429, ROA 465 (Ackerman Cr., 3/5/04 Dep).

D. At The Height Of The Telecom Boom, Winstar Obtains More Favorable Financing Terms.

By the middle of 2000, the relationship between the companies had become rockier. This was the height of the telecom boom, and Winstar found itself in the enviable position of attracting vast amounts of new capital. In May 2000, Winstar obtained $1.15 billion in new financing to pursue its aggressive build-out plans from a consortium of bank lenders. Op. at ¶ 31, ROA 347. Winstar then drew down on this bank facility to pay off its debt to Lucent under the First Credit Agreement. Jt. Stip ¶ 8, ROA 327. Lucent in turn released its lien on Winstar's assets, Op. at ¶ 32, ROA 347, which were pledged instead to secure the new loans under the bank facility. In May 2000, Winstar also raised almost $1 billion in the form of an equity infusion and $1.6 billion in the form of a public debt offering. PX 186, ROA 1428.

Winstar used this opportunity to extract extremely favorable credit terms under the new Lucent-Winstar credit agreement, the "Second Credit Agreement." DX 29, ROA 507 (Second Credit Agreement). Under this new agreement, Winstar was entitled to have up to $1 billion outstanding at any one time. Jt. Stip. at ¶ 9. Because Winstar had pledged its own assets to secure the loans under the bank facility, the Second Credit Agreement required Winstar to establish special entities, WVF-1 and WVF-LU2, to be the actual borrowers under the agreement. ROA 374 at 19-62-63 (Keefe Tr.). Although Winstar guaranteed the loan, Lucent obtained a lien only on the equity of and assets held by those borrowers, and not on any assets of Winstar or its other subsidiaries. *Id.* at 63-64. Moreover, Lucent agreed that Winstar could draw on the line of credit to purchase not only equipment but also certain services, DX 29 at § 6.06, ROA 507, even though the collateral securing the loan consisted only of equipment (and the proceeds of that equipment).[14] Lucent also agreed to restrictions on its ability to sell the Winstar loans, a highly

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[14] DX 32 at § 1.02, ROA 510; DX 33 at § 1.02, ROA 511 (Security Agreements for borrowers WVF-1 and WVF-LU2 respectively, defining "Collateral" securing the loans under the Second Credit Agreement).

unusual concession. ROA 374 at 19-74-75 (Keefe Tr.). In sum, Winstar effectively doubled its line of credit from Lucent while providing Lucent with a substantially weaker pool of assets to secure the loan, and obtaining other favorable credit terms.

The Second Credit Agreement did expressly provide, however, that if Winstar received any additional funds under the bank facility, *those funds* were to be paid to Lucent to reduce Winstar's outstanding borrowings. *Id.* at 19-74. Specifically, the agreement provided that Winstar could incur additional indebtedness under the bank facility only if "the proceeds . . . were applied to prepay [amounts owed to Lucent]." DX 29 at § 6.12 & § 1.01, ROA 507.

The agreement also included a refinancing provision that allowed Lucent, in its discretion, to issue a "refinancing notice" when Winstar's outstanding borrowings reached $500 million. ROA 374 at 19-75 (Keefe Tr.); *see also* DX 29 at § 2.18, ROA 507. Upon issuance of such a refinancing notice by Lucent, Winstar had 90 to 105 days to prepay or refinance the loans. After that time period, Lucent (1) could increase the interest rate on the loans by two percentage points; (2) could require prepayment or convert its Winstar loans to marketable notes; (3) was no longer required to finance network build-out services (thus increasing the value of the collateral securing the loan); and finally, (4) could enforce the content provisions of the Supply Agreement on a draw-by-draw basis rather than annually. DX 29 at § 2.18, ROA 507; *see also* PX 201, ROA 1443. In short, the refinancing provision gave Lucent the right to take various steps to reduce its exposure, while still allowing Winstar to draw up to the full $1 billion credit limit during the "refinancing period."

