18-3188

To Be Argued By:
RICHARD J.J. SCAROLA

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In re: LEHMAN BROTHERS HOLDINGS INC., LEHMAN BROTHERS INC.,

Debtors,

344 INDIVIDUALS, Indentified in the
Notices of Appearances of ECF Dkt. Nos. 8234, 8905 & 9459,

Appellant,

—against—

JAMES W. GIDDENS, as Trustee for
THE SIPA LIQUIDATION OF LEHMAN BROTHERS INC.,

Trustee-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF AND SPECIAL APPENDIX FOR APPELLANT

RICHARD J.J. SCAROLA
ALEXANDER ZUBATOV
SCAROLA ZUBATOV SCHAFFZIN PLLC
1700 Broadway, 41st Floor
New York, New York 10019
(212) 757-0007

Attorneys for Appellant

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The 344 individuals identified in the Notices of Appearance at Bankr. ECF#s[1] 8234, 8905 & 8905 ("Appellants"), by their counsel, Scarola Zubatov Schaffzin PLLC, submit this Memorandum on appeal of the District Court's affirmance of the Bankruptcy Court's grant of summary judgment subordinating Appellants' claims under a deferred compensation pension plan as creditors in the Lehman Brothers Inc. ("LBI") bankruptcy and denial of Appellants' cross-motion for summary judgment. The Respondent is the LBI bankruptcy trustee (the "Trustee").

Statement of Subject Matter and Appellate Jurisdiction

The District Court had jurisdiction over the case under 28 U.S.C. §1334(a) and this appeal pursuant to 28 U.S.C. §158(a), based upon the decision [A-603] and order [A-624] of the Bankruptcy Court, *In re Lehman Brothers Inc.*, 574 B.R. 52 (Bankr. S.D.N.Y. 2017), that had subordinated Appellants' claims, and Appellants' timely Notice of Appeal on July 25, 2017 [A-621]. This Court has jurisdiction over this appeal pursuant to 28 U.S.C. §158(d) and 28 U.S.C. §1291, based upon the final order of the District Court of September 26, 2018, *In re Lehman Brothers Inc.*, No. 1:17-cv-06246-AT (S.D.N.Y. Sept. 26, 2018) [SA-1], and its Judgment dated September 27, 2018 [SA-16], affirming that decision of the

[1] ECF cites in this form are to the Docket Nos. in the Bankruptcy Court below, Case No. 08-01420 (SCC) SIPA.

Bankruptcy Court, and Appellants' timely Notice of Appeal on October 24, 2018 [A-764].

Statement of the Standard of Review and of the Issues Presented

This appeal presents the following issues, each of which requires *de novo* review. *See In re Weber*, 719 F.3d 72, 75 (2d Cir. 2013) ("We conduct a 'plenary review' of a decision of 'a district court functioning in its capacity as an appellate court in a bankruptcy case.' …. Thus, we review de novo the bankruptcy court's legal conclusions"):

- Where Appellants entered into deferred compensation pension plan agreements (the "Agreements"[2]) with the debtor's predecessor, Shearson Lehman Brothers Inc. ("Shearson"), in 1985, including a provision that Appellants would be subordinated creditors of Shearson, but, by the plain text of the Agreements, not subordinated with respect to successors of Shearson that might emerge and succeed to the duty to pay Appellants' pensions, is that subordination provision now inapplicable and unavailable to the Trustee for the debtor, LBI, that was a successor to Shearson?

- Where (i) the debtor in bankruptcy had materially breached the parties' Agreements' specific contractual protections against Appellants' exposure to subordination and the risk of the debtor's insolvency, and (ii) Appellants would not have faced this bankruptcy or subordination risk had the debtor performed its prophylactic duties (all facts conceded for the Trustee's motion), do the debtor's breaches negate the Trustee's effort to nonetheless treat Appellants' claims as subordinated?

- Where the Trustee exercised its right in bankruptcy to "reject" the Agreements as executory contracts — through which right a trustee can make an economic choice at the expense of one creditor for the benefit of other bankruptcy estate creditors to "reject" rather than "assume" a contract,

[2] A copy of one of the Agreements is at A-370.

while accepting in exchange as the consequence of rejection that (i) the rejected creditor (here, Appellants) has a claim for breach (measured based on Appellants' pension accruals' value prior to the bankruptcy filing), and also (ii) the rejection negates any further contract burdens on the rejected creditor — is the Trustee precluded from selectively cherry-picking and attempting to save from rejection, and seeking to enforce, the Agreements' subordination provisions, where the law is absolute that the Agreements' burdens on Appellants were vitiated in all respects upon rejection by the Trustee?

As to each issue, Appellants contend that the answer is "Yes," that summary judgment granted to the Trustee should be reversed, and summary judgment should be directed for Appellants (or, at a minimum, there should be reversal and remand for discovery and trial).

Statement of Facts and Statement of the Case

A. *Nature of the Case, Procedural History and Rulings Presented for Review*

This case involves a deferred compensation pension plan formed in 1985 by Shearson. [A-352-53] It was known as the Executive and Select Employees Plan ("ESEP") and was fully funded by Appellants with their own money through voluntary deferrals of income earned and otherwise payable. [A-352-53] The Trustee for the bankruptcy of LBI, Shearson's ultimate successor, seeks subordination of Appellants' pension rights [A-13]; subordinated status would reduce to zero Appellants' already-gutted pensions. [A-392]

The Trustee commenced its case to subordinate Appellants' pension claims through "short form" motions [A-5], rather than an "adversary proceeding" that,

under the Bankruptcy Rules, is similar to traditional litigation and is required by bankruptcy law applicable to trustee subordination cases. Upon Appellants' objection to the "short-form" procedures [A-25], the motion papers were "deemed" by the Bankruptcy Court a "complaint," with service of a summons not required, and the motions were deemed by the Bankruptcy Court to be a "converted" adversary proceeding. [A-79-81] In that unusual litigation posture, Appellants "answered" with the assertion of "defenses" discussed in substantial detail — specific reasons why subordination is not available to the Trustee (or the debtor and its estate) in the circumstances presented. [A-149] Appellants then sought to arbitrate the issues presented here based on the Agreements' narrow arbitration clause requiring arbitration specifically, and only, in "any controversy arising out of or relating to the subordination provisions," but the Bankruptcy Court, exercising discretion in a bankruptcy case, declined to enforce the parties' agreement to arbitrate, *see* Bankr. ECF# 9617, and the District Court, *see In re Lehman Bros. Holdings, Inc.*, 14 CIV. 7643 ER, 2015 WL 5729645 (S.D.N.Y. Sept. 30, 2015), and this Court, *see In re: Lehman Brothers Holdings Inc.*, 663 Fed. Appx. 65 (2d Cir. 2016), upheld the Bankruptcy Court's decision to exercise discretion to nullify the arbitration clause. The Trustee was then allowed to move for summary judgment before any discovery proceedings. *See* Bankr. ECF# 14080. Appellants' opposed, including on the ground the motion was premature as

being presented before any ordinary pretrial proceedings were had; when their objection was denied, Appellants cross-moved for summary judgment in their favor.

The Bankruptcy Court, Hon. Shelley C. Chapman, granted the Trustee's motion and denied Appellants' motion in its decision dated July 17, 2017, *In re Lehman Brothers Inc.*, 574 B.R. 52 (Bankr. S.D.N.Y. 2017) [A-603]. Appellants appealed from that decision in all respects to the District Court, Hon. Analisa Torres, and the District Court affirmed in a decision dated September 26, 2018, *In re Lehman Brothers Inc.*, No. 1:17-cv-06246-AT (S.D.N.Y. Sept. 26, 2018) [SA-1].

Appellants' defenses to subordination are described in Facts §B. Appellants' defenses to the Trustee's subordination case are set forth briefly in their answering pleading [A-149],[3] but also rely on the text of the parties' Agreements (each Appellant signed an agreement identical as to what is in issue, with an example at A-370) [A-353], facts in the public domain, documents

[3] Appellants did not have a context in the Bankruptcy Court in which to plead a complete statement of facts supporting the defenses that they would establish at trial, because they were the defendants in a "converted" adversary proceeding. [A-79-81] In fact, they pleaded far more than typically would be done by way of "speaking" defenses, to ensure that the general parameters of their allegations were known at the pleading stage. [A-149-72] Appellants' defenses are amplified in their Local Bankruptcy Rule 7056-1 Statement of Facts as to Which There Is No Dispute [A-573], and reflected in their discovery requests [A-420-31, 445-49 & 555-56].

annexed to their counsel's Declaration [A-352] and facts stated in sworn submissions in the record below, including the Affidavit of Robert A. Genirs, sworn to March 1, 2017 [A-347], a member of Shearson's senior management principally involved in developing the ESEP plan who communicated on Shearson's behalf with potential participants about it (and also an Appellant himself). Mr. Genirs was Chairman of the "ESEP Committee" and executed for Shearson the ESEP Agreement with each Appellant. [A-347] At the time ESEP was developed in 1985, Mr. Genirs was also the Chief Administrative Officer of one of the divisions of Shearson. [A-347]

B. *Appellants and Their Pension Claims*

Appellants were Shearson employees and were solicited by Shearson to enter into the employee-funded deferred compensation pension plan in 1985. [A-390-91] Appellants self-funded their pensions between 1985 and 1988 in amounts often as much as half of their earned employment income. [A-370] At the same time, Shearson profited from the plan. The plan, common at the time, was very profitable for the employer through tax benefits then available to employer/plan sponsors. [A-580]

LBI, an entity that emerged after numerous material changes to the business that had been the 1985 Shearson, had the duty to pay Appellants' pensions when LBI and its parent, Lehman Brothers Holdings Inc., filed bankruptcy cases in

September 2008. [A-391] By then, Appellants' aggregate pension rights exceeded $1 billion. [A-391] The bankruptcy filing and the Trustee's rejection of the Agreements as executory contracts extinguished future accruals and payments after September 2008, and Appellants now have claims only for approximately $260 million (the amount accrued prior to the September 2008 bankruptcy). [A-391] Appellants as a group today average approximately 78 years old, and now include many widows/widowers or other survivors. [A-392] Appellants have not received a penny of payment since September 2008. [A-392]

C. *The ESEP Vehicle and Its Differences from Earlier Deferred Compensation Plans — Its Size, Timing and the Manner of Its Formation, and the Three Negotiated and Discussed Mitigations of Subordination or Insolvency Risk*

ESEP was unique, as compared with earlier deferred compensation plans created by Shearson and its predecessor entities in the 1970s and 1980s, in terms of both its overall monetary size and the unprecedentedly large, at least for that firm, number of employees to whom ESEP was made available. [A-349] The reason was that upcoming tax law changes would negate the tax benefits making such plans profitable for employers. [A-580] Shearson offered ESEP to an unusually large group of employees to implement a large plan before those tax law changes took effect. [A-349]

The large dollar amount of proposed employee income deferrals led many, including those new to such plans, to voice concerns — in particular, about future risk for the very recently formed new entity that had become Shearson in 1985 out of amalgamation of other, disparate businesses. [A-348] This concern led to negotiations to limit the extent of exposure to future possible insolvency or subordination and provisions to protect the pension benefits that would not be paid for 20 to 50+ years into an unforeseeable future for Shearson and the financial industry. [A-350]

The Agreements ultimately contained the protections against insolvency or possible subordination discussed below.

1. *The Parties' Agreed that the Risk of Subordination Be Limited with Respect to a Possible Insolvency of Shearson but Not Any Future Iteration of Shearson as Shearson and the Industry Would Change*

Appellants assert as one basis for their defenses that the language of the Agreements provides, for reasons discussed here and in Argument §I.A., that their subordination exposure was limited to insolvency of Shearson as it existed in 1985, but would not extend to later successor iterations of Shearson that might arise and succeed to the duty to pay Appellants' pensions. In brief, as also discussed below, in Argument §I.A.1, the Agreements expressly refer to Shearson's "successors" only in key provisions where successors were intended to be included. The Agreements do not similarly use the word "successors" in describing the scope of

possible subordination, and subordination is specified only with respect to Shearson but not to its successors.

a. *The Parties' Agreement to Limit Subordination Risk to Circumstances Then-Existing but Not in the Event of Future Material Change to Shearson*

The limitation on the extent of Appellants' subordination risk arose for the following reasons.[4] In order to bring employees into the plan, Shearson established a committee comprised of senior management which held many extensive meetings with large groups of the current Appellants and other prospective participants. [A-350] That committee's members were also prospective plan participants. [A-350] For reasons discussed by Mr. Genirs in his Affidavit, the end result of these discussions was that the Agreements were agreed by the parties not to contain a subordination risk for Appellants in the event of substantial changes to the very unique business that was Shearson as it was then known and constituted. [A-350] Mr. Genirs' description illustrates the evidence Appellants would adduce in discovery and trial, if necessary, of the parties' negotiations about the extent and limits of acceptable risk that led to their Agreements' risk limitation:

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[4] Appellants maintain that the Agreements' language is clear on its face in limiting their subordination risk, but include this extrinsic evidence both (i) because, if the Court finds the language ambiguous, the extrinsic evidence would resolve any ambiguity in Appellants' favor, and (ii) as background against which the Agreements can be construed.

