Hearing Date: May 19, 2003 at 10:00 a.m.
Objection Deadline: May 13, 2003 at 4:00 p.m.

**UNITED STATES BANKRUPTCY COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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| In re:<br><br>WORLDCOM, INC.,<br><br>Debtors. | Chapter 11<br><br>Case No. 02-13533 (AJG)<br><br>Jointly Administered |

# OBJECTION OF ALAN G. HEVESI, COMPTROLLER OF THE STATE OF NEW YORK, AS ADMINISTRATIVE HEAD OF THE NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS AND AS TRUSTEE OF THE NEW YORK STATE COMMON RETIREMENT FUND, TO THE ADEQUACY OF THE DEBTORS' DISCLOSURE STATEMENT PURSUANT TO SECTION 1125 OF THE BANKRUPTCY CODE DATED APRIL 14, 2003

Alan G. Hevesi, Comptroller of the State of New York, as Administrative Head of the New York State and Local Retirement Systems and as Trustee of the New York State Common Retirement Fund, the Court-appointed lead plaintiff ("Lead Plaintiff") in the consolidated securities class action captioned *In re WorldCom, Inc. Securities Litigation,* Master File No. 02 Civ. 3288 (DLC) (S.D.N.Y.), individually and on behalf of all other persons and entities who purchased or acquired publicly traded shares, bonds or notes of WorldCom, Inc. ("WorldCom" or the "Debtor") between April 29, 1999 and June 25, 2002 (collectively, with Lead Plaintiff, the "Class Claimants"), objects to the adequacy of the Debtors' Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code, dated April 14, 2003 (the "Disclosure Statement"), and states as follows:

## BACKGROUND

1. On July 21, 2002 and November 8, 2002 (the "Petition Dates"), WorldCom and certain of its direct and indirect domestic subsidiaries (collectively, the "Debtors") commenced individual cases under Chapter 11 of the United States Bankruptcy Code. The cases are being jointly administered.

2. On or about October 11, 2002, Lead Plaintiff filed a consolidated class action complaint against certain of WorldCom's former officers, directors, auditors, underwriters, investment bankers, advisors and others (collectively the "Non-Debtor Defendants") alleging violations of §§ 11, 12(a)(2) and 15 of the Securities Act of 1933 in connection with the various public offerings of the publicly traded shares, bonds and notes and §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 in connection with secondary market purchases of WorldCom shares, bonds and notes. WorldCom was not named as a defendant pursuant to the automatic stay (11 U.S.C. § 362(a)).

3. The Securities Litigation is proceeding against the Non-Debtor Defendants.

4. On or about April 14, 2003, the Debtors filed the Disclosure Statement and Joint Plan of Reorganization (the "Plan").

5. The Class Claimants appear to be members of Class 7 ("WorldCom Subordinated Claims") under the Plan (*see* Disclosure Statement ("D.S.") at p. 62-63; Plan at p. 16).

6. WorldCom Subordinated Claims consist of *all* Securities Litigation Claims (D.S., at p. 62), defined as

> Claims[s] against any of the Debtors, whether or not the subject of an existing lawsuit, arising from rescission of a purchase or sale of shares or notes, or any other securities of any of the Debtors or any affiliate of any of the Debtors, for damages from the purchase or sale of any such security, or, except as otherwise provided for in the Plan, for reimbursement, contribution, or indemnification allowed under 502 of the Bankruptcy Code on account of any such Claim, including Claims based upon allegations that the Debtors made false and misleading statements and engaged in other deceptive acts in connection with the sale of securities.

Plan, at p. 10; *see also* D.S., at 62.

7. Class 7 includes bond purchase and stock purchase litigation claims held by the Class Claimants, which, under the Plan, are treated as subordinated pursuant to 11 U.S.C. § 510(b).

8. Holders of allowed Class 7 Claims and/or Interests receive no distribution under the Plan. *See* D.S., at 63; Plan at 16.

**PRELIMINARY STATEMENT**

9. A disclosure statement may be approved as adequate only if it contains information sufficient to allow a "reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan." 11 U.S.C. § 1125(a). Lead Plaintiff submits that the Disclosure Statement does not satisfy this requirement as it does not contain sufficient information to enable a reasonable person to make an "informed judgment about the Plan." The Plan and Disclosure Statement are ambiguous and/or omit material facts that may mislead or preclude holders of claims or interests from making judgments about the Plan or cause such holders to assume that classifications and conclusions reached by the Debtor in the Plan and Disclosure Statement are appropriate. In addition, the Plan does not comply with the requirements of the Bankruptcy Code.