Throughout the course of the negotiations on the Second Credit Agreement, Winstar represented to Lucent that it did not intend to draw on the new loan until the fall of 2000. ROA 375 at 20-17 (Perricone Tr.). Just before the loan closed, however, Winstar informed Lucent that it would likely draw on this line in July or August of 2000. *Id.* Then, on May 23, 2000—just 19 days after the closing of the loan—Winstar submitted a draw request for $160 million, DX 686, ROA 1165, even though at the time Winstar had almost $600 million cash on hand, due in part to the recent capital infusion. DX 687, ROA 1166; ROA 375 at 20-20 (Perricone Tr.). Relations between the companies had clearly deteriorated. As one Lucent executive wrote in an internal email: "This is not in the spirit of the new deal. This is reprehensible. The company [Winstar] lied to us about the usage." DX 295, ROA 774.

Lucent set out to assign its Winstar loan to two investment banks, Bear Stearns and Donaldson, Lufkin & Jenrette. ROA 375 at 20-23-25 (Perricone Tr.). The terms that Lucent was able to negotiate were quite favorable, given that the loans were under-collateralized: a sale of the full $248 million for approximately 93 cents on the dollar. *Id.* at 20-25. Despite its earlier contrary indications, however, Winstar refused to agree to the assignment of the loans. *Id.* at 20-25. Thereafter, Winstar continued to borrow heavily under the Second Credit Agreement, and despite the terms of the Supply Agreement, more than half of Winstar's borrowing financed the purchase of non-Lucent equipment. *See* DX 285, ROA 764.

E. The Lucent And Winstar Relationship Further Deteriorates.

Lucent seeks to end the pass-through practice. By September 2000, Lucent was deeply displeased with the state of its relationship with Winstar. The parties had been unable to agree on a Transition Plan relating to the network build-out; Lucent's undercollateralized exposure to Winstar was increasing at a greater rate than Lucent had been led to believe because of Winstar's aggressive use of the Second Credit Agreement, often to purchase non-Lucent products and services; Lucent had absorbed administrative costs for the pass-through of Wireless expenses for six quarters in hopes of obtaining the Transition Plan; and, finally, Winstar had effectively blocked Lucent's attempts to reduce its exposure by assigning Winstar's borrowing to other entities.

Frustrated by the delay in agreeing to a Transition Plan, Lucent determined to end the pass-through practice. *See* ROA 366 at 11-38 (Harris Tr.). On September 22, 2000, Lucent wrote to Winstar stating that it was rejecting Winstar's September 8, 2000 purchase order for services rendered in the third quarter of 2000. DX 390, ROA 869. Winstar ultimately persuaded

Lucent to pass through, once again, the expenses for third quarter 2000 services, as reflected in Lucent's September 27, 2000 letter. DX 424, ROA 903. Lucent stated that thereafter, "Winstar would perform this work only upon prior receipt of a mutually acceptable written purchase order from Lucent (and not at its sole initiative)." *Id.*

The parties enter into the software pool agreement. At the end of the third quarter of 2000, Winstar agreed to a $212 million purchase of goods from Lucent. Op. at ¶¶ 51, 52, ROA 347. That purchase included a software pool agreement, which was an arrangement through which Winstar would be able to obtain access to various Lucent software programs. DX 421, ROA 900. The software pool agreement, which was accompanied by various post-dated ancillary agreements, provided Lucent substantial revenue. Lucent's accounting treatment of this series of agreements was admittedly improper. *See* DX 739 at ¶¶ 52-61, ROA 1219 (SEC Civil Complaint). Lucent itself recognized that issue, conducted an internal investigation, and identified a number of responsible individuals. Lucent thereafter revised its earlier announcement of projected revenue for fiscal year 2000 and immediately reported the matter to the SEC, ultimately paying a substantial fine. ROA 376 at 21-16 (Schacht Tr.).