> "[I]t was discussed expressly that the agreements provided for subordination of the obligations to employees who participated in ESEP in the event there were to be a failure of the Shearson broker-dealer, and it was also discussed, often hand-in-hand, that such a failure was made substantially more remote because of the presence of American Express…. Put differently, it was discussed and understood that we were taking a known and understandable subordination risk that was specific to an entity capitalized as described above and owned by American Express with the mitigation of risk those circumstances afforded; and not a risk of subordination to some future unknown — such as the debtor entity in this case became." [A-350]

> "Those of us in management were of course also eligible to participate in ESEP, and many of us did, to the extent of a substantial financial commitment of our then-current earned employment compensation. We did so with the understanding that we were exposed to subordination to the Shearson broker-dealer as we then understood it, risks we found acceptable. *We did not intend a risk of subordination for others or ourselves if the duty to pay our future retirement benefits were to be held by some future entity that did not afford the same* de facto *assurances against ultimate risk as were present under the American Express umbrella of companies at the time the agreements were made.*" [A-350 (emphasis added)]

> "So we were willing to and did take the risk of subordination with regard to the employer Shearson we then had as it was then known and existed. But we did not take that risk without any limit, as to possible future successors to the duty to pay our retirement benefits. *Doing so would have been taking a grave risk with our current income and future retirement plans, as to a future unknown and unknowable counterparty. We took only that risk we could then know and assess; not a greater risk with our retirement assets were they to be owed by some future successor entity.*" [A-349-50 (emphasis added)]

As is reflected in Mr. Genirs' description, there were two sets of immediate, then-current, characteristics of Shearson and of the financial industry informing the negotiations: (i) Shearson was itself only recently formed — a very recent amalgamation of financial industry businesses consolidated into a new, larger business, but with no track record or assurance of future stability, especially as

measured against the 50+-year timeline for ESEP payments;[5] and (ii) the immediate, then-present, comfort in 1985 of solvency and stability for Shearson because it had just become part of the behemoth American Express group of companies.[6] [A-348] Their upshot was that there was great reason for short-term

[5] Shearson itself was a very new creation in 1985, and Appellants had just experienced huge changes in the nature, size, ownership and capitalization of the entity that employed them. For one, Shearson/American Express and Lehman Brothers Kuhn Loeb, Inc. had only recently merged in 1984, when Shearson/American Express paid $360 million to buy Lehman Brothers Kuhn Loeb Inc. *See* https://en.wikipedia.org/wiki/Lehman_Brothers. (In the absence of pretrial discovery, and with the Trustee not contesting Appellants' description below of the changes at Shearson following 1985, the extensive descriptions of those changes in reliable sources readily available, including sources such as Wikipedia, corroborate Appellants' allegations of those changes. *Cf. Alfa Corp. v. OAO Alfa Bank*, 475 F. Supp. 2d 357, 361-62 (S.D.N.Y. 2007) ("Countless contemporary judicial opinions cite internet sources, and many specifically cite Wikipedia").) Lehman Brothers Kuhn Loeb had itself been formed only in 1977 by an earlier version of Lehman, first acquiring Abraham & Co. in 1975, and then merging with Kuhn, Loeb & Co. in 1977. Shearson/American Express was an American Express-owned securities company focused on retail brokerage while Lehman Brothers Kuhn Loeb was engaged in the very different business of investment banking. The combined firms became Shearson Lehman/American Express in 1984. Significantly, from the start of the newly formed business, the retail brokerage and investment banking lines of business did not mesh well, and even before that, there had been widely known and open conflict between the trading and core investment banking lines of business within the pre-1984 Lehman Brothers Kuhn Loeb. *See* https://en.wikipedia.org/wiki/Lehman_Brothers; https://en.wikipedia.org/wiki/Shearson.

[6] Shearson's status as a part of American Express deeply influenced the ESEP Committee's negotiations with Appellants in defining what would and would not be acceptable risk, because the unique presence of American Express in the corporate mix brought into sharp focus the exposure Wall Street firms faced to future changes in corporate and capital structure. Shearson, as it existed in 1985, at the time of the ESEP negotiations, was generally considered substantially immune

comfort, but also great reason not to accept long-term risk that a future iteration of Shearson would be less financially secure and fail (and wipe out the participants' pensions).

Against this backdrop, the potential plan participants, many being new to pension plans such as ESEP, and looking at contributing a substantial amount of not only their current income, but also their overall net worth, raised with management their significant concerns about these issues — the prospect of further material entity and industry changes and, relatedly, the prospect or risk of subordination during the life of the plan which would see payments still being

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from insolvency risk, both because it was "dependent on American Express for its liquidity and ability to satisfy regulatory net capital requirements" [A-348], and because, as it was a subsidiary of American Express, American Express would stand in the way of insolvency in all but the most dire of circumstances. [A-348] American Express was the ballast. Thus, accepting subordination risk at the Agreements' outset, with regard to Shearson itself as it then existed — as distinct from future, changed Shearson successor entities that might emerge through further, future business changes without the same composition, configuration and ultimate back-up — was not problematic. Mr. Genirs explains these considerations in detail. [A-349] For example:

> "Shearson … was dependent on American Express for its liquidity and ability to satisfy regulatory net capital requirements, and, in turn, American Express was a financial behemoth that was an ultimate backstop against insolvency and any event in which a subordination could have an adverse effect on ESEP participants." [A-348]

Any future, materially different, iteration of Shearson, however, would likely have been a vastly more risky entity. Mr. Genirs further explains this, and the materiality of these considerations to Appellants' willingness to accept then-identifiable and knowable, but not all, future risk, further in his Affidavit. [A-349]

made to some as far out as more than 50 years into the future. In the end, as described by Mr. Genirs, while there was a willingness to accept a known risk that was limited and tangible, it was agreed that the employee participants who are now Appellants would not face risks of subordination/insolvency associated with the unknown and unknowable but very likely changes that would come in the years ahead to the newly created Shearson. [A-349]

b. *The Implementation of the Parties' Agreement to Limit Subordination Risk*

As also discussed in Argument §I.A., the parties' agreement to limit subordination risk was implemented by Shearson, the drafter, by excluding "successors" from the definition of "Shearson" and from the Agreements' subordination provisions. The Agreements were modeled for their text (in large part, word-for-word) on similar earlier deferred compensation plans of Shearson's predecessor businesses (multiple examples are in the record, *see, e.g.,* A-471-544). The essentially standard language used in the earlier deferred compensation agreements was changed in this limited but critical way:

- Earlier agreements had defined "Shearson" (or its predecessor, as the case may have been) at the outset of those earlier agreements to include, expressly, the employer entity's "successors."
- In the ESEP Agreements, instead, the word "successor" was stricken from the definition of "Shearson" and "Company," and, thus, Shearson was not defined to include its future "successors."

- The Agreements did, however, use the "successor" term and concept in order to refer specifically to Shearson's "successors" in the places where it still made sense or was required as a matter of logic or accuracy to do so. In those places, it was necessary and served a different purpose unrelated to subordination, including, as the prime examples, adding the word so as to extend the *obligation* to pay the pension benefits to be an obligation of "successors" of Shearson and to certain payment "clawback" provisions that a successor logically should have the right to invoke.

- The Agreements did not extend subordination risk with respect to Shearson's successors or refer to successors in the subordination clause of ¶9(d) at all.

This was not random or imprecise use of language, but precise drafting of, and a clearly advised change from the models/precedents used for drafting of, the Agreements, and is discussed more fully in the Argument §I.A.1. below, with a full explication of the import to the text of the selective use of word "successor" in some places, but not in the definition of Shearson or in the subordination language in the Agreements. This change had the effect of implementing the parties' intent that subordination exposure would not extend to materially changed successor iterations of Shearson.

To put to rest possible doubt, in the event the Court finds the language ambiguous, Mr. Genirs makes clear that management instructed counsel drafting the Agreements to implement this change to the language which has the effect of limiting subordination exposure to an insolvency of Shearson but not its successors:

> "I and others in senior management of course did not draft the documents that constitute the ESEP documentation, or that implemented the understandings explained above…. I understand and believe the drafting was performed principally by attorneys at outside counsel, including the Willkie Farr & Gallagher firm (I believe in material parts by then junior attorneys to mid-level attorneys implementing instructions from management)." [A-350]
>
> "I am clear, however, that we in management expressed clearly to counsel the concerns described above as to limits of our agreement to be subordinated — in other words, to the then-known and existing Shearson broker-dealer — and that counsel in fact implemented the instruction to accommodate those concerns. I am aware that … the ESEP agreement provides for subordination only in the event of insolvency as to the Shearson broker-dealer, but does not provide for insolvency in the event the obligations to us were to become due to us from a successor entity to the Shearson broker-dealer. That was the intent of both Shearson … and the intent of the claimants in this case who entered into an ESEP agreement with Shearson." [A-350-51]

Thus, consistent with the parties' intent, the Agreements were drafted to provide for a contractually agreed subordination for so long as Shearson was as it was in 1985, but not if and when Shearson would undergo material changes such that a successor entity emerged as a consequence of those changes.

2. *Appellants Were Told of a Further Protection in the Contracts — Found in the Agreements' Plan "Administrative Committee" with Authority to Protect Appellants from Insolvency Risk*

Appellants assert a separate basis for a defense that the Agreements contain an additional protection for Appellants against employer insolvency/subordination explained by Shearson to Appellants during negotiations — in this instance, a protection found in earlier agreements as well, but which was not implemented by

Shearson or LBI. Specifically, the Agreements provide for the establishment of an Administrative Committee, with duties and powers (referred to in numerous places in the Agreements (at ¶2(a), ¶4, including the footnote, ¶5(a), (b), (f) and (i))).

The Agreements, at ¶4, gave the "Administrative Committee" the power to terminate ESEP and pay participants "not less than the amount of compensation theretofore deferred and/or withheld," plus interest as described in the Agreements at a minimum amount and with intent that the rate be the highest available under the Agreements. As explained by Mr. Genirs, the Administrative Committee's power to terminate the plan included the protective mechanism for the benefit of Appellants in the event of financial instability.

> "An additional safety mechanism against insolvency risk was included in the ESEP documentation. Specifically, the plan's Administrative Committee had the authority to terminate the plan and return deferred compensation contributions (including with certain accruals). This provision was included to allow the Administrative Committee, in the event of any future financial difficulties, to remove the ESEP participants from harm's way — by way of subordination and otherwise — by terminating the plan and returning the funds then accrued." [A-351]
>
> "I understand that others recall specific discussion of this provision at some of the meetings I had as a member of management and Chairman of the ESEP Committee with the senior employees who became participants in ESEP. I do not specifically recall any one such public discussion, but agree generally that the provision was in place, and it makes sense that it would have been discussed at those meetings recalled by others." [A-351]

The amount that would be returned is the substantial equivalent of the amounts Appellants are able to claim here. Appellants assert as one of their defenses that

the Administrative Committee was — and was discussed by the ESEP Committee with Appellants as — a separate, additional protection, and one on which Appellants relied, but which Appellants did not receive.[7] As discussed below (A-354 and Facts §D.2.; Argument §II.), the debtor failed to maintain the Administrative Committee at all.

3. *The Agreements Contained the Additional Protection Against Subordination Risk — the "Right the Ship" Duty — in the Event Shearson Faced Financial Trouble*

Appellants assert as a further basis for a defense that the Agreements had an additional material protection against subordination risk in the event Shearson/the debtor hit financial trouble: the Agreements' ¶9(a) mandates that the debtor abide by certain minimum net capital requirements measured by various federal regulations of broker-dealers (as specified in detail in the Agreements) and, if its capital ever were to fall below those levels, the company must suspend ESEP payments due and then, in substance, immediately "right the ship," so that it could make payments again with its capital in compliance — *viz.*, "*shall*, as promptly as is consistent with the protection of its customers, reduce its business to a condition whereby the amounts the payment of which has been suspended could be paid."

[7] Such committees with the same role and authority/power were in place at other firms and in some instances exercised the protection power in the face of a firm's financial instability. It appears this kind of termination was implemented at at least one other firm during the 2008 financial crisis. [A-354]

Agreements ¶9(a) (emphasis added). As discussed below (Facts §D.3.; Argument §II.), the debtor's net capital fell far below the required levels for a period of years before its bankruptcy, triggering the right the ship duty, but the debtor failed to right the ship or to take any other steps mandated by the Agreements. [A-361-68]

D. *The Numerous Events that Occurred After 1985 Which, Under the Defenses Appellants Assert to the Trustee's Subordination Case, Eliminated Exposure to Subordination for Appellants*

Four things occurred after the Agreements were made in 1985 that terminated the risk of subordination under the Agreements. These events are the factual bases for Appellants' defenses to subordination. Three occurred before the bankruptcy:

- Shearson underwent drastic changes as an entity, rendering its later incarnations successors to Shearson such that the subordination provisions no longer had force or effect (§D.1; *see also* Facts §C.1 and Argument §I.)
- the debtor materially breached the Agreements' protections against insolvency and subordination by not establishing or maintaining an Administrative Committee (§D.2; s*ee also* Facts §C.2 and Argument §II.)
- the debtor materially breached the Agreements' "Right the Ship" protections against subordination risk by ignoring its duties once its net capital fell below the right the ship trigger levels (§D.3; *see also* Facts §C.3 and Argument §II.)

Additionally, a fourth defense, explained more fully in Facts §D.4 and Argument §III, is that the Trustee in bankruptcy "rejected" the Agreements when it had the opportunity to reject or adopt the debtor's executory contracts. The Agreements

are such executory contracts, as discussed in Facts §D.4. The effect of rejection is to nullify any right the Trustee might have had to enforce the subordination clauses or invoke selectively any other contact provision against Appellants. (Argument §III.)

1. *Changes to Shearson After 1985 Rendered the Entity into Which It Soon Changed, and Ultimately by 2008, the Debtor LBI, a Successor to Shearson Within the Meaning of the Agreements, with the Result that Appellants' Entitlements Could No Longer Be Subordinated*

Soon after the Agreements were signed, the kind of dramatic and negative, changes to Shearson to which Appellants did not agree to have subordination exposure actually occurred — precipitously, on a huge scale and with fundamental change to the business that had been Shearson. The resulting entity therefore became a "successor" to Shearson. This is well-established by facts in the public domain.

To begin in 1988, Shearson completed a $1 billion merger with E.F. Hutton, forming the new entity, "Shearson Lehman Hutton." *See, e.g.,* https://en.wikipedia.org/wiki/Shearson & https://en.wikipedia.org/wiki/Lehman_Brothers. By comparison, the Lehman Brothers Kuhn Loeb business that had become Shearson itself had been acquired in 1984 for only $360 million. https://en.wikipedia.org/wiki/Lehman_Brothers. Two years later, the Hutton business imploded, with drastic financial consequences, and

was sold, leaving deep financial and reputational losses for the remaining entity, which was again renamed "Shearson Lehman Brothers." *See* https://en.wikipedia.org/wiki/Shearson.