10. As shown herein, the Plan and Disclosure Statement require modifications to bring the Disclosure Statement into compliance with 11 U.S.C. § 1125, and to make the Plan confirmable under the Bankruptcy Code. Specifically, the Disclosure Statement is not adequate and should not be approved for the following reasons:

A. The classification of bond purchase litigation and stock purchase litigation claims is improper under 11 U.S.C. § 1122(a) and contrary to the meaning and intent of 11 U.S.C. § 510(b);

B. The Plan and Disclosure Statement describe broad injunctions, which are improper and fail to affirmatively state the Plan (i) does not release the

non-Debtor Defendants or any non-Debtor from the claims asserted in the Securities Litigation, and (ii) do not affect in any way Lead Plaintiff's right, individually and on behalf of the Class Claimants to obtain relief for the claims asserted in the Securities Litigation against any non-Debtor; and

C. The Disclosure Statement fails to provide any information concerning the pending trustee motions filed by the Ad Hoc MCI Trade Claims Committee and Dissenting MCI Bondholders, both of which refer to the Debtors' attempt to substantively consolidate the cases through the Plan; nor does it disclose the Indenture Trustee's Motion for the Appointment of an Official Committee of MCI Communications Creditors. Not only must the motions be disclosed, but the impact on the creditors and on the Debtors' reorganization in the event either motion is granted must be described as well.

11. ***To the extent any objection, in whole or in part, contained herein is deemed to be an objection to confirmation of the Plan rather than, or in addition to, an objection to the adequacy of the Disclosure Statement, Lead Plaintiff reserves the right to assert such objections, as well as any other objection, to confirmation of the Plan.***

## OBJECTION

### A. The Classification of Bond Purchase Litigation and Stock Purchase Litigation Claims is Improper under 11 U.S.C. § 1122(a) and is Contrary to the Meaning and Intent of 11 U.S.C. § 510(b).

12. Classification of claims or interests is governed by Bankruptcy Code Section 1122, which provides that substantially similar claims or interests should be included in the same class. *See* 11 U.S.C. §1122(a).

13. The Class Claimants recognize the well-accepted principle that the Bankruptcy Code's requirement of substantial similarity does not mean that claims or interests within a particular class must be identical. *See*, *e.g.*, *In re DRW Property Co.*, 60 B.R. 505, 511 (Bankr. N.D. Tex. 1986). It is equally well established that Section 1122 "bars aggregating dissimilar claims in the same class." *In re Boston Post Road Ltd. Partnership*, 21 F.3d 477, 481 (2d Cir. 1994). Since the bond litigation claims are dissimilar to the other subordinated claims in Class 7, these types of claims cannot, consistent with the Bankruptcy Code, be classified together.

14. When Congress enacted the Bankruptcy Code in 1978, it intended in part to clarify the treatment of claims by defrauded shareholders, whose "unsettled status" had created confusion in cases decided under the Bankruptcy Act. *In re Computer Devices, Inc.*, 51 B.R. 471, 478-479 (Bankr. D.Mass. 1985). Compare *Oppeheimer v. Harriman Nat'l. Bank*, 301 U.S. 206 (1937) (defrauded shareholder claims were equal to general unsecured claims) with *In re Stirling Homex Corp.*, 579 F.2d 206 (2d Cir. 1978) (defrauded shareholder claims were not entitled to priority over common shareholders). To clarify the treatment of such claims, Congress included Section 510(b) in the Bankruptcy Code, which mandates the subordination of claims based upon the rescission of a purchase or sale of a security to claims based upon the underlying security.

15. Creditors whose subordinated claims are based on debt instruments are granted the same status as general unsecured creditors. *See In re Computer Devices*, 51 B.R. at 479 (quoting S. Rep. No. 989). However, "'[i]f the security is an equity security, the damages or rescission claim is subordinated to all creditors *and treated as the equity security itself*.'" *Id.* (emphasis added).

16. Based on the foregoing, *Section 510(b) bond litigation claims have the same status as general unsecured claims and, accordingly, are senior to all other Section 510(b) claims.* Accordingly, the bond litigation claims are improperly classified as Class 7 under 11

U.S.C. § 1122(a).[1] Such claim holders should participate in any distribution under the Plan to the same extent as general unsecured creditors rather than be lumped with claims which are junior in status. Moreover, while some bond purchasers still retain the subject bonds, a substantial number no longer hold them, but nonetheless have been damaged by the Debtors, including WorldCom, and should be compensated. Indeed, there is no basis to eliminate a significant group of bond purchasers who were defrauded by WorldCom and others from participation in any distribution under the Plan simply because they no longer retain the bonds they purchased. At the very least, for Disclosure Statement purposes, information should be provided regarding this classification dispute and its potential impact on distributions under the proposed Plan.