But Winstar also obtained substantial benefits from entering into the software pool agreement; Winstar extracted, as a concession from Lucent, certain additional services, credits, and price discounts. DX 739 at ¶ 54, ROA 1219; *see also* DX 699 at 104-105, ROA 1178. As the SEC concluded: "[Winstar] understood Lucent's critical need to recognize revenue in its fiscal year ending September 30, 2000, and used that leverage to gain very favorable additional terms for Winstar." *Id.*

Organizational change occurs at Lucent. In this same period, in response to the volatile conditions in the telecom industry, Lucent underwent a substantial internal organizational change. Former CEO Henry Schacht was rehired as CEO in October 2000 to replace Rich McGinn, ROA 376 at 21-8 (Schacht Tr.); Bill Plunkett, liaison to the Winstar account, was terminated, *id.* 21-35; and Nina Aversano, who had been the head of North American sales, left the company, *id.* at 21-

35. Lucent conducted a thorough reexamination of many of its policies, and determined to adopt a more cautious business strategy. To that end, Lucent reigned in its aggressive approach to vendor financing. *Id.* at 21-11-12. Consistent with its overall retrenchment, Lucent examined its accounts and considered issuing a refinancing notice to Winstar. *See id.* at 21-13-15.

Winstar persuades Lucent not to issue a refinancing notice. By October 23, 2000, less than a month after the execution of the software pool agreement, Winstar had borrowed more than $500 million under the Second Credit Agreement, despite being flush with capital in May 2000. DX 285, ROA 764 (total borrowings about $690 million). Because Winstar had exceeded the $500 million refinancing trigger, Lucent considered exercising its right to issue a refinancing notice under the Second Credit Agreement. But Winstar's CEO asked Lucent not to do so, ROA 376 at 21-13-14 (Schacht Tr.), and Lucent acquiesced.

F. Winstar Enters Into A Strategic Relationship With Siemens; Siemens Funds Are Earmarked To Pay Lucent.

By November 2000, Winstar was actively negotiating with Siemens, a direct competitor of Lucent's, to create a new strategic relationship. DX 441, ROA 920. Winstar sought to buy the type of equipment and services from Siemens that Lucent had hoped to sell to Winstar. Likewise, Siemens sought to enter into an agreement that would obligate Winstar to purchase its equipment. *See* DX 474, ROA 953 (Winstar-Siemens Agreement). Moreover, Siemens offered to provide Winstar with financing in the form of an additional $200 million tranche of the existing $1.15 billion bank facility that Winstar had obtained in May of that year. *Id.* By December 2000, that deal was ready to close. DX 518, 997.

All of the relevant parties—Lucent, Winstar, Siemens, and the other participants in the bank facility—understood and agreed that the net proceeds of the Siemens loan would go to pay off debt owed to Lucent under the Second Credit Agreement. As noted, under the Second Credit Agreement, Winstar was required to use the net proceeds of any increase to the bank facility to repay its outstanding Lucent balance. *See, e.g.*, DX 29 at § 6.12(d), ROA 507. At the time of the

Siemens loan, Winstar's indebtedness to Lucent exceeded $750 million. DX 285, ROA 764 & DX 7, ROA 485. Therefore, upon receiving the proceeds of the Siemens loan as an increase to the bank facility, Winstar was required to transfer the proceeds to Lucent to pay down its borrowings. Jt. Stip. at ¶ 23, ROA 327. Had Winstar failed to do so immediately, it would have defaulted under the Second Credit Agreement. That, in turn, would have been a default under the terms of the bank facility, which specified that Winstar's failure to pay any indebtedness over $25 million when due was an Event of Default. DX 284 at § 9.01(f), ROA 763.

Accordingly, in November 2000, one month before the Siemens loan closed, the administrative agent for the bank facility, Bank of New York, informed all of the other lenders in the facility, including Siemens, that the existing bank facility needed to be amended to allow Winstar to use the Siemens proceeds to "repay outstandings under the credit agreement with Lucent." *See* DX 721 at Siemens ICN 02210, ROA 1200. Each of the members of the bank facility, including Siemens, executed that amendment, dated December 6, 2000. *See* DX 516 at 79, Siemens ICN 01539, ROA 995.