Shortly before the disposition of the Hutton business, in 1990, an entirely new division was formed within Shearson Lehman Hutton, with responsibility for capital markets and investment banking (but not the Shearson retail brokerage businesses), and named "Lehman Brothers" in what was called a "revival" of the pre-1984 Lehman Brothers name. *See, e.g.,* http://www.upi.com/Archives/1990/06/06/Shearson-sets-reorganization-Lehman-Brothers-name-to-be-revived/1531644644800/. In 1993, the asset management and retail brokerage lines of business that had previously operated together with all of the other amalgamated business lines that had been packaged under the name "Shearson" in 1985 were sold to Primerica (later becoming "Smith Barney Shearson"). *See* https://en.wikipedia.org/wiki/Shearson & https://en.wikipedia.org/wiki/Lehman_Brothers. It was then that the new "Lehman Brothers" division first created around the time of the Hutton divestment in 1990 began to operate as "Lehman Brothers Inc.," to continue on, but only as to the capital markets and investment banking line of business. *See id.* Further still, in 1994, the last notional link of that new business to the now-evaporated 1985 Shearson entity was severed when American Express spun off this remaining

business, along with its parent company, to the public, creating an entity even further removed from the 1985 Shearson. *See id.* Thus, the new entity, though it bore a "revival" of the old "Lehman" name, was fully distinct and separated from the business model and structure, the capitalization, the companies and the lines of business that had been amalgamated to form Shearson in 1984, and that existed when the Agreements were made in 1985. It was materially changed — for the worse — in terms of the nature of its more limited scope of business, its size, its capitalization and its ownership. *See id.*; *see also* Argument §I.B.2.

2. *The Debtor's Breach of the Duty to Maintain an Administrative Committee for the ESEP Plan Is a Further Defense to Subordination*

The debtor materially breached its duty to maintain the Administrative Committee, discussed above (§B.2.), which could have protected Appellants from what occurred in this bankruptcy, and Appellants raise this as a further complete defense to the Trustee's subordination case. It is widely understood and not disputed by the Trustee that no Administrative Committee was maintained soon after ESEP went into effect. [A-354] Appellants were thus deprived of this protection for years, including for years while the debtor operated in deep financial distress.

3. *The Debtor's Breach of the "Right the Ship" Duty Is a Further Defense to Subordination*

In the years that followed, the debtor also materially breached the "right the ship" duty, and Appellants raise this as a further complete defense to the Trustee's subordination case. Again, the Trustee did not dispute below Appellants' allegation of this breach for purposes of its own motion. *See* Bankr. ECF# 14128, at 14. In fact, LBI failed to maintain its net capital at the levels required by the Agreements for years before the bankruptcy, and hid that fact; and, upon such failure, failed to take steps the Agreements mandated to protect Appellants from the effects of possible insolvency (and the risk of subordination). The abundant and irrefutable evidence that, among other things leading to the LBI bankruptcy, the debtor's capital was at levels far below the minimum capital requirements and trigger levels in the Agreements' ¶9(a), was compiled at the Bankruptcy Court's direction. This evidence is thoroughly detailed for the Bankruptcy Court in the *Report of Anton R. Valukas, Examiner*, dated March 11, 2010.[8] The debtor employed numerous financial manipulations to misrepresent its financial condition and hide its non-compliance with minimum capital regulations. While lying about its financial condition, the debtor failed to take steps required by Agreements ¶9(a) to correct its financial condition or otherwise protect Appellants' pensions through

[8] The evidence in the Valukas Report is discussed in detail at A-361-68.

mandated steps. If the debtor had not breached the Agreements (and in fact adhered to its right the ship duties when its capital deficiencies triggered those duties), Appellants would have been paid at least their accruals to date, if not their future benefits as well. Argument §II. discusses this defense further.

4. *The Agreements Are Rejected, and Hence Now Vitiated, Executory Contracts, and that Is Yet a Further and Additional Defense to Subordination.*

Appellants also assert the additional defense to subordination that the Agreements are rejected executory contracts. Again, for purposes of its summary judgment motion, the Trustee concedes this. *See* Bankr. ECF# 14128, at 14. As background, and as discussed more fully in Argument §III., a contract is executory if both parties have a continuing material obligation; and in bankruptcy, such a contract can be "rejected" by a debtor's trustee — and hence vitiated if rejected — rather than assumed and performed. The result is that rejection is treated as breach, and a Trustee cannot then rely on or seek to enforce the rejected contract in any respect.

The Agreements are executory contracts because there were significant continuing obligations on both sides at the time the bankruptcy commenced. The Trustee had continuing duties, including to pay Appellants' pension benefits (Agreements ¶2), to maintain the Administrative Committee (Agreements ¶4) and to "right the ship" if the debtor's net capital fell below the minimum requirements

(Agreements ¶9(a)). Appellants had duties including "to repay to Shearson, its successors or assigns" any deferred compensation payments made to them if such payments would have resulted in a violation of minimum net capital thresholds, including in the context of this insolvency (Agreements ¶¶9(b) & (c)), and the Trustee was in fact considering electing to exercise that clause after the bankruptcy. [A-355] In addition, Appellants had the duty to cooperate with Shearson to assist with the pension plan's tax-driven *sine qua non*: securing and maintaining life insurance contracts or other investments to be secured on their lives (including submission to medical exams and similar active participation on demand). Agreements ¶10.

These executory Agreements were automatically rejected when the Trustee failed to assume them within the time mandated by 11 U.S.C. §365(d)(1).[9] As discussed at Argument §III. below, because these are rejected contracts, it is a further defense for Appellants that the Trustee cannot selectively save from the rejection, and rely on or seek to enforce, a subordination provision.

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[9] The Bankruptcy Court issued orders adjourning that date, apparently adjourned for the final time by order dated February 16, 2012, extending the time to assume or reject executory contracts until June 4, 2012. *See* Bankr. ECF# 4913. Below, the Trustee did not dispute that reckoning.

Summary of Argument

Section I.A. argues that the Trustee cannot invoke the Agreements' subordination provisions because the parties' Agreements limited Appellants' exposure to subordination to only Shearson as it was constituted when the Agreements were made, but not to Shearson's "successors." The Courts below disagreed. This Court should reverse because the Agreements' plain text requires the finding that subordination risk was limited to Shearson and not extended to Shearson's successors. By contrast, the Trustee argued below for an unworkable construction of the language and ultimately fell back on the assertion that the language it cannot reconcile should be ignored as drafting error, and overridden to reach the result it seeks. At a minimum, and at worst for Appellants, that text should be deemed ambiguous on this point, requiring reversal for discovery and trial. Section II.B. argues that the debtor, LBI, is unquestionably a successor to Shearson. The correct analysis to determine whether LBI is a successor entity to Shearson is to construe the word "successor" as the parties intended. The only possible construction of "successorship" here would look to material changes in Shearson's areas of business, capitalization, composition of entities and the similar factors bearing on whether changes to the entity materially changed its risk profile for persons in Appellants' relation to Shearson. There is overwhelming evidence of changes to Shearson after the Agreements were made in 1985, which ultimately

resulted in LBI, the debtor, in 2008, being a "successor" under that correct analysis. Further, the Trustee and the debtor have admitted, including judicial admissions, operating as judicial estoppel, that LBI is, in fact, a "successor" to Shearson. The parties made a bargain that Appellants' exposure to subordination would be circumscribed so as not to include any exposure to Shearson's successors, and that Agreement should be enforced.

Section II. argues that the subordination provisions cannot be invoked in any event for an independent and discrete reason: the Agreements included contract duties for the debtor which specifically and directly would have protected Appellants from exposure to subordination risk if performed; but those contract duties were breached, materially, by the debtor. Those protections are clearly stated in the Agreements, and their breach is conceded by the Trustee for purposes of its motion below. Black letter law holds that such material breach vitiates the contracts and all of their burdens on Appellants, including possible subordination. And here, the rule applies with even more force because the material breaches were of duties that actually would have protected Appellants from any possible subordination result.

Section III. argues that the subordination provisions cannot be invoked for an additional, independent reason: the Agreements are "rejected" "executory contracts" under bankruptcy law and, once rejected, any contract burdens on

Appellants are vitiated by the rejection. Rejection is an economic choice a trustee can make for the benefit of a bankruptcy estate; and the law is clear that when a trustee exercises its right to reject and takes the benefits of rejection (here, at the expense of Appellants, who lost their pension rights and received only significantly discounted bankruptcy claims), there are consequences: relieving the rejected other party of all burdens of the contract. The law is also clear, and extensive, that upon rejection, this Trustee may not selectively save — "cherry-pick," as the cases describe it — a provision such as the subordination clause it would like to keep after rejection. The Trustee below adduced not a single case to the contrary in the face of Appellants' extensive authority supporting this defense.

To the extent there is doubt on any of these three issues, the result should, in all events, be reversal because there is a perceived ambiguity in the Agreements which can only be resolved at trial after discovery.

Section IV. addresses Appellants' right to summary judgment in their favor on this record.

The Decision should be reversed for each of these reasons.

Argument

Summary judgment is appropriate only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits ... show that there is no genuine issue as to any material fact and that the moving

party is entitled to a judgment as a matter of law." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 247-248 (1986); "[a]ll ambiguities must be resolved and all inferences drawn in favor of the party against whom summary judgment is sought," and the motion should only be granted "[w]hen no rational jury could find in favor of the nonmoving party because the evidence to support its case is so slight." *Gallo v. Prudential Residential Servs., Ltd. Partnership,* 22 F.3d 1219, 1223-24 (2d Cir. 1994). "[W]hen the party opposing the motion has not been dilatory in seeking discovery, summary judgment should not be granted when [it] is denied reasonable acces s to potentially favorable information." *Robinson v. Transworld Airlines, Inc.*, 947 F.2d 40, 43 (2d Cir. 1991). Summary judgment for Appellants rather than the Trustee should have been granted on the undisputed facts and law described below. At worst for Appellants, there should be reversal for discovery and trial.

Standard of Review

Each issue presented on this appeal requires *de novo* review by this Court. *See In re Weber*, 719 F.3d 72, 75 (2d Cir. 2013) ("We conduct a 'plenary review' of a decision of 'a district court functioning in its capacity as an appellate court in a bankruptcy case.' …. Thus, we review de novo the bankruptcy court's legal conclusions"). New York law applies to the issues presented. *Cf*. SA-4.

I.

THE SUBORDINATION PROVISION DOES NOT APPLY BECAUSE, PURSUANT TO THE AGREEMENTS' PLAIN LANGUAGE, IT HAD NO EFFECT ONCE A SUCCESSOR TO SHEARSON EMERGED WITH THE DUTY TO PAY APPELLANTS' PENSIONS

The result below construed the Agreements to be "unambiguously" consistent with the Trustee's reading of them but did so at the cost of nullifying key words and usage in the Agreements, as well as taking no stock of the fact that the Trustee's construction could not even be implemented to govern the parties' relations without engendering absurd results (a fact that serendipitously can be ignored by the Trustee because the bankruptcy, of course, ended the need for that implementation). Appellants show in § I.A. that the text of the Agreements is 100% consistent with Appellants' construction, as well as the parties' intent, that Appellants would cease to have subordination risk if Shearson as it was constituted in 1985 underwent material changes rendering the changed entity Shearson's successor. Appellants show in §I.B. that "Shearson" is defined *not* to include its "successors" (while in other parts of the Agreements where successors are intended to be covered, the word "successors" is used), and that the debtor is such a successor within the meaning of the Agreements and also by the Trustee's judicial admissions that operate as judicial estoppel against the Trustee arguing otherwise.

A. *The Subordination Provision Does Not Apply to Shearson's "Successors."*

By way of preview to §A., first, Appellants show in §I.A.1. that the Trustee would impermissibly ignore, and nullify, the Agreements' limited definition of Shearson and limited use elsewhere of the word "successors." The Trustee labeled the precise use of "successors" as "arguably unnecessary" — in effect, arguing that the Agreements' language should be ignored as a drafting error. *See* Bankr. ECF# 14420, at 7. In fact, the language of the negotiated subordination provision was advisedly and specifically limited to applying in the event of a bankruptcy of only *Shearson*, as the drafter defined "Shearson," but not its successors such as LBI. This is consistent with the common contract practice of pre-defining what rights and duties parties would have if a successor emerges. It is not permitted for the Trustee or a court to rewrite or reform the Agreements to nullify their plain language and intent.

Second, Appellants show in §I.A.2 that the Trustee's reading of the Agreements would not only render the precise language used on this issue in the Agreements a nullity, but also render the Agreements nonsensical and incapable of sensible implementation in many other respects. Any other conclusion would have the words mean, "unambiguously," the opposite of their only possible meaning. Any other conclusion would also violate canons of contract construction and logic

and abrogate the words to which the parties agreed. The District Court's misconstruction of terms in the Agreements is also discussed in §I.A.2.

Third, Appellants show in §I.A.3 that extrinsic evidence — admissible if the Agreements are deemed ambiguous and also to show that Appellants' construction is in any event reasonable and supported by the nature of the parties' relationship and the circumstances under which the Agreements were made — makes it even clearer that Appellants read the Agreements correctly.

1. *The Agreements' Text Is Clear that Appellants Cannot Be Subordinated if There Were a Successor to Shearson such as this Debtor.*

The Agreements provide for subordination, but they do so as to Shearson only, as it is defined, and not its successors. At the time of this bankruptcy, Shearson did not exist and certainly had no creditors.

The drafter's deliberate and selective use of the word "successors" in other provisions of the Agreements, including, especially, in the "Binding Effect" language of ¶11, although not in the definition of "Shearson" itself, is at the crux of this construction issue. This selective use places continuing burdens on successors to Shearson to, in substance, pay pensions to Appellants. The text is equally clear that Appellants' duties and burdens under the Agreements do not extend to successors of Shearson except in the few limited and logically placed contract terms where the word "successors" was specifically used to create such a burden in

those particular, limited and logically identified circumstances. The subordination provision does not use the word "successors" and thus is not one of those limited circumstances.

Specifically, the subordination provision, at Agreements ¶9(d), states:

> "Employee irrevocably agrees that the obligations of *Shearson* hereunder with respect to the payment of amounts credited to his deferred compensation account are and shall be subordinate in right of payment and subject to the prior payment or provision for payment in full of all claims of all other present and future creditors of *Shearson*…" (emphasis added).

It does not extend subordination to Shearson "and its successors," even though other terms in the Agreements *are expressly* extended to successors. Similarly and consistently, Agreements ¶5(d) states that "[t]he payments to be made by Shearson to Employee hereunder are unsecured subordinated obligations of *Employer only*, and Employee is only a general subordinated creditor of *Shearson* in that respect" (emphasis added).