### B. The Plan and Disclosure Statement Improperly Provide Broad Releases to Non-Debtors and Improperly Enjoin the Prosecution of Claims Against Non-Debtors.

17. The Plan provides and the Disclosure Statement describes broad releases and injunctions such that non-Debtors are being released without any showing that such extraordinary releases satisfy the rigid requirements of applicable case law holding that such releases are appropriate only in certain rare circumstances.

18. The Plan and Disclosure Statement provide that all holders of a claim or interest against the Debtors' (including WorldCom's) current or former officers, directors, agents, employees or principals "are *permanently enjoined* … from commencing or continuing in any manner, *any action or other proceeding of any kind* with respect to any such Claim or Equity Interest." D.S. at 76; Plan §10.04, at 33 (emphasis added).

19. The Plan therefore appears to effectively release the Non-Debtor Defendants and other non-Debtors from any and all liabilities for the claims asserted in the Securities Litigation,

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[1] In its formulation of Class 10 and Class 13, the Debtors acknowledge the need to classify subordinated bond claims separately. The Debtors offer no justification for their attempt to classify all subordinated claims of the WorldCom entities in a single class, Class 7.

despite the fact that the Class Claimants are receiving nothing for such release and are deemed to reject the Plan. Thus, the release and injunction is nonconsensual and is supported by absolutely no consideration.

20. The underlying facts here do not even remotely resemble the factual underpinnings for the releases allowed in *SEC v. The Drexel Burnham Lambert Group, Inc*. (*In re The Drexel Burnham Lambert Group, Inc.*), 960 F.2d 285 (2d Cir. 1992); *cert. dismissed*, 506 U.S. 1088, 122 L. Ed.2d 497, 1133 S.Ct. 1070 (1993); *Abel v. Shugrue* (*In re Ionosphere Clubs,* Inc.*),* 184 B.R. 648 (S.D.N.Y. 1995); and *Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694 (4th Cir. 1989), *cert. denied*, 493 U.S. 959, 110 S.Ct. 376, 107 L.Ed.2d 362 (1989). The Debtors herein fail to provide in either the Plan or Disclosure Statement any factual basis to establish the required "unusual circumstances" which justify confirmation of a plan containing such extraordinary relief.

21. The issues in *Drexel* involved class certification, approval of a settlement of class claims against the debtor, and a fixed pool of assets to satisfy the claims. The settlement provided, in part, that future claims of a sub-class against the debtor's officers and directors were enjoined. The Second Circuit found that absent the injunction, the officers and directors would not have settled. The settlement agreement was essential to the ultimate reorganization of the debtor as it resulted in substantial funds to be distributed to individuals such as the Class Action Plaintiffs herein. 960 F.2d at 293.

22. Following *Drexel*, other courts within the Second Circuit have relied on its restriction or limitation of non-debtor releases to the facts of that case. In *In re St. Johnsbury Trucking Co., Inc.*, 185 B.R. 687 (S.D.N.Y. 1995), the federal government sought a stay of the order confirming the debtor's plan because the plan provided for the release of certain non-debtors from claims under the federal environmental and tax statutes. Citing *Drexel*, the court noted that the debtor failed to "conclusively establish the propriety of . . . the releases." 185 B.R.

at 689. The court recognized the requirement that clear and discrete circumstances be established to justify non-debtor releases.

23. In *The LTV Corp. v. The Aetna Casualty and Surety Co. (In re Chateauguay Corp.)*, 167 B.R. 776 (S.D.N.Y. 1994), the court noted that the broad power provided to the Bankruptcy Court by 11 U.S.C. §105(a) does not give "unfettered discretion to discharge a non-debtor from liability." *Id.* at 780. The Court considered *Drexel*, *MacArthur v. Johns-Manville Corp.*, 837 F.2d 89, 93 (2d Cir. 1988), *cert. denied*, 488 U.S. 868, 109 S.Ct. 176, 102 L.Ed.2d 145 (1988); and *A.H. Robins, supra*, where the debtors provided clear factual support and where unusual circumstances existed so as to allow the respective courts to conclude that the releases were essential to the reorganization because the released parties were making substantial contributions to the reorganizations.

24. The Second Circuit's position regarding releases and injunctions of claims against non-debtor parties has also been considered in recent decisions of both the Third and Sixth Circuits. These decisions emphasize the Second Circuit's requirement *that non-debtor releases may only be permitted under certain unusual circumstances*.