Although it would receive the proceeds of the Siemens loan, Lucent was nonetheless displeased with Winstar's decision to obtain the Siemens financing. For one thing, Lucent was aware that as soon as Winstar turned over the Siemens proceeds to Lucent, Winstar would be able to continue drawing on the line of credit provided by Lucent under the Second Credit Agreement. In other words, the pay-down would increase the availability under that loan agreement, leaving Lucent no better off. DX 491, ROA 970. Moreover, Siemens—which became a participant in the bank facility—would share in that facility's stronger collateral base, even though its loan was made later in time. Furthermore, Lucent was effectively being required to finance Siemens products and services, ROA 375 at 20-32-33 (Perricone Tr.); *see* DX 477, ROA 956, and Winstar would now have a new strategic relationship with a major business rival of Lucent's.

During its negotiations of the Siemens loan, Winstar sought to persuade Lucent to waive its contractual right under the Second Credit Agreement to receive the proceeds from that loan.

See e.g. DX 486, ROA 965. Lucent declined to do so. DX 498, ROA 977. On December 7, 2000, Winstar closed on the Siemens loan for $200 million. Jt. Stip. at ¶ 10, ROA 327. That same day, Winstar drew down the full amount of the loan. As it was required to, Winstar immediately transferred the proceeds to Lucent to reduce the outstanding balance under the Second Credit Agreement.[15] *Id.* at ¶¶ 17, 23. Even after Lucent was paid the proceeds of the Siemens loan, Winstar's outstanding borrowings from Lucent still placed it above the $500 million refinancing trigger. Accordingly, on December 19, 2000, Lucent issued a refinancing notice. DX 544, ROA 1023.

G. After December 7, 2000, Lucent Provides Winstar Additional Loans And Other New Value.

On December 29, 2000, Winstar submitted a $62.3 million draw request to Lucent, under the Second Credit Agreement, to finance network build-out services performed by Wireless during the fourth quarter of 2000. DX 9, ROA 487; JX 9 at 38-40, ROA 468 (Montemarano Cr.). Lucent had not agreed in advance to the performance of these services, as Winstar continued to manage the build-out of the network.[16] Consistent with the September 27, 2000 letter, however, Winstar and Lucent no longer engaged in the "pass-through" transactions under the Subcontract. Neither Lucent nor Wireless generated or exchanged any purchase order or invoice for network build-out services performed between September 27, 2000 and December 29, 2000. Lucent initially refused the draw request, but ultimately allowed Winstar to borrow the $62.3 million. In doing so, however, Lucent told Winstar that this funding was a one-time accommodation and

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15 Although Winstar borrowed $200 million from Siemens, it received only $194 million after payment of certain loan fees to Siemens. Winstar paid Lucent only $188.2 million because its partial repayment of its Lucent loan balance entitled it to a refund of loan fees it had previously paid Lucent in May 2000. Jt. Stip. at ¶ 17, ROA 327.

16 As one Winstar employee put it in an email to a colleague: "Lucent seems determined to hire each individual [employee of Wireless]. I have no intention of giving them all the detail that they have requested . . . . My perspective on this process is very simple—we develop a scope of work and associated deliverables, Lucent sub-contracts back to Winstar to provide the work covered in the scope. The process should be that Lucent hires Winstar to provide X deliverable defined in the scope, which would be one PO with a set price, and Winstar just does the work." DX 452, ROA 931.

would not be repeated in 2001. *See* JX 9 at 40-42, ROA 468 (Montemarano Cr.); DX 599, ROA 1078.

Lucent also provided equipment and services for Winstar's network after December 7, 2000, shipping Winstar $28.6 million worth of equipment. ROA 376 at 21-51-52 (Terrell Tr.); PX 480 at ¶ 6, ROA 1722; *see also* DX 644, ROA 1123 (invoices). Winstar never paid Lucent for any of this equipment. *Id.* In addition, Lucent lent Winstar a further $115 million for equipment under the Second Credit Agreement, from late December 2000 through February 2001. Winstar used more than half of those proceeds, $90 million, to purchase non-Lucent equipment. DX 8, 10-11, ROA 486, 488-89.