The critical point is that while these provisions refer to "irrevocabl[e] … subordination," they define, describe and limit the scope of that risk if a successor to Shearson were to emerge, and the entity to which subordination risk was assumed by Appellants, in the same manner contracting parties typically draft a

contract to apply to some things and not to others. There is nothing odd or anomalous in circumscribing by contract what transpires in a successor scenario.[10]

The critical language supporting Appellants' contention is this: "Shearson" is the defined term in the Agreements, in the opening paragraph, for "Shearson Lehman Brothers Inc.," with no inclusion of "successors" in that defined term. Similarly, the term "Employer" (used in ¶5(d)) is defined in the same paragraph as that same entity "for itself and as agent for certain of its subsidiaries as provided in paragraph 8," again with no mention of "successors." Further, ¶8, entitled "Parties to Agreement" states that it "is between Employee and Shearson or a subsidiary or affiliate of Shearson for which Shearson is acting as agent hereunder, whichever is Employee's actual employer as of the date hereof;" and again, "successors" does

[10] Contracting parties commonly define the scope of their rights and duties should a successor to one emerge. The District of Columbia Court of Appeals summarized cases so holding:

> "Initially, we note that [successor] is a word with many legal applications and that it is therefore difficult to define precisely. Recognizing this difficulty, Mr. Justice Marshall once remarked, 'There is, and can be, no single definition of "successor" which is applicable in every legal context.' …. To determine the meaning of 'successor' in the area of labor law, Mr. Justice Marshall appears to endorse a case-by-case approach with emphasis on the facts of each case…. *The same fact-oriented approach has also been employed by courts in defining the limits of purely contractual successorship*. *Van Deusen v. Ruth*, 343 Mo. 1096, 1103 (1938); *Thompson v. North Texas National Bank*, 37 S.W.2d 735, 739 (Tex.Com.App.1931)."

Safer v. Perper, 569 F.2d 87, 95 (D.C. Cir. 1977) (citations omitted) (emphasis added).

not appear at all. The word "successors" does, then, however, appear in other select and logical places in the Agreements.

In contrast to the definition and use of "Shearson" as not including successors, the drafter used the term Shearson's "successors" (and "assigns") expressly and with precision in three *other* provisions of the Agreements where such references were needed to implement a logical and necessary result. Express "successorship" language implementing that intent appears in ¶11, in which the word "successors" was used by the drafter in the last paragraph of the Agreements' ¶11, entitled "Binding Effect," containing the following plain statement making it clear that in the event a successor entity to Shearson emerged, that entity would have Shearson's duty to pay the pensions and will be *bound by* all of Shearson's other duties and obligations in the Agreement:

> "This agreement shall be binding upon Employee and Employee's heirs and legal representatives and upon Shearson and Shearson's successors and assigns. Employee's rights hereunder, including rights to receive payments, are not assignable."

There is also express use of "successor" in the two other provisions appearing *immediately prior to* ¶9(d) (the subordination clause) — ¶¶9(b) and 9(c) — where it was necessary and logical to implement a right Shearson or, as the case might be, its successor, would have to recoup from Appellants certain benefit payments in some limited circumstances, regardless of whether Appellants would return money to Shearson or a successor. *But nonetheless "successors" is not used*

in the very next paragraph, ¶9(d), which is the Agreements' subordination language itself.

Thus, the omission of the word "successor" in both the definition of "Shearson" and its omission in ¶9(d)'s subordination clause — while it is selectively used in the preceding sub-paragraphs of ¶9 and in ¶11's "Binding Effect" provision — can be read to provide for subordination only in the event of insolvency of the 1985 Shearson entity, but not its "successors." These selective uses of the word "successors" show that the drafter plainly knew how to use the word "successors" where it was needed and intended, and how to define a key term in the Agreements, such as the meaning and identity of "Shearson." If "successors" had been intended, as the Trustee argued below, to be implied into every use of the word "Shearson," and impliedly included in the scope of the definition of "Shearson," nothing would have been simpler than to have *actually* used the word "successors" in defining "Shearson" or the "Company" — as was done in earlier agreements that served as these Agreements' model (*see* Facts §C.1.b). It is unthinkable that the drafter (while making revisions with the opposite effect — removing "successors" from the definition where it appears in earlier model agreements — nonetheless intended "successors" be implied into the text after all. Yet that is the illogical conclusion with which the Trustee is left and on which it relied below.

Well-settled contract construction rules require that these words be construed as Appellants contend. The fact that the drafter used "successors" in these precise ways and in only three places must be read as intentional, rather than some mere carelessness or inadvertence to be implied away on a pre-discovery motion. The "standard canon of contract construction *expressio unius est exclusio alterius* … [requires] that the expression of one thing implies the exclusion of the other." *See In re New York City Asbestos Litig.*, 41 A.D.3d 299, 302 (1st Dept. 2007); *see also Roberts v. Chesapeake Operating, Inc.*, 426 F. Supp. 2d 1203, 1208 (D. Kan. 2006) ("The parties clearly could have incorporated language to include a successor to the Williams Natural Gas Company because they did so with respect to the Kansas Gas Supply Corp. Under *expressio unius est exclusio alterius,* the Court finds that the failure to include the words 'or its successors' manifests an intent to limit the price index to the Williams Natural Gas Company and not successor companies"). These precise and selective uses of "successors" here is conclusive in favor of Appellants' construction.[11]

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[11] Similar issues as to the parties' intent frequently arise in the law of guaranty, which similarly looks to that intent in determining whether a guaranty remains in effect after substantial changes to the guaranteed entity. *See, e.g., Fehr Bros., Inc. v. Scheinman*, 121 A.D.2d 13, 18-19 (1st Dep't 1986) ("The major inquiry, therefore, has been to determine whether the changes in the entity, the debts or responsibilities of which are guaranteed, have the effect of creating a principal with a new identity and one the debts of which the guarantor never intended to guarantee when he executed the agreement. In this regard, relevant factors include: changes in business name, form, composition, management, or

2. *The Trustee's Textual Reading Would Lead to Absurd Results, and the District Court Relies on an Erroneous Reading of the References to "Shearson" in the Agreements.*

a. *The Trustee's Reading of the Text Is Incorrect.*

The Trustee's explanation of the Agreements results in many irreconcilable logical absurdities, *non sequiturs* and impossibilities that would infect the entirety of the Agreements. This apparently explains the Trustee's ultimate retreat below to the fallback argument that Appellants' construction based on the text can be explained only as drafting error that the Court should disregard. *See* Bankr. ECF# 14420, at 7.

Specifically, for example, the Trustee argued below that it would interpret the "Binding Effect" clause to confer Shearson's and the employees' obligations *and* rights upon Shearson's "successors" and the employees' "heirs and legal representatives" respectively. This construction not only ignores the plain language — which, critically, speaks only of what is "binding upon" successors, not what inures to their benefit, Agreements ¶11[12] — but would also necessarily

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ownership, the involvement of the guarantor in the business entity; and, whether the guarantor participated in the changes. *These factors must be assessed on a case by case basis with due regard given to the guarantor's intent*. Form, however, is not to be exalted over substance") (emphasis added).

[12] Significantly, to have conferred all of the Agreements' rights on Shearson's successors, had that been intended, the "Binding Effect" clause could have contained the boilerplate phrasing found in uniform contract language sources: "[t]his Agreement is binding on *and inures to the benefit of* the parties and their

have many absurd results. It would, for one, mean that the Agreements' many references to the employees' employment/death/retirement/disability would have to be, in equal measure, references to the employment/death/retirement/disability of the employees' heirs and legal representatives, yielding numerous *non sequiturs* but also, in effect, creating the impossibility of a whole second pension plan with the heir and/or legal representative *possessing all the original rights of each employee*.[13]

That all cannot be, yet it is the result for which the Trustee argues. Because "[u]nder traditional contract interpretation rules, a provision may not be interpreted

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respective successors and assigns." Uniform Law Annotated §2-210, Form 3 (emphasis added); *see also* "Binding Effect" at ContractStandards, available at https://www.contractstandards.com/clauses/binding-effect, updated November 4, 2016 ("Binding Effect. This agreement *benefits* and binds the parties and their respective heirs, successors, and permitted assigns" (emphasis added)).

[13] It is apparent that total nonsense would arise from reading the Agreements provision-by-provision, as the Trustee would do, and substituting "heir" and/or "legal representative" each time the Agreements refer to a right possessed by an "Employee," just as the Trustee would substitute "Shearson's successors" each time the Agreements confer a right upon "Shearson" only. Shearson, for instance, per ¶2, would have a duty — one that would make no sense — to make payments to the Employee's heir/legal representative or heir's/legal representative's beneficiary, with the first such payment coming on the date the heir/legal representative reaches age 65, *see* ¶2(a)(i), while if the heir/legal representative becomes totally disabled before retirement, Shearson would have to make payments from the date the heir/legal representative stops working. *See* ¶2(a)(c). Innumerable provisions would become garbled beyond possible implementation in similar ways, *contrary to the drafter's precise use of its text*.

in a manner which would render it an absurdity," *Saffire Corp. v. Newkidco, LLC*, 286 F. Supp. 2d 302, 308 (S.D.N.Y. 2003), this is yet another reason for reversal.[14]

b. The District Court Relied on Misapprehensions About the Agreements.

The District Court stated that Appellants' construction "rest[s] *in large part*" on extrinsic evidence [SA-10 (emphasis added)], but that is not so. While ample extrinsic evidence supports Appellants' construction and would resolve any ambiguity in their favor, their construction, as discussed above, is squarely supported by the text.[15]

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[14] The Trustee at times also falls back on quoting the phrase "Employee irrevocably agrees" in Agreements §9(d) where Appellants' agreement to subordination is stated. It argues, in substance, that "irrevocably" moots all other provisions as to the scope of subordination risk, without regard to what the contract provides as to scope. That is sophistry. The word "irrevocably" is as to Appellants' agreements, but the issue here is the scope and extent of those agreements — in particular, as to subordination risk. If the Agreements otherwise do not, as Appellants argue, extend subordination risk to the successor scenario, the word "irrevocably" does not operate as an override, to expand their meaning, to do so.

[15] The District Court also discussed at length a perceived change in Appellants' argument between opening and reply briefs as to whether the limit of subordination was tied to the Shearson/American Express relationship continuing (a relationship not expressly mentioned in the Agreements), going so far as to hold that this perceived inconsistency "most undermines" their overall argument. [SA-8] There was no inconsistency, and indeed even the District Court begins its discussion by stating only "Appellants *seem to argue*," rather than that they *did* argue. [SA-9 (emphasis added)] Appellants did not in fact argue that the Agreements contained a test based on the Shearson/American Express relationship continuing, but rather, that subordination risk would end if a successor emerged by reason of changes to

The District Court then treated the precise definition of "Shearson" and the limited use of the word "successors" as random and superfluous, when it is in fact precise and logical. The District Court discussed Appellants' textual argument, but incorrectly, because it did not apprehend that the word "successors" is included in the Agreements *in the only three places where it made sense and is required* and that this precise use leads to the workable construction Appellants propose (unlike the unworkable one discussed above in §I.A.2.a. proposed by the Trustee).

Specifically, the District Court concluded that Appellants' construction "is not reasonable, and that the [A]greements unambiguously do not contain … a limitation on the applicability of the subordination provisions (or any special meaning of 'successor' for purposes of the subordination provisions)" [SA-10]; stated that the defined term "Shearson" — as discussed above, defined so as not to include "successors" — "is repeated over [130] times in each contract" [SA-8];

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the entity that caused "material changes in its risk profile," as stated in Appellants' District Court briefs:

> "Each change to the 1985 Shearson described above rendered the changed entity a 'successor' within the meaning of the Agreements, which embody the parties' intent that subordination would be off the table *if and when the 1985 Shearson underwent material changes in its risk profile like those that occurred*."

S.D.N.Y. ECF# 11, at 38. Thus, Appellants did not argue, as the District Court stated, that successorship is tied to the Shearson/American Express relationship. That relationship was predominant in the parties' minds in 1985, but not, itself, the definition of "successor."

and found that it "is not reasonable to conclude that the parties intended" to use the word "successors" or the language of ¶11's "Binding Effect" clause in a way that would (as Appellants contend) actually have the meaning the words on the page conveyed because, the District Court continued, it would require "each of the over [130] uses of 'Shearson' to have one of two meanings depending on whether it is used to discuss a benefit or burden." [SA-8] The District Court also pointed out that "successors" appears "only twice" (it actually appears three times), and observed that it saw no significance in the Agreements' extending only burdens (through "is binding upon" language in Agreements ¶11) but not contract *benefits* (the absence of "inures to the benefit" of successors language) to Shearson's successors, even though, as discussed in §I.A.1., that is standard language used to extend benefits to successors, which readily could have been included, if intended.

Based on the amalgam of these observations, the District Court ignored the logic of the language to conclude that Appellants' construction is unreasonable and unambiguously incorrect, and that the Trustee's construction, despite being irreconcilable with the language and resulting in seeding absurdities throughout the Agreements, is correct. The District Court's adoption of an unworkable and illogical construction is itself reversible error.

But worse, the District Court's discussion is just plain wrong. Its references to "130" uses of "Shearson" that, it concludes, would need to be parsed, under

Appellants' construction, to find "one of two meanings depending on whether it is used to discuss a benefit or a burden to Shearson" — the lynchpin of the District Court's discussion — do not identify any actual flaw in Appellants' construction, because the reality is that in those 130 uses, there are many continuing duties for Shearson and its successors, *but virtually no prospective benefits*, because Shearson reaped its benefits at the time the contract was made (when it received Appellants' money). Put differently, Shearson, for practical reasons, has only prospective *duties*, with the notable exceptions of the ¶¶9(a) and (b) clawback provisions, where the word "successors" was logically used. Thus, no difficult parsing of the Agreements' uses of "Shearson" into its duties (which pass to successors) and its rights (which do not) is actually required.

Significantly, neither the District Court nor the Trustee below could identify (i) a concrete need for such parsing of any clause, (ii) any anomalous result for Shearson or its successors which would occur under Appellants' construction or (iii) any deprivation of contemplated contract benefits for Shearson/its successors when the contract is read as Appellants contend it must be. The reason, of course, is that there are none. And that is because the Agreements were drafted correctly and carefully in the manner Appellants construe them so that there is no need for such parsing, and there are no such anomalies. Yet the District Court would superimpose the subordination result sought by the Trustee on this text — a textual

round peg in a square hole — based on its incorrect analysis, even though the text requires the opposite result. That is plain error. *See, e.g., Rothenberg v. Lincoln Farm Camp, Inc.*, 755 F.2d 1017, 1019 (2d Cir. 1985) (summary judgment is improper when a court dismisses "an interpretation that gives a reasonable and effective meaning to all the terms of a contract," which "is generally preferred to one that leaves a part unreasonable or of no effect").[16]

[16] The District Court also cited *Altvater Gessler-JA Baczewski Int'l (USA) Inc. v. Sobieski Destylarnia S.A.*, 572 F.3d 86 (2d Cir. 2009), for the proposition that successor corporations "are generally entitled to enforce their predecessors' agreements" unless "the parties agreed otherwise." [SA-4-5] Here, of course, Appellants contend that the parties *did* agree otherwise. *Altvater* also does not support the result below for additional reasons. It did not arrive at any conclusions whatsoever about the rights of a possible successor, but rather, ultimately held that a *possible* successor party was *not* entitled to invoke a clause in an agreement simply because it was an inapplicable forum clause. *Id.* at 90. More, *Altvater* does not hold, as the District Court stated it does [SA-4-5], that there is such a general rule, and in fact, any "general rule" as to the scope of rights and duties a successor takes from a predecessor is not what the District Court described. Rather, it looks to the totality of the circumstances presented. For example, in *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964), cited by the District Court, the Supreme Court's decision actually held: "principles of law governing ordinary contracts" do *not* automatically bind successors to the contracts of their predecessors, *id.* at 543. As the Sixth Circuit further explained in *Cobb v. Contract Transport, Inc.*, 452 F.3d 543, 552 (6th Cir. 2006), "[t]he Supreme Court refined *Wiley*'s doctrine of successor liability in *NLRB v. Burns International Security,* 406 U.S. at 281-82, 92 S.Ct. 1571, clarifying that a defendant-company could be a successor for one purpose but not for another purpose." The correct statement under New York law is succinctly stated by the Third Circuit: a party "may be a successor for some purposes and not for others," and "while reported cases may be instructive as to how the term 'successor' is interpreted in other contexts, the task here remains to discern the understanding of the parties…. [T]he term 'successor' must be given the meaning intended by the drafters of the Plan and reasonably understood by its

3. *At Best for the Trustee, the Subordination Provision Is Ambiguous, and Summary Judgment in the Trustee's Favor Must Be Denied, While All Extrinsic Factual Evidence Would Strongly Support Appellants' Reading of that Provision.*

While Appellants believe the considerations adduced above are more than sufficient to conclude that the subordination provision unambiguously does *not* apply to Shearson's successors, even if this Court were to conclude that this is not clear on the Agreements' face, there should be reversal and remand, because, at the least, there is ambiguity in the language which cannot be resolved against Appellants on a pre-discovery motion. The Trustee, as noted above, has effectively admitted that it has no explanation for the three specific uses of the term "successors" except drafting error. *See* Bankr. ECF# 14420, at 7. The Trustee's textual argument does not hang together at all, while Appellants' does;

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beneficiaries." *Taylor v. Contl. Group Change in Control Severance Pay Plan*, 933 F.2d 1227, 1234 (3d Cir. 1991).

Finally, the District Court cited a Maryland District Court decision applying Maryland law, *Mehul's Inv. Corp. v. ABC Advisors, Inc.*, 130 F. Supp. 2d 700 (D. Md. 2001), with little comment, but apparently for the broad proposition that even if a contract did not state that it would "inure to [an assignee's] benefit," but nonetheless was "binding" on the assignee, the assignee could enforce it, and that the Trustee should similarly be able to enforce the Agreements. [SA-8] In fact, that case merely held that "[i]n the absence of a contrary provision …[,] rights and duties under an executory bilateral contract may be assigned and delegated," except where the specific identity of the parties to the agreement is an essential component of the bargain. *Id.* at 705-08. The Agreements here *do* have a "contrary provision" as discussed herein, and of course, *the identity of the parties was essential to their bargain*. That case is neither relevant nor, as a statement of Maryland law, controlling.

and if the Trustee's construction were credited at all, that should lead to no more than finding an ambiguity precluding summary judgment.

The relevant law, of course, is clear that an ambiguity in a contract creates an issue of fact precluding summary judgment.[17] In fact, numerous courts have held terms such as "successor" and "company" (in successorship scenarios) are ambiguous when construing agreements involving future employee benefits. *See*, *e.g*., *Taylor, supra,* 933 F.2d at 1234; *Anderson v. Pittsburgh-Des Moines Corp.*, 893 F.2d 638, 640 (3d Cir. 1990).

More, as Appellants' interpretation of the contractual language is, at the absolute least, reasonable in giving effective meaning to all its terms, and in giving meaning to the Agreements as a whole, it cannot possibly be rejected out of hand at this stage. *Rothenberg*, *supra*, 755 F.2d at 1019 ("Such a reading gives literal effect to the words of that phrase and is therefore not unreasonable…. [A]n interpretation that gives a reasonable and effective meaning to all the terms of a contract is generally preferred to one that leaves a part unreasonable or of no effect…. [S]ummary judgment was therefore improper") (citations omitted); *see also Scholastic, Inc. v. Harris*, 259 F.3d 73, 83 (2d Cir. 2001) ("In determining

[17] *See, e.g., Rothenberg*, *supra*, 755 F.2d at 1019 ("'[w]here contractual language is susceptible of at least two fairly reasonable interpretations, this presents a triable issue of fact….' *Heyman v. Commerce & Industry Insurance Co.,* 524 F.2d 1317, 1320 (2d Cir. 1975) (quoting *Aetna Casualty & Surety Co. v. Giesow,* 412 F.2d 468, 471 (2d Cir. 1969))" (citations omitted)).

whether a contract is ambiguous, a court must look at 'the entire integrated agreement,' to 'safeguard against adopting an interpretation that would render any individual provision superfluous'").

Further, Appellants' interpretation of the contractual language is supported by "the relation of the parties and the circumstances under which [the Agreements were] executed," which a court "should examine" "in deciding whether an agreement is ambiguous." *Kass v. Kass*, 91 N.Y.2d 554, 566 (1998).[18]

Further still, any ambiguity in the language would generally be interpreted against the drafter, *see*, *e.g*., *Pagan v. NYNEX Pension Plan*, 52 F.3d 438, 443 (2d Cir. 1995) ("The rule of *contra proferentem* is 'that when one party is responsible for the drafting of an instrument, absent evidence indicating the intention of the parties, any ambiguity will be resolved against the drafter'"), and here, Mr. Genirs makes clear that the drafter's — management's — intent was actually consistent

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[18] The District Court declined to follow *Kass's* guidance, based upon *Barclays Capital Inc. v. Giddens (In re Lehman Bros. Inc.)*, 478 B.R. 577, 591-92 (S.D.N.Y. 2012), *aff'd sub nom. Giddens v. SEC (In re Lehman Bros. Inc.)*, 761 F.3d 303 (2d Cir. 2014), but *Barclays Capital* gives no reason for this Court not to consider the Appellants'/Shearson parties' relation and circumstance as relates to the limited extent of risk and the Agreements' limited definition of "Shearson." Unlike those kinds of common background facts contemplated by *Kass*, the Bankruptcy Court in *Barclays Capital*, in this bankruptcy, actually looked to the bankruptcy judge's own personal involvement in and recollection of the drafting of the contract being construed. *Id*. at 590-92. That prompted the district court, on appeal, to find that went beyond what *Kass* allows; nothing similar is presented by Appellants here.

with Appellants' construction, and additional facts supporting Appellants' defenses would come into evidence upon discovery.

As discussed above (Facts §C.1.a), Mr. Genirs makes clear that the parties, including Shearson management, intended that subordination risk would not extend beyond Shearson as it then existed and could be known, analyzed and understood by employees electing to defer earned compensation in exchange for distant future pension rights. [A-349] And that understanding was conveyed by management to its counsel that drafted the Agreements for Shearson. [A-350] Not only the plan participants, but Shearson management itself, had keen awareness of this issue — the risk, and the extent of acceptable risk, which the potential participants in the ESEP plan would and should take. [A-350] Thus, the precise use of the term "successor" to limit the risk of subordination to Shearson as it existed in 1985 is consistent with the parties' extensive negotiations and the intention of both Shearson and Appellants.[19] [A-350] For all these reasons, both

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[19] The Agreements' selective use of the word "successor" is a change from earlier, similar agreements used as a model, and which had expressly and globally defined the employer/plan sponsor to *include* Shearson's future "successors," and thus is plainly meaningful and intentional, rather than random or erroneous. Such a significant change to a model agreement does not occur as a matter of meaningless happenstance. As discussed in Facts §C.1.b., unlike the definitions of "Shearson" and "Employer" in the Agreements (as well as in the statement of the "Parties to Agreement" in ¶8) as including *only* the particular Shearson entity and its affiliates or subsidiaries, those *earlier* agreements contain, in the definition of "Company" on the first page, the overarching definition of the employer-party to the Agreement: "'Company' means Shearson Lehman Brothers Inc., a Delaware

in the Agreements' text and in light of the "relation of the parties and the circumstances," *see Kass, supra*, the Agreements are, at worst for Appellants, ambiguous, the extrinsic evidence supports Appellants' construction both as context for interpretation and to resolve any perceived ambiguity in Appellants' favor, and summary judgment for the Trustee should, therefore, in all events, have been denied.

B. *The Debtor Is No More Than a "Successor" to Shearson.*

Turning to the issue of whether LBI was indeed a successor to Shearson, the Trustee has argued it is not, and that the 2008 LBI debtor is really the same as Shearson, based upon a myopic and irrelevant analysis (and that for that reason, the Agreements' subordination clause has survived). This section demonstrates why that argument fails.

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corporation, and its successors and assigns…." [A-473, 493, 510 & 527] That defined term — "Company" — is then used in those plans' general subordination provisions (¶8.4 in those agreements), which are, in principal part, verbatim identical to the subordination provision in the Agreements. [A-484, 502, 518 & 539] This difference is significant and intentional (for obvious reasons Mr. Genirs explains [A-348-51]). Thus, the earlier agreements did use the term "successors" expressly in their definition of the employer entity — exactly as the drafter *did not do* in the ESEP Agreements. In fact, the four plans *pre-date* the September 1985 ESEP. [A-474 (plan "Effective Date" of January 1, 1977), 495 (plan "Effective Date" of January 1, 1985), 511 (plan "Effective Date" of November 1, 1976) & 527 (plan "Effective Date" of January 1, 1979)]

By way of preview to § B., first, the correct test is discussed below in §I.B.1. — whether LBI is a "successor" in the meaning of the word "intended by the drafters" and "reasonably understood by" the parties. Below, the Trustee relied on a purported paper trail at the Delaware Secretary of State to argue that alleged technical continuity between Shearson and LBI renders LBI not a "successor" to, but "one and the same as," Shearson. If argued here, Appellants can show the point to be factually flawed (there is no such technical continuity), but the analysis is the wrong one. The cases are abundant that the correct analysis looks to the meaning of "successors" as the word is used and the parties intended in their agreements (here, as these parties intended, to limit Appellants' exposure to subordination if there were to be an insolvency by a materially changed "successor" iteration of Shearson). Section I.B.2. applies that correct legal standard to the facts in the record: interpreting "successor" as the parties' intended and in accordance with the contract's purpose in its context. Section I.B.3. discusses that not only is LBI no more than a "successor" to Shearson for purposes of the subordination provision, but that the debtor and the Trustee itself have explicitly admitted this fact in many judicial contexts, including a successful argument by the Trustee affirmatively to seek relief in this bankruptcy case on the ground that LBI is a "successor" to Shearson; and thus the principles of judicial

estoppel and judicial admissions foreclose the Trustee from arguing that LBI is not a successor to Shearson.

1. *"Successor" Must Be Assessed with Reference to the Word's Meaning Reasonably Understood by the Parties in Light of the Agreements' Purpose and Context.*

The relevant inquiry is, as noted above, whether the debtor is the same entity as, or a "successor" to, Shearson *for purposes of the Agreements*, in the common-sense way the contracting parties understood the word. Assessed by that standard, there can be no dispute that the debtor is a successor; and at worst for Appellants, this is a fact issue for trial. The Trustee would not apply this standard, but a wealth of authority requires it.

"There is, and can be, no single definition of 'successor' which is applicable in every legal context." *Howard Johnson Co., Inc. v. Detroit Loc. Jt. Exec. Bd., Hotel and Rest. Emp. and Bartenders Intern. Union, AFL-CIO*, 417 U.S. 249, 264, n.9 (1974). *See also Cobb, supra,* 452 F.3d at 552 ("The Supreme Court refined *Wiley*'s doctrine of successor liability in *NLRB v. Burns International Security,* 406 U.S. at 281-82, 92 S.Ct. 1571, clarifying that a defendant-company could be a successor for one purpose but not for another purpose"). "'Successor' and 'succession' have no fixed meaning in all cases.... The word 'successors,' in a grant to a corporation and its successors, is to be interpreted according to the surrounding circumstances. *One corporation may be the successor of another*

within the meaning of such a provision although there is neither a merger nor a consolidation." *Fletcher Cyclopedia Corporations* §7203 (Perm. Ed. 1999) (emphasis added).

When the term "successor" is used in a contract, court after court has held that its meaning is to be determined in light of how the parties would reasonably understand the word given the purpose and context of that particular contract. For example, applying New York law, which governs the Agreements, the Third Circuit held:

> "while reported cases may be instructive as to how the term 'successor' is interpreted in other contexts, the task here remains to discern the understanding of the parties…. [T]he New York cases cited by Taylor concern whether a company can be considered a successor for purposes of imposing tort liability. This case does not involve defining the term 'successor' for purposes of imposing statutory or tort liability. Rather, the term 'successor' must be given the meaning intended by the drafters of the Plan and reasonably understood by its beneficiaries."