H. Lucent Refuses To Honor Winstar's March 2001 Request To Borrow.

Notwithstanding Lucent's prior statements that it was ending the pass-through practice, on March 27, 2001, Winstar submitted to Lucent a $62 million request for borrowing under the Second Credit Agreement, DX 668, ROA 1147, stating that the funds would be used to finance network build-out services performed by Wireless during the first quarter of 2001, services for which Lucent did not give its advance direction or consent, and that were not reflected in any exchange of invoices or purchase orders. *See* JX 9 at 50-51, ROA 468 (Montemarano Cr.). Lucent was not required to pay for any such services. In light of Winstar's various covenant defaults under the Second Credit Agreement, Lucent refused to honor the draw request. DX 663, ROA 1142; *see also* PX 409, ROA 1651.

I. Winstar Files For Bankruptcy And Sues Lucent.

On April 18, 2001, Winstar and its affiliates filed voluntary Chapter 11 petitions (Case No. 01-01430), and immediately sued Lucent, initiating this adversary proceeding. The efforts to reorganize the debtors' businesses were unsuccessful, and on December 19, 2001, substantially all of Winstar's assets were sold for approximately $42.5 million. ROA 367 at 12-34 (Scherf Tr.); PX 460 at 10, ROA 1702. On January 24, 2002, the Bankruptcy Court converted the cases to chapter 7.

As of the time of the bankruptcy, Winstar owed Lucent approximately $735 million for unpaid loans, for which Lucent filed proofs of claim. *See* DX 46 at tab A.1 & A.4, ROA 524. With respect to the equipment securing these loans, the parties entered into a series of stipulations during the bankruptcy case in which they agreed that the value of that collateral (which was ultimately sold with the other assets) was only approximately $21 million. Those funds today are held in escrow.

ARGUMENT

I. THE PREFERENCE JUDGMENT MUST BE REVERSED.

The preference statute, section 547(b) of the Bankruptcy Code, provides that a trustee may avoid any transfer of (1) an interest of the debtor in property that is (2) to or for the benefit of a creditor; (3) for or on account of an antecedent debt owed by the debtor before that transfer was made; (4) made while the debtor was insolvent; (5) made between 90 days and one year before the date of the filing of the bankruptcy petition, if the creditor at the time of the transfer was an insider; and (6) that enables the creditor to receive more than the creditor would receive in a distribution in a chapter 7 bankruptcy had the transfer not occurred. 11 U.S.C. § 547(b).

The preference statute serves the fundamental bankruptcy objective of achieving equality of treatment among unsecured creditors. In the immediate period before filing for bankruptcy, a debtor presumably may pay some creditors and not others. These preferential payments to certain creditors run contrary to the goal of equal treatment of creditors. Consequently, a trustee is permitted to unwind certain preferential payments made before the bankruptcy.

The $188.2 million judgment on the Trustee's preference claim entered here, however, must be reversed for three separate and independent reasons. *First*, because Lucent received the Siemens repayment more than 90 days before Winstar filed for bankruptcy, the Trustee had to show that Lucent was an insider of Winstar. She did not and could not. She relied exclusively on evidence of various corporate misdeeds. Until the bankruptcy court's decision in this case, no court had ever found that type of evidence sufficient to establish insider status. The law requires far more: a showing that the insider exercised managerial control over the debtor and its business affairs. There was no evidence in this case of such control.

Second, Winstar never made a transfer of its interest in property to Lucent. Instead, the funds transferred to Lucent were *Siemens* funds that were "earmarked" for Lucent. The transaction at issue did not diminish the estate's property at all: it merely substituted Siemens for Lucent as a creditor. Under established law—and for good and common-sense reasons—such a swapping out of one creditor for another is not a "preference."

Third, even if the payment of the Siemens loan proceeds did give rise to preference liability, the amount of the preference should have been substantially reduced in light of Lucent's affirmative defense that it had provided subsequent "new value" to Winstar under section 547(c)(4) of the Bankruptcy Code. The bankruptcy court's new value analysis ignored entire lines of argument and made no reference at all to the evidence cited in support of this defense.