Taylor, supra, at 1234. *See also AA Sales & Associates, Inc. v. JT & T Products Corp.*, 24 Fed. Appx. 605, 607, n.3 (7th Cir. 2001) ("Although 'successor' generally may include an entity next in time, *see* Webster's Third New International Dictionary 2282 (1986) ('[O]ne that follows.'), when the term[] is used to indicate the scope of contractual liability, it takes on a specific meaning, as we have identified in the text"); *Van Deusen v. Ruth*, 343 Mo. 1096, 1103 (1938) ("From the discussion it is evident that the general meaning of the word 'successor' is defined by Webster, *supra*. However, the exact meaning as applied

to a contract wherein the word is used must depend largely on the kind and character of the contract, its purposes and circumstances, and the context"); *Great Am. Ins. Co. v. Primo*, 512 S.W.3d 890, 894 (Tex. 2017) (same); *California Nat. Bank v. Woodbridge Plaza LLC*, 164 Cal. App. 4th 137, 146 (Cal. App. 4th Dist. 2008) ("[W]e do not agree with the trial court that 'successor' means a legal successor in interest to the Bank of Irvine. Whether the space was occupied by a successor in interest or merely a successor operating a financial institution would not matter to plaintiff in its desire to ensure its rent was not more than a competitor's in the center. 'A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting'").

Below, the Trustee argued that Shearson and LBI are the same based on their assertion that Delaware Secretary of State records connect Shearson to LBI in a myopic view of entity continuity for that office's records purposes. Appellants pointed out below that the Delaware records did not even hang together to support the contention. But even if they did, the cases discussed above require that the Agreements' successorship language be construed as Shearson and Appellants intended.

2. *The Relevant Facts Pertaining to "Successorship" Make Clear that in Light of the Agreements' Purpose and Context, the Debtor Is, at Most, a "Successor" to Shearson.*

The most natural and common-sense reading of the Agreements is that the defined term "Shearson" and the meaning of the word "successors," as it is used in the Agreements — even without, although certainly confirmed by, Mr. Genirs' Affidavit and other extrinsic evidence — is that the word "successors" was intended to mean future iterations of Shearson with a risk profile and composition materially different from that of the Shearson entity that they knew and with which they contracted and as to which they accepted subordination exposure. That issue — the level of risk exposure Appellants would face as to any future, changed Shearson — manifestly was addressed by the parties in their definition of Shearson and use, and omission, of the word "successors." When the omission of "successors" from the definition of Shearson is given this intended and common-sense interpretation, LBI is plainly a "successor" to Shearson.

While the Trustee, below, has mischaracterized the many drastic changes between Shearson of 1985 and LBI of 2008 as a mere "name change," that conclusion cannot be reached on this pre-discovery, undeveloped record, and is contradicted by the public record. Even the Bankruptcy Court stated that "LBI may loosely be referred to as a 'successor' to Shearson" [A-606], and the District Court catalogued many of these changes (and certainly did not hold that LBI was

the same as Shearson). [SA-3, 10] The actual facts — discussed in Facts §D.1. — include many entity-changing acquisitions, mergers, consolidations, asset sales, spinoffs and ownership changes that transformed the 2008 debtor entity into no more than a "successor" to the 1985 Shearson. This is true both from the standpoint of the parties' intent and also any common-sense definition of corporate successorship. The changes in the substantive composition and financial circumstances of the business were dramatic, with the entity ultimately emerging being wholly different as well as more risky in every material respect. *See also* SA-3.

The 1985 Shearson was not, after these changes, in any connotation of the word "successor," the same as the later-created subdivision of Shearson that would become the free-standing LBI. It became a new construct created in 1990 to "revive" the "Lehman" name, was further separated from the 1985 Shearson by the 1993 disassembly of the businesses and was later spun off by American Express in 1994. It was, in every sense, a successor to Shearson because it was a completely different entity, including in: (i) the fact it was now an investment bank only, without the lines of business it had had as Shearson in, for example, retail brokerage; (ii) its capitalization and capital structure; (iii) its ownership; and (iv) its absence of the backstop of American Express, which Mr. Genirs explained was

crucial to the parties' limited willingness to accept subordination as to Shearson but not any materially different successors.

Each change to the 1985 Shearson described in Facts §D.1 rendered the changed entity a "successor," and certainly those changes as a whole did, such that subordination risk ended for Appellants.

3. *The Trustee Has Admitted the Debtor Is a "Successor" to Shearson, Having Taken that Exact Position in this Case, and the Debtor Has Been Represented and Has Represented Itself as a "Successor" in Many Other Legal Settings.*

This issue can be even more easily determined in Appellants' favor because the Trustee and, pre-bankruptcy, LBI, have frequently alleged and admitted that LBI is a successor to Shearson. In one instance, in this bankruptcy case, the Trustee actually affirmatively alleged that LBI is Shearson's successor, and the Trustee prevailed. Thus, it is an admitted fact resulting in a judicial admission and judicial estoppel, and that renders it conclusive that LBI is a successor to Shearson. Specifically, in one of its short-form motion "Omnibus Objections" [A-451] related to claims other than those at issue here, the Trustee asked the Bankruptcy Court to subordinate claims stemming from *other* deferred compensation plans. Unlike the ESEP Agreements, those agreements had clear language making their subordination provisions applicable to Shearson's "successors." The Trustee expressly pointed out, in its argument for subordination of those claims, that those

claimants had agreed to subordinate their payments to Shearson's "unsubordinated obligations and senior subordinated obligations, *as well as to those of its successors and assigns*." [A-456 (emphasis added)] The Trustee then affirmatively alleged that the debtor, LBI, is a "successor" to Shearson — and did so in a manner necessary to the argument it won. Specifically, after stating that "[e]ach of the [deferred compensation] Plans was offered only to select employees at LBI and/or its affiliates *and predecessors*," [A-456 (emphasis added)], the Trustee argued that "the Claimants explicitly agreed to subordinate distribution of any benefits under the Plans to payment in full of all unsubordinated creditors of LBI, *as successor to Shearson*." [A-459 (emphasis added)]

This was an accurate statement and a conclusive admission, and operates as judicial estoppel on this point. It was made as central to an argument that *there was successorship* — in the same way Appellants allege here — to apply a subordination provision in a Shearson-era deferred compensation plan to other creditors based on successorship. As an affirmative and necessary allegation of fact made by the same party in this same case, it is a "judicial admission" binding the Trustee and operating as judicial estoppel. *See, e.g., Mitchell v. Washingtonville Cent. Sch. Dist.*, 190 F.3d 1, 6 (2d Cir. 1999) ("party invoking judicial estoppel must show that (1) the party against whom the estoppel is asserted took an inconsistent position in a prior proceeding and (2) that position was

adopted by the first tribunal in some manner …, such as by rendering a favorable judgment"); *Purgess v. Sharrock*, 33 F.3d 134, 144 (2d Cir. 1994) ("Counsel's statement of fact constituted an admission of a party. It was made in a legal brief filed with the court subject to the penalty of sanctions").

The Trustee sought below to elide judicial admission and estoppel effect by calling "successorship" a "legal question," while citing no case to support that characterization. In fact, as discussed above in §I.B.1, successorship, as used in the Agreements, and whether changed iterations of Shearson fit that meaning, are fact questions — fact questions that must be answered in Appellants' favor, *see* Argument §I.B.2., and even more dispositively so by reason of judicial estoppel and admission.[20]

The fact that LBI is, at most, Shearson's successor is also stated in many court and regulatory filings. For example, a 1996 SEC order instituting an administrative proceeding against Lehman Brothers Inc., as it then existed [A-558], was titled "In the Matter of LEHMAN BROTHERS INC., as successor to

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[20] Significantly, in its motion to subordinate Appellants' claims, the Trustee took a markedly different approach from other motions where it affirmatively alleged "successorship." In its motion against Appellants, no statements affirmatively alleging successorship were made, despite the similar context, and more, the Trustee skirted entirely the "successorship" issue in its motion/complaint against Appellants by disingenuously substituting "[LBI]" — using brackets within a quote, instead of quoting the Agreements' references to "Shearson" where it could only be quoted by the Trustee from the ESEP Agreements without the word "successors." Bankr. ECF# 7264, ¶¶12-14.

SHEARSON LEHMAN BROTHERS INC." The SEC, among other things, noted that while, "[i]n 1993, most of Shearson's retail branch offices were sold to Smith Barney, Harris Upham & Co.[,] … Lehman Brothers, *as successor to Shearson*, retained responsibilities for any regulatory liability incurred by Shearson prior to the sale." (Emphasis added.) *The debtor itself* has identified itself as a "successor" to Shearson in court filings. *See, e.g., Shearson Lehman Bros., Inc.*, *successor in interest to Shearson Lehman Hutton, Inc. v. Wasatch Bank*, 788 F. Supp. 1184 (D. Utah 1992); *In re Schulman*, 196 B.R. 688, 691 (Bankr. S.D.N.Y. 1996) ("Lehman Brothers, Inc. ('Shearson'), successor in interest to Shearson Lehman Hutton, Inc., sued Richard Schulman for a declaration that certain debts owed Shearson are non-dischargeable pursuant to section 523(a)(2)(A) or (a)(4) of the Bankruptcy Code").[21]

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[21] Many other decisions identified the fact of the succession of the debtor from what was Shearson in 1985 — including in ways material to case outcomes. *See, e.g., Trustees of Capital Wholesale Electric etc. Fund v. Shearson Lehman Brothers, Inc.*, 221 Cal. App. 3d 617, 620 (Cal. App. 3d Dist. 1990) ("Shearson Lehman Brothers, Inc. is the successor to Lehman Brothers Kuhn Loeb, Inc. and the predecessor to Shearson Lehman Hutton, Inc."); *Barbier v. Shearson Lehman Hutton Inc., successor-in-interest to Shearson Lehman Brothers, Inc.*, 948 F.2d 117 (2d Cir. 1991); *Matter of Arb. Between Barbier and Shearson Lehman Hutton Inc.*, *Successor-in-interest to Shearson Lehman Brothers, Inc.*, 943 F.2d 249, 250 (2d Cir. 1991) ("This is an appeal from a judgment … confirming an award of compensatory and punitive damages on claims of unauthorized trading against respondent, Shearson Lehman Hutton, Inc., as successor in interest to Shearson Lehman Brothers, Inc."); *Milnes v. Salomon, Smith Barney, Inc.*, 2002 N.Y. Slip Op. 50507(U), 2002 WL 31940718, at **2-5 (N.Y. Sur. Ct. Broome Co. Oct. 11, 2002) ("Shearson Lehman Hutton was merged into and after several name

Thus, the Trustee is estopped from denying the point it litigated and won — that LBI is a successor to Shearson — and numerous other judicial admissions and judicial administrative treatments confirm that obvious fact.

II.

THE SUBORDINATION PROVISION IS VITIATED BECAUSE OF THE DEBTOR'S MATERIAL BREACHES OF THE AGREEMENTS' PROVISIONS SPECIFICALLY PROTECTING APPELLANTS AGAINST THE RISK OF INSOLVENCY AND SUBORDINATION

The debtor materially breached duties that would have protected Appellants from any possible subordination or insolvency scenario. There were two such breaches: (i) by failing to implement the "right the ship" duties as LBI's net capital fell below levels required by contract measurements tied to federal regulations in the years prior to the bankruptcy and which, if honored, would have avoided insolvency (or led to a pre-bankruptcy payout of accrued pension amounts); and (ii) by its failure to constitute, as required by the Agreements, the Administrative Committee, which had the power specified in the Agreements to end the plan, pay pensions accrued and avoid the consequences of insolvency in the face of financial trouble. These duties and breaches are described in Facts

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changes, the successor firm became Salomon Smith Barney, Inc.… Since the arbitration clause in the Shearson Lehman client agreement does not state that it runs in favor of 'successor' firms it is not enforceable by Salomon").

§§D.2. & D.3., and more fully in the record at A-352-68. For purposes of its own motion, the Trustee conceded both breaches. *See* Bankr. ECF# 14128, at 14.

The critical fact is that each breach vitiated specific, targeted protections for Appellants against possible subordination/insolvency. Had the debtor not breached (in either of the two discrete ways), Appellants would have been paid at least amounts they now claim because they would have received their pension accruals before any bankruptcy — and possibly much more, if the right the ship protocol had been followed and bankruptcy avoided.

For the reasons that follow, each breach forecloses the possibility of subordination. In §A., Appellants discuss the operation of the basic contract law principles of material breach, which require reversal (and the District Court's incorrect application of those principles). In §B., Appellants discuss why the District Court was incorrect in concluding that the breached contract provisions did not actually protect Appellants. In §C., Appellants discuss why the few cases relied upon by the Trustee and the District Court do not apply here and do not negate the nullifying effect of the debtor's material breaches on possible subordination.

A. *Under Well-Settled Principles of Contract Law, the Debtor's Material Breaches of Contract Protections Against Subordination Vitiate All of the Contract Burdens on Appellants, Including the Subordination Clause on Which the Trustee Relies.*

When a party to a contract assumes risks, but also receives specific contract protections in the way of specific conduct by the other, second party which would protect against or mitigate those risks, it is axiomatic that if that other, second, party later breaches its duty to perform the risk-limiting conduct, then the first party is relieved of the risk it assumed.

This principle is clear in the general rule of contract law that any material breach of contract vitiates in all respects the contract burdens on the party whose rights were breached. The rule has been stated clearly and unequivocally by this Court: "it seems settled now in New York that with the breach fall *all* the other parts of the contract." *U.S., for Use of Susi Contracting Co. v. Zara Contracting Co.*, 146 F.2d 606, 610 (2d Cir. 1944) (emphasis added). "[T]he essence of the *Zara* case … is that *the provisions of the contract — all of them — fall like a house of cards when a breach occurs.*" *George Colon Contracting Corp. v. Morrison*, 162 N.Y.S.2d 841, 918 (Monroe Co. Sup. Ct. Jul. 13, 1954), *aff'd,* 2 A.D.2d 869 (4th Dept. 1956) (emphasis added).[22]

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[22] Cases making this same point are legion. *See, e.g., Enron Fed. Sols., Inc. v. U.S.*, 80 Fed. Cl. 382, 398 (Fed. Cl. 2008) ("What, then, are the legal consequences of a material breach? A basic statement of the law applicable to this issue is: a party who materially breaches a contract relieves the non-breaching party from *all*

That general rule applies with greater force here because the material breaches were of specific contract protections against subordination/insolvency risk now in issue. The breaching debtor's Trustee cannot ignore a breach of that protection and later seek the subordination that would have been avoided by the debtor's contract performance pre-bankruptcy.[23]

The District Court erred in a number of ways in its discussion of this issue. For example, it stated that "Appellants cite no supporting authority" holding that breaches like the debtor's "'of specific contract protections against subordination/ insolvency risk' … foreclose[] the possibility of subordination." [SA-11-12] But the many cases cited above and before the District Court stand for exactly Appellants' proposition — indeed, where a breach eviscerates a contract protection against risk of such harm (such as subordination), it is at the very heart of the material breach protection to relieve the non-breaching party from the harm that was at risk. The District Court ignored this.

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of the non-breaching party's contract obligations" (emphasis added)); *Bear, Stearns Funding, Inc. v. Interface Group-Nevada, Inc.*, 361 F. Supp. 2d 283, 291 (S.D.N.Y. 2005) ("A fundamental principle of contract law provides that the material breach of a contract by one party discharges the contractual obligations of the non-breaching party").

[23] The harm here was caused by the debtor pre-bankruptcy, and "the trustee stands in the shoes of the debtor and can only assert claims that the debtor could have asserted prior to filing for bankruptcy." *Wornick v. Gaffney*, 544 F.3d 486, 490 (2d Cir. 2008). "[T]he trustee is subject to defenses that could be asserted against the debtor." *In re Magnesium Corp. of Am.*, 399 B.R. 722, 758 (Bankr. S.D.N.Y. 2009).

Certainly, the District Court was correct in noting that neither Appellants nor the Trustee identified a material breach case in which a subordination clause in particular was at issue exactly as it is here. But that neither harms Appellants' position nor helps the Trustee's, because the general contract principle cited above — "all the other parts of the contract," *Zara*, *supra*, at 610 will "fall like a house of cards when a breach occurs," *George Colon*, *supra,* at 918 — applies to every contract. The fact that no party locates a case applying the rule with regard to a contract involving subordination (or any other particular fact pattern) means only that that particular contract fact pattern has not been discussed in a published opinion. But the rule applies to a contract involving subordination nonetheless, as it applies to any contract on any subject. Failure to apply the rule here would be not only illogical, but would nullify the unambiguous contract protection against risk like the one breached here; that cannot be and is not the law.[24]

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[24] The District Court also took pains to distinguish two cases Appellants cited below which actually do support Appellants' position in discussing subordination in related settings, *Noonan v. Wonderland Greyhound Park Realty LLC*, 723 F. Supp. 2d 298 (D. Mass. 2010), and *Alden State Bank v. Sunrise Builders, Inc.*, 48 A.D.3d 1162 (4th Dep't 2008). Appellants did and do not rely on those case as on-point applications of the material breach rule in a subordination context, and described them so as to make clear that they are distinguishable. But recognizing that, as discussed above, neither party identified a case with close to identical facts or applying material breach principles in the context of contractual subordination, Appellants cited *Noonan* and *Alden* because the principles discussed are the closest found to this fact scenario, and the discussions of the courts in those case supports Appellants' position. Appellants explained (i) that *Noonan* denied summary judgment to the party seeking subordination based on allegations of a material

The District Court erred further, eliding application of settled material breach principles by ignoring the plain meaning of the many material breach cases Appellants cited, and seeking to distinguish *Zara* and a New York Court of Appeals case in a way that does not comport with the law.[25] Specifically, the District Court stated in substance that the entire body of material breach law is limited to the narrow proposition that material breach only precludes requiring the wronged party's "*performance*." [SA-11 (emphasis added)] The District Court then stated that in this case, the Trustee "does not seek to compel Appellants' performance, but rather to uphold a subordination provision which contemplates a SIPA liquidation like the one at issue here." *Id*. This is a distinction with no relevant difference, as the logic of this set of facts, and the cases cited above, show. As it happens, the Trustee *is* a plaintiff in an adversary case *seeking to enforce* a

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breach of a duty that, if performed, would have negated subordination (breach of a duty to allow plaintiff Noonan to acquire senior debt which would have avoided subordination), *supra*, at 340; and (ii) that *Alden* recognized the principle that the other contracting party's earlier breach would nullify the contract's subordination clause, but held in that particular case that the non-breaching party elected to continue with the contract after it, in substance, waived the breach, *supra*, at 1163. The distinctions the District Court drew from these cases do not diminish their support for Appellants' position.

[25] Ignoring Appellants many citations to authority below, the District Court essentially dismisses those cases, stating, incorrectly, that Appellants rely "*[f]or the most part*" on *Zara* and the Court of Appeals case, while neglecting to discuss the wealth of caselaw actually cited. [SA-11 (emphasis added)] The caselaw the District Court ignored amply supports Appellants' position.

subordination clause; but even if "enforcement" were not in issue, the cases hold that *all* contract burdens on Appellants fall with the breaches here.

More central to the real issue before this Court, if the debtor had performed its unambiguous protective duties, Appellants would not face the harm they suffered. The debtor would have taken the required steps to restore its "business to a condition whereby the amounts the payment of which ha[d] been suspended could be paid." Agreements ¶9(a). Appellants surely had the right to enforce the right the ship rules by litigation had they known of the breach (here, they could not know, any more than LBI's regulators did). They had a right, and they had a remedy. To hold now that they are denied a remedy because subordination does not in some sense ask for "performance" not only vitiates the remedy, but would render the right (*viz.*, the protection against insolvency risk) itself meaningless from the beginning. It does not give the debtor a license to breach with no consequence. To read both the right and remedy out of the contract would be bad law, and, per the cases cited, is not the law.

In fact, therefore, it should matter nothing whether the burden on Appellants is called "performance," "enforcement" of something to be "upheld" or anything else. The risk of harm must abate when contracted protection from it was denied by breach.

Significantly, there is not a single case cited by the Trustee or the District Court supporting a different result on these or any similar facts. On these facts, there should be reversal and judgment for Appellants.

And if not, to the extent this Court would consider holding otherwise, it should at most find that the scope of the Agreements' protections are ambiguous, and that also would require reversal.

B. *The District Court Is Incorrect that the Breached Provisions Do Not Protect Appellants*.

The District Court also rejected Appellants' material breach defense on the ground that the breached provisions "contain no indication that they are linked to the subordination clauses" and that Appellants impermissibly rely "*for the most part*" on "extrinsic evidence" to assert that they are, *see* SA-12 (emphasis added) — in substance, holding as a matter of law that those provisions did not in fact protect Appellants.

But the language and protection is plain on the face of the Agreements. To begin, with respect to the right the ship duty, the duty is set forth in ¶9(a) that is part of ¶9 titled: "Subordination Provisions." Further, ¶9(a)'s right the ship duty (i) is mandatory and (ii) directly protects the plan participant Appellants from insolvency and subordination risk. If net capital requirements are breached, the Agreements (i) mandate that Shearson "shall" suspend the pension payments and

take the protective steps mandated, and (ii) describe those steps to include that Shearson then "shall, as promptly as is consistent with the protection of its customers, reduce its business to a condition *whereby the amounts the payment of which has been suspended could be paid*." Agreements ¶9(a) (emphasis added). This manifestly protects Appellants in the event of financial trouble, in the same contract paragraph addressing possible insolvency/subordination scenarios, and no extrinsic evidence is offered, much less required, to see that. And if there were any reason for doubt, then there should, at worst for Appellants, be a finding of ambiguity on this point, such that the holding below must still be reversed.[26]

The protection afforded by the Administrative Committee is also plain on the Agreements' face. The District Court held that "the agreements do not obligate Shearson to create or maintain the committee" [SA-12], yet: the Agreements (i) spell out the Committee's various duties in numerous provisions (at ¶2(a), ¶4,

[26] The District Court stated: "there is no indication in the agreements that the failure to take steps to meet the capital requirements would cause Appellants' 'irrevocably' subordinated claims to become unsubordinated." [SA-12] But that makes no sense for the reason discussed in the preceding §II.A. The potential for subordination falls with the breach of the contract protection against it. The potential for subordination is not being revoked, but rather, it is a contract term, and that term falls in the face of the debtor's material breach; that contractual prospect of subordination falls by operation of contract law with all other contract burdens on Appellants.

The District Court also stated: "in any event, LBI continued to make payments until its liquidation." [SA-12] It did, but that is not a reason to reject Appellants' defense; rather, it is further proof of the debtor's breach of the requirement of Agreements ¶9(a) that such payments be *suspended* until the debtor's financial condition improved such that payments could again be made.

including the footnote, ¶5(a), (b), (f) and (i) (including to "interpret[] and construe[]" the Agreements)); (ii) provide that it shall be a committee of the Shearson "Board of Directors" (¶2(a) and ¶4 at Fn.); and (iii) convey upon the Administrative Committee the power to terminate the plan.

With these duties imposed by contract on this Committee of Shearson's Board of Directors, it simply cannot be that Shearson had no duty to create the Committee and could leave all of those duties delegated by the parties to the Committee in, in effect, limbo. To conclude on a pre-discovery motion that there was no duty to create a Committee would vitiate the contract provisions requiring Committee action — and that makes no sense. Yet that is what the District Court held was its unambiguous construction as a matter of law. That holding must be reversed.

The District Court also quoted the Trustee's argument that the Administrative Committee, had it existed, was not obligated to terminate the plan per ¶4 of the Agreements to protect Appellants or prefer Appellants over others pre-bankruptcy. [SA-12] It is correct that an Administrative Committee might not have acted, but what matters is that *it might have*. But Appellants were deprived of the protection completely because there simply was no Committee in place.[27]

[27] If the Court were to look to extrinsic evidence, Appellants alleged that this protection was described to them pre-contract as material and significant. (Facts §D.2.)

Again, the District Court cannot reach its holding as a matter of law; reversal is required.

C. *The Cases Cited by the District Court and the Trustee as to Choices Made by Contracting Parties About Issues Such as Forum Selection or Damage Limitations in the Event of a Breach Are Irrelevant to Whether a Subordination Provision Survives Material Breach of a Contract Protection Against It*.

The Trustee argued and the District Court agreed that courts "frequently enforce contract provisions that benefit a breaching party." [SA-10-11] But the cases cited by the District Court and the Trustee, described below, have nothing to do with breach of a protection against insolvency/ subordination and are wholly irrelevant to the issue this Court must decide. Rather, each case deals with a straightforward dickered term about *how or where the parties would litigate any alleged breach of a contract duty and the scope of available damages*:

- upholding a clause *barring future lost profits/consequential damages* in a later breach action: *Metro. Life Ins. Co. v. Nobile Lowndes Int'l*, 84 N.Y.2d 430, 435-6, 439 (1994);

- upholding a *forum-selection clause* in the event of a later breach action: *Beaubois v. Accolade Construction Group, Inc.*, No. 15 Civ. 05302 (GBD), 2016 WL 94255, at *3 (S.D.N.Y. Jan. 7, 2016); and

- upholding an *arbitration clause*: *Recruiters of Albany, Inc. v. Mgmt. Recruiters Int'l, Inc.*, 643 F. Supp. 750, 752 (N.D.N.Y. 1986).

These are cases only about agreements as to *how to litigate* material (and other) breach issues. Litigation "traffic-copping" provisions like these are,

logically, preserved after breach and enforced even if the breach were material. That does not diminish Appellants' argument. They are irrelevant to the issue before the Court: whether material breach of protections against subordination risk for Appellants vitiate the possibility of subordination precisely because performance, rather than breach, would have avoided subordination. Tacitly acknowledging that it has no answer, the Trustee below made no mention of *that* issue at all.

III.

THE SUBORDINATION PROVISION IS VITIATED BECAUSE THE AGREEMENTS ARE REJECTED EXECUTORY CONTRACTS

Appellants' claims cannot be subordinated because the Agreements were executory contracts that were automatically rejected by the Trustee, and thus, as a matter of settled law, the Agreements were rendered wholly unenforceable by the Trustee — with the result, as discussed below, that, pursuant to 11 U.S.C. §502(g)(1), Appellants' claims must be determined based on their *pre*-bankruptcy value (*i.e.*, for the full amount of pre-bankruptcy pension payments accrued pre-bankruptcy and not subject to the Trustee invoking contractual subordination in the debtor's bankruptcy case).[28]

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[28] For purposes of the Trustee's pre-discovery summary judgment motion, both parties and the courts below have assumed the Agreements *are* executory. Because summary judgment *in Appellants' favor* depends on the Agreements being

This is a simple application of the common-sense proposition that "a debtor must assume or reject an entire contract, and cannot cherry-pick the provisions it does not like," *In re Hawker Beechcraft, Inc.*, 486 B.R. 264, 278 (Bankr. S.D.N.Y. 2013), a doctrine unanimously applied in innumerable cases. *See, e.g., AGV Productions, Inc. v. Metro-Goldwyn-Mayer, Inc.*, 115 F. Supp. 2d 378, 390-91 (S.D.N.Y. 2000), *aff'd,* 37 Fed. Appx. 555 (2d Cir. 2002) ("[A debtor] could not have assumed some of the provisions of an agreement and rejected others, because

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executory, Appellants point out that a contract is executory when "the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." *In re Riodizio, Inc.*, 204 B.R. 417, 421 (Bankr. S.D.N.Y. 1997). That is so here. As discussed at Facts §D.4, the Trustee, for example, had outstanding the core contractual duty, among others, to pay Appellants their pensions, *see* Agreements ¶2, while Appellants, for example, had outstanding duties "to repay to Shearson, its successors or assigns" any deferred compensation payments made to them if such payments would have resulted in a violation of minimum net capital thresholds, including in the context of this insolvency, and to comply with demands to submit to medical exams and similar acts needed to maintain life insurance or annuity policies that were the fulcrum of the plan. *See* Agreements ¶¶9(b) & (c); ¶10. Where both parties have ongoing obligations, a contract is executory. *See, e.g., In re Lehman Bros. Holdings Inc.*, 422 B.R. 407, 416 (Bankr. S.D.N.Y. 2010) ("[E]ach of LBSF and BNY has unsatisfied contractual obligations to make various payments. These outstanding obligations to make payments pursuant to the Swap Agreement constitute sufficient grounds to find that the contract in question is executory") (citation omitted). Pursuant to 11 U.S.C. §365(d)(1), "if the trustee does not assume or reject an executory contract … of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected." In this case, there is no dispute the Trustee did not assume the Agreements, and thus they are rejected. *See* Facts §D.4.

under the law of bankruptcy a contract cannot be assumed in part or rejected in part. *See … In re Leslie Fay Cos., Inc.,* 166 B.R. 802, 808 (S.D.N.Y.1994) ('An executory contract cannot be assumed in part and rejected in part'); *In re Atlantic Computer Sys., Inc.,* 173 B.R. 844, 849 (S.D.N.Y. 1994) (a debtor may not 'cherry-pick' pieces of a contract it wishes to assume or reject)"); *In re Atlantic Computer Sys., Inc.*, 173 B.R. 844, 849 (S.D.N.Y. 1994) ("a debtor may not repudiate merely obligations while enjoying other bargained for consideration"); *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1311 (5th Cir. 1985) ("Thus, the often-repeated statement that the debtor must accept the contract as a whole means only that the debtor cannot choose to accept the benefits of the contract and reject its burdens to the detriment of the other party to the agreement"); *In re Metro Transp. Co.*, 87 B.R. 338, 342-43 (Bankr. E.D. Pa. 1988) ("We recognize that assumption or rejection of an executory contract requires an all or nothing commitment"); REJECTION OF EXECUTORY CONTRACTS AND LEASES, Ginsberg & Martin on Bankr. (5th Ed.) §7.03 (2016) ("[t]he trustee may not reject (i.e., breach) one obligation under a contract and still enjoy the benefits of that same contract").