A. Lucent Was Not An Insider Of Winstar.

Lucent received the $188.2 million at issue more than 90 days but less than one year before Winstar's bankruptcy filing. Thus, for the Trustee to recover the transfer as preferential, she had to prove that Lucent was an insider of Winstar's at the time of the transfer. *See* 11 U.S.C. § 547(b)(4)(B). In holding that Lucent was an insider, the bankruptcy court applied a legal standard wholly unsupported by the governing law. It is settled that an insider must exercise significant managerial control over the debtor's business affairs. The bankruptcy court did not so find, and the record is entirely devoid of any evidence that could support such a finding.

The purpose of the extended preference look-back period for insiders under section 547 is to identify those creditors who so control the operations of the debtor that, if they receive a pre-filing transfer from the debtor, they are likely to have received it not for legitimate business reasons, but because the creditor was manipulating the debtor to the detriment of other creditors. "The basic goals of § 547(b) are (1) to prevent a rush by creditors to dismantle the debtor, and (2) to promote the policy of equality of distribution between similarly situated creditors by preventing debtors from selecting certain creditors to favor by transfers of property on the eve of bankruptcy." *Badger Freightways, Inc. v. Continental Illinois Nat'l Bank and Trust Co. of Chicago (In re Badger Freightways, Inc.)*, 106 B.R. 971, 981 (Bankr. N.D. Ill. 1989). The preference statute allows recovery against insiders and non-insiders alike of transfers made in the 90 days before bankruptcy. But a debtor can plan around the 90-day period. So, for those creditors such as the company's officers and directors, who can direct the debtor's operations and thus control the date on which the debtor files for bankruptcy, the Bankruptcy Code provides an extended preference period. *Id.*

As a matter of law, Lucent was not such an insider. Where, as here, the debtor is a corporation, the Bankruptcy Code provides a list of persons or entities that qualify as insiders. *See* 11 U.S.C. § 101(31).[17] Lucent obviously does not fit—and the Trustee did not contend that Lucent fits—most of the categories specified by the statute. Lucent was clearly not itself a director or officer of Winstar. Indeed, it did not even have a representative on Winstar's board, and no employee of Lucent was an officer of Winstar. Lucent was not a general partner of Winstar; Lucent was not a general partnership in which Winstar was a general partner; and Lucent was not a relative of a general partner, director, or officer of Winstar. Nor was Lucent an affiliate or managing agent of Winstar. *Id.* at § 101(31)(E) and (F). Thus, Lucent could have been a statutory insider of Winstar only if it was a "person in control" of Winstar.[18]

[17] Section 101(31) of the Bankruptcy Code provides that "'insider' includes - . . . (B) if the debtor is a corporation - (i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer, or person in control of the debtor."

[18] Because the statutory definition of insider states only what the term "includes," it provides a non-exhaustive list of insiders. Accordingly, an ostensibly separate category, the so-called "non-statutory insiders," exists. *See Hirsch v. Tarricone (In re A. Tarricone, Inc.)*, 286 B.R. 256, 262 (Bankr. S.D.N.Y. 2002). But, in the commercial and corporate context, courts commonly apply the same standard to determine if an entity is a statutory "person in control" or a "non-statutory insider." *See Butler v. David Shaw, Inc.*, 72 F.3d 437, 443 (4th Cir. 1996) (holding that, to satisfy the non-statutory insider standard, the alleged insider "must exercise sufficient authority over the debtor so as to unqualifiedly dictate corporate policy and the

1. The bankruptcy court applied the wrong standard in concluding that Lucent was a "person in control" of Winstar, relying on allegedly improper transactions rather than requiring actual managerial control on December 7, 2000.

The words of the Bankruptcy Code, like those of any other statute, must be read to mean what they say.[19] The essential requirement of the "person in control" standard is actual managerial control of the debtor. *Lynn v. Continental Bank, N.A. (In re Murchison)*, 154 B.R. 909, 913 (Bankr. N.D. Tex. 1993). To determine whether a creditor exercised actual managerial control, courts look to whether the creditor made personnel decisions, handled payroll or accounts receivable, and otherwise managed the debtor's business. *See, e.g., Butler*, 72 F.3d at 443. The requisite control is "sufficient authority over the corporate debtor so as to [unqualifiedly] dictate corporate policy and the disposition of corporate assets."[20] Thus, a quite substantial body of law makes clear that a "person in control," in the business, commercial, or lender contexts, requires a showing that the creditor exercised managerial or operating control.