While the District Court concluded that Appellants "fail[] to cite any cases" for the rule that a debtor may not reject a contract and still choose to exercise rights under that same contract or that "those provisions which favor the debtor disappear

from the contract" [SA-14], in light of the large, settled and uniform body of authority discussed above, that conclusion is manifestly incorrect.

In fact, the result below — permitting the Trustee to reject, selectively, the Agreements' chief burden, the payment obligation (thereby leaving Appellants with only massively discounted bankruptcy claims), but then enforce, and benefit the bankruptcy estate through, the Agreements' subordination provision (vitiating the remaining value of Appellants' claims completely) — is textbook impermissible cherry-picking. It is absolutely unprecedented, flying in the face of these legions of cases, *and neither the Trustee nor the courts below have cited a single case in which a debtor was permitted to enforce a subordination — or any other — provision in an executory contract it has chosen to reject*.

Below, the Trustee argued, without citation to a single subordination case or to *any* case where a *debtor* was permitted to enforce provisions in a rejected contract, that a subordination provision should constitute some sort of extraordinary exception to the otherwise unequivocal "no cherry-picking" doctrine described above. But even in analogous scenarios, such as where even a rejected party (other than the rejecting trustee) seeks to enforce post-breach liquidated damages provisions in a rejected contract, courts have affirmed the doctrine to be absolute, holding that "[i]f an executory contract is rejected, its damages clause is also rejected." *In re TransAmerican Nat. Gas Corp.*, 79 B.R. 663, 667 (Bankr.

S.D. Tex. 1987) ("To enforce the liquidated damages clause of a duly rejected executory contract would in effect enforce the executory contract…. [T]his court adopts the principle of law as articulated in the cases cited and recognizes that the full executory contract is rejected"); *In re Hamilton Roe Intern., Inc.*, 162 B.R. 590, 596 (Bankr. M.D. Fla. 1993) ("[W]hen a debtor rejects an executory contract, a debtor rejects the contract in its entirety…. *As a result, the contractual remedies contained in a damage provision are similarly unenforceable*…. [T]he Court finds that Plaintiff is unable to enforce the agreement's damage provision. *If the contract is executory and deemed rejected, the entire contract is repudiated, including the damage clause*") (emphasis added). In light of this caselaw that prohibits *even the non-rejecting creditor* from relying upon contractual provisions addressing the terms of a recovery, it would be all the more anomalous to permit the *debtor* — the party that made the economic choice to reject, and thus breach, the contract — to enforce contractual provisions such as subordination.

In response to this rule and caselaw, the Trustee and the District Court have stated and relied upon no more than an uncontroversial proposition invariably invoked in cases *to benefit creditors* and protect their rights to ordinary damages for breach in the face of the debtor's rejection of a contract: in that limited sense, the Trustee is correct that rejection "does not completely terminate the contract." [SA-13] This proposition has never been and cannot be used to benefit the *debtor*

or to resurrect a rejected subordination clause. Rather, the basic point of this doctrine, even as described in the very cases upon which the Trustee and the District Court rely, is only that the debtor's rejection does not make the *creditor's* contractual rights vanish, but rather, gives rise to a claim for a breach. In one case discussed by the District Court [SA-13], *Matter of Contl. Airlines*, 981 F.2d 1450 (5th Cir. 1993), the court made clear that its holding addressed only the effect of rejection *on the debtor's* burdens from the contract and did not suggest in any way that there could be any possible further burdens on *the creditor* whose contract is rejected (and as to whom the debtor may not selectively cherry-pick and use some parts of the contract). *See id.* at 1459. The court held, as to *the debtor* being barred from avoiding contract burdens upon rejection or avoiding the consequences of rejection/breach, "that [the debtor's] rejection … of the collective bargaining agreement between the parties did not serve to relieve [the debtor] of its obligations under the agreement," *id*. at 1452, and that "a party aggrieved by contract rejection may assert a claim for damages [which the debtor sought to avoid based on the rejection]…. Contract rejection damages are based upon what an employee would have made under the rejected contract"). That holding supports Appellants' defense that Appellants were owed exactly what they claim now: their pre-bankruptcy pension accruals (what they "would have [had] under the rejected contract" before the bankruptcy).

The other two cases cited by the District Court are similarly limited to a holding about *the debtor's* continuing burden, with no support for the result this Trustee seeks here, based on those two cases. *See In re Lavigne*, 114 F.3d 379, 386-87 (2d Cir. 1997) (concerning the issues before *this Court in this case, Lavigne* held only that "[t]he *debtor's* obligations are unaffected [by rejection], and provide the basis for a claim;" the remainder of the discussion merely appears more complicated in other respects because the debtor had the contract right to cancel the contract pre-bankruptcy, equivalent to post-bankruptcy rejection, with the contract expressly providing that termination for any reason will give the debtor 60 days to purchase insurance "tail coverage," and the court held rejection was immaterial and equivalent to such contractual termination so that the "tail coverage" right could be exercised, and also that the insurance "tail coverage" option at issue in that case was in any event "more than a contractual obligation — it is a statutory obligation" (all facts irrelevant here)) (emphasis added, citation omitted); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 687, 703 (Bankr. S.D.N.Y. 1992) ("Rejection merely frees the estate from the obligation to perform; it does not make the contract disappear. Accordingly, *we also reject the Debtor's argument that it can reject the ground out from under Cohen's interest in the escrowed bond portfolios*," enforcing a creditor's pre-bankruptcy escrowed property right upon rejection (emphasis added)).

None of these cases, nor any other case research has revealed, involves a scenario where, as here, the Trustee would reject, *i.e.*, breach, the contract and then still expect to enforce its contractual rights against the creditor to improve still further the bankruptcy estate's financial position at the creditor's expense. Yet that is what this Trustee seeks here. In fact, these cases hold that the creditor is entitled to what it would have had *prior* to the bankruptcy filing — exactly what Appellants here claim. As *Contl. Airlines*, *supra*, plainly states, "[c]ontract rejection damages are based upon what an employee would have made under the rejected contract." *Id.* at 1459; *see also* 11 U.S.C. §502(g)(1) ("claim arising from the rejection, under section 365 of this title …, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined … the same as if such claim had arisen *before the date of the filing of the petition*" (emphasis added)); *see also In re Leslie Fay Companies, Inc.*, 166 B.R. 802, 808 (Bankr. S.D.N.Y. 1994) (if an executory contract is rejected, "the breach in accord with what has been termed the 'relation back' doctrine is treated as if it had occurred prepetition").

Applying this doctrine, what the employees here would have received under the rejected Agreements are, of course, *their pension payments*, accruals through September 2008, as measured immediately *prior to* the bankruptcy, *viz.*, the amount of their claims here, not subordinated bankruptcy claims; at the same time,

rejection cut off future interest accruals. *See, e.g., In re Andover Togs, Inc.*, 231 B.R. 521, 544 (Bankr. S.D.N.Y. 1999) ("When … a debtor rejects an unexpired lease, the breach is deemed to occur at the time the bankruptcy petition was filed, 11 U.S.C. §365(g)(1), and the result of the breach is to give the landlord a general unsecured claim for damages caused by that rejection").

That payment of the pre-bankruptcy accrual is, of course, payable at the bankruptcy recovery rate, an approximately 60% reduction in this case, the so-called "bankruptcy discount," and that reflects the substantial benefit the Trustee achieves for the bankruptcy estate from rejecting rather than assuming and paying the executory Agreements — in exchange for having to abide by the no "cherry-picking" rule. In accordance with that rule, no authority — and no case identified below — permits the Trustee to invoke further contractual rights in the rejected contract to *subordinate* these claims and reduce their value still further (here, to zero).

The District Court incorrectly relied on the Agreements' statement that the obligations to pay Appellants are "unsecured subordinated obligations," ¶5(d), and that Appellants "shall not be entitled to participate or share … in the distribution of the assets of Shearson" until all senior claims are paid, ¶9(d), to conclude that what Appellants would have received, *even in the event of a pre-petition breach*, are subordinated claims. [SA-14] This is error for two reasons.

First, as discussed above, rejection vitiates those provisions, and the Trustee cannot invoke them. But second, separately, the District Court ignores the statutory mandate and correct analysis that Appellants' rights upon rejection are measured "the same as if such claim had arisen *before the date of the filing of the petition.*" 11 U.S.C. §502(g)(1) (emphasis added). What Appellants had pre-bankruptcy was not just a right to "participate … in [a] distribution of assets" in a bankruptcy. On that "date," Appellants had full right to payment of their accrued pensions, could have sued for and collected on that right and would have received that full amount at that time without being vitiated by "subordination." In bankruptcy, they receive what they would have received then, pre-petition (though of course later subject to the same "discount" suffered by all creditors). No case allows the Trustee to reject a contract, but then vitiate the claims further by invoking a contract clause, whether subordination or any other potential burden on a rejected party which a rejecting Trustee could find in a contract. No case holds otherwise, and executory contract law requires the result that Appellants' executory contract defense seeks.[29]

[29] The District Court and Trustee also discussed what can only be called "scare" arguments that deferred compensation agreements could never have enforceable subordination clauses and that these Agreements, if subordination falls with rejection, would never be subordinated, because they would never be assumed. [SA-14] If true, it would be irrelevant if executory contracts law requires that result. It operates blind, as it must, to consequences for contracts that it must take as found and analyze under a uniform rule consistently applied. It would not be an

For all these reasons, the Trustee's rejection of these executory contracts renders the subordination provisions unenforceable.

IV.

APPELLANTS' CROSS-MOTION FOR SUMMARY JUDGMENT SHOULD BE GRANTED

The undisputed facts and law compel summary judgment *in Appellants' favor*. For the reasons discussed at §I., the Agreements' subordination clause cannot apply because a successor to Shearson emerged. For the reasons discussed at §II., the debtor materially breached the Agreements in ways that vitiated protections Appellants had from subordination, and thus vitiated any possibility of subordination. For the reasons discussed at §III., the Agreements are rejected executory contracts, and the subordination provision falls with rejection.

The Trustee asserted that it needed discovery to oppose Appellants' cross-motion. But it was incumbent upon the Trustee to have submitted an affidavit showing, in essence, what specific discovery it needed from Appellants, how

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absurd consequence, but rather, a commonplace — though sometimes counterintuitive — result of the law of executory contract rejection. But more, (i) not all deferred compensation (or other) contracts are executory, so these rules would not apply to "all;" (ii) Appellants' ongoing duties could have ended in some circumstances, such that even these contracts would cease to be executory; and (iii) the subordination provision at issue still had meaning for Shearson pre-bankruptcy because the mere prospect of subordination gave Shearson benefits in measuring its capital reserves. The outcomes posited are not so scary.

discovery would help oppose the motion, what efforts it had made to obtain discovery and why it was unable to obtain those materials from its own files.[30] *See* Fed. R. Civ. P. 56(d) (nonmovant must show by affidavit or declaration that, for specified reasons, it cannot present facts essential to justify its opposition); *see also* *Gurary v. Winehouse*, 190 F.3d 37, 43-44 (2d Cir. 1999) ("party resisting summary judgment on the ground that it needs discovery … must submit an affidavit showing '(1) what facts are sought [to resist the motion] and how they are to be obtained, (2) how those facts are reasonably expected to create a genuine issue of material fact, (3) what effort affiant has made to obtain them, and (4) why the affiant was unsuccessful in those efforts'"). "[T]he failure to file such an affidavit is fatal to a claim such as [the Trustee made] even if the party resisting the motion alluded to a claimed need for discovery in a memorandum of law." *See id*. The Trustee's failure to file such proof and its more fundamental failure to explain why it needs discovery on these issues from Appellants, *rather than from, in substance, itself (and the materials it controls)*, were fatal to any attempt by the Trustee to oppose Appellants' cross-motion on the basis it needed discovery. Appellants' cross-motion for summary judgment should have been granted.

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[30] Notably, Appellants submitted a Declaration as part of their opposition to the Trustee's summary judgment motion which *does* make it abundantly clear that and why Appellants require discovery, how it would help oppose the motion and efforts Appellants have made to pursue discovery (including specific discovery requests that the Trustee had ignored for years). [A-353-55, 361]

Conclusion

For the foregoing reasons, this Court should reverse and either direct summary judgment in Appellants' favor or remand the case for discovery and trial.

Dated: February 5, 2019

SCAROLA ZUBATOV SCHAFFZIN PLLC

By__/s/_Richard J.J. Scarola______________
Richard J.J. Scarola
Alexander Zubatov
Attorneys for the 344 Individuals Identified in the Notices of Appearance at Bankr. ECF Dkt. Nos. 8234, 8905 & 9549
1700 Broadway
41st Floor
New York, NY 10019
Tel.: (212) 757-0007

CERTIFICATE OF COMPLIANCE WITH FEDERAL RULE OF APPELLATE PROCEDURE 32(a)

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B), as enlarged in this appeal in accordance with this Court's Order dated December 17, 2018, allowing the parties to file opening briefs of up to 21,000 words, because it contains 20,991 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(5) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14-Point font.

Dated: February 5, 2019

SCAROLA ZUBATOV SCHAFFZIN PLLC

By__/s/_Richard J.J. Scarola_____________
Richard J.J. Scarola
Alexander Zubatov
Attorneys for the 344 Individuals Identified in the Notices of Appearance at Bankr. ECF Dkt. Nos. 8234, 8905 & 9549
1700 Broadway
41st Floor
New York, NY 10019
Tel.: (212) 757-0007