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disposition of corporate assets") (quoting *Hunter v. Babcock (In re Babcock Dairy Co.)*, 70 B.R. 662, 666 (Bankr. N.D. Ohio 1986)). Here, the bankruptcy court purported to consider only whether Lucent satisfied the statutory definition of an insider as a "person in control of the debtor." However, the result does not turn on which doctrinal category is employed: because the legal standard is the same, Lucent is neither a "person in control" nor a "non-statutory insider."

19 *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) ("when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms"). In addition, the canon of *ejusdem generis* also supports the conclusion that a "person in control" must exercise control of the same nature, and to the same extent, as the more specific enumerated "insiders." *See Andrews v. United States*, 441 F.3d 220, 223-24 (4th Cir. 2006) ("According to the *ejusdem generis* canon, '[a] general word or phrase [that] follows a list of specifics . . . will be interpreted to include only items of the same type as those listed.'" (citation omitted); *In re A. Tarricone*, 286 B.R. at 263 (employing *ejusdem generis* canon in interpreting meaning of non-statutory insider, in light of section 101(31)(B)(i)-(vi)).

20 *In re Murchison*, 154 B.R. at 913 (citation omitted).

Here, although the bankruptcy court at one point recited the proper legal standard,[21] it declined to apply it. The court did *not* find specific evidence of managerial or operating control. It did *not* analyze whether Lucent unqualifiedly dictated Winstar's corporate policy and the disposition of Winstar's corporate assets. And it did *not* consider whether Lucent controlled such things as Winstar's personnel, payroll or accounts receivable. Rather, the bankruptcy court took the view that the "[t]rue test of 'insider' status is whether one's dealings with the debtor cannot accurately be characterized as arm's-length." Op. at ¶ 135, ROA 347.[22] In so holding, the bankruptcy court erred as a matter of law.

Certainly, some courts have begun the insider discussion by reference to dealings at "arm's length." For example, the Second Circuit has stated that an insider is one who has "a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor."[23] But even these courts have made clear that such general observations cannot replace the requirement that an insider have actual managerial control. "Flexibility notwithstanding, courts have required *evidence of extensive control* before

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21 The bankruptcy court quoted from a case that explained that, in determining whether a creditor is a "person in control," "courts examine whether the creditor had more ability to assert control than the other creditors, whether the creditor made management decisions for the debtor, directed work performance, and directed payment of the debtor's expenses." Op. at 73-74, ¶ 136, ROA 347, quoting *Meeks v. Bank of Rison (In re Armstrong)*, 231 B.R. 746, 749-50 (Bankr. E.D. Ark. 1999).

22 For this proposition, the bankruptcy court purported to quote *Grossman v. Charmoy (In re Craig Systems Corp.)*, 244 B.R. 529, 539 (Bankr. D. Mass. 2000), but that case lends no support to the bankruptcy court's analysis, and does not even contain the language that the bankruptcy court used. To the contrary, *In re Craig Systems* simply noted that whether "the alleged insider dealt at arm's length with the debtor" was one factor a court might consider, but it made clear that, in the final analysis, "[f]or a person to be considered an insider it must appear that they have at least a controlling interest in the debtor or . . . exercise sufficient authority over the debtor so as to unqualif[iedly] dictate corporate policy and the disposition of corporate assets." *Id.* (citations and internal quotations omitted).

23 *Herbert Const. Co. v. Greater N.Y. Savs. Bank (In re 455 CPW Assocs.)*, No. 99-5068, 2000 WL 1340569, at *5 (2d. Cir. Sept. 14, 2000) (Attachment A). *See also Browning Interests v. Allison (In re Holloway)*, 955 F.2d 1008, 1011 (5th Cir. 1992) (courts should consider the closeness of the parties' relationship and whether the transactions were conducted at arm's length).