25. The Third Circuit in *Gillman v. Continental Airlines* (*In re Continental Airlines*), 203 F.3d 203 (3d. Cir. 2000), provides a thorough analysis of third party releases, supporting the rationale of those cases which have permitted third parties releases and injunctions where the parties that were enjoined (creditors) were provided with some meaningful consideration for the loss of their rights against non-debtors. *Continental*, at 212. *Drexel, supra*, at 293; *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640, 649 (2d Cir. 1988); *A.H. Robins, supra*, 880 F.2d at 702. The consideration was provided through "substantial contributions" paid by the non-debtor parties in exchange for their releases. *Continental* at 213.

26. Perhaps the best analysis for the allowance of the injunction in *Drexel* was provided by the Fifth Circuit in *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746 (5th Cir.

1995). The Second Circuit "'upheld permanent injunctions of third party claims because while the injunction permanently enjoined the lawsuits, it also channeled those claims to allow recovery from separate assets and thereby avoided discharging the non-debtor.'" *Continental*, at 213, quoting *Zale*, at 760.

27. As in *Zale*, no alternative means is provided to the Class Claimants here to recover from the Non-Debtor Defendants. The Plan and the Disclosure Statement are silent as to any contributions being made by any of the Non-Debtor Defendants in exchange for the extraordinary injunctive relief apparently provided to them in the Plan. The Plan and Disclosure Statement do not reveal that any financial accommodation is being made by the released parties in favor of the Class Claimants in consideration for releasing their claims. On the contrary, securities claimants are being totally disenfranchised under the Plan, and the claims being prosecuted against certain of these non-Debtor defendants in the Securities Litigation arguable would be extinguished.

28. Confirmation of a plan requires that it satisfies *all* of the elements of 11 U.S.C. § 1129(a). 11 U.S.C. § 1129(a)(1) requires that the Plan comply "with the applicable provisions of [Title 11 of the United States Codes; *i.e.*, the Bankruptcy Code]."

29. Lead Plaintiff submits that the Plan does not comply with the applicable provisions of Title 11, specifically 11 U.S.C. §§ 524(e) and 1122(a).

30. 11 U.S.C. § 524(e) provides that:

> the discharge of a debt of a debtor does not affect the liability of any other entity on, or the property of any other entity for such debt.

31. Clearly, the Release of the Class Claimants' claims against non-Debtors is inconsistent with the provisions of the Bankruptcy Code, and the Plan is therefore unconfirmable.

32. If it is the Debtor's intention to release non-Debtor third parties with respect to the claims in the Securities Litigation, then the Disclosure Statement describes a plan of reorganization that is unconfirmable on its face and, therefore, should not be approved. See, *e.g.*, *In re 266 Washington Associates*, 141 B.R. 275, 288 (Bankr. E.D.N.Y. 1992) ("A disclosure statement will not be approved where, as here, it describes a plan which is fatally flawed and thus incapable of confirmation."), *aff'd*, 147 B.R. 827 (E.D.N.Y. 1992); *In re Copy Crafters Quickprint, Inc.*, 92 B.R. 973, 980 (Bankr. N.D.N.Y. 1988) ("[A]pproval [of a disclosure statement] should not be withheld if … it is apparent that the plan will not comply with [Bankruptcy] Code §1129(a)…"); *In re Pecht*, 57 B.R. 137, 139 (Bankr. E.D.Va. 1986)("If, on the face of the plan, the plan could not be confirmed, then the court will not subject the estate to the expense of soliciting votes and seeking confirmation"). This principle applies here. The Plan (and Disclosure Statement) - or at least those portions purporting to grant third party releases without providing adequate justification and consideration - do not satisfy the Bankruptcy Code's various confirmation requirements. Assuming the Debtors are willing and able to cure the identified informational defects, there are certain glaring problems that cannot be remedied even through additional disclosure. As to those matters, the Court need not await the resolution of confirmation objections. These facial defects render the Plan unconfirmable as a matter of law and should preclude further consideration of the Disclosure Statement.

### C. The Disclosure Statement Fails to Provide Information Concerning the Pending Trustee and Committee Formation Motions.

33. On April 17, 2003, the Ad Hoc MCI Trade Claim Committee moved for the appointment of a Chapter 11 trustee to administer the affairs of the debtor, MCI Communications Corporation ("MCIC").

34. On April 21, 2003, the Dissenting MCI Bondholders moved for the appointment of a Chapter 11 trustee for MCIC.

35. Both motions arise out of the Plan's attempt to substantively consolidate all of the jointly administered cases rather than provide for a stand alone plan for MCIC.

36. Based upon the same premise, on April 30, 2003, HSBC Bank USA, as Indenture Trustee under the Junior Subordinated Indenture dated as of May 29, 1996; and the Supplemental Indentures dated as of May 29, 1996, July 24, 1998, and November 12, 1998, with respect to MCIC's Subordinated Deferrable Interest Debentures, filed a motion for the appointment of a separate official committee of MCI creditors to assure adequate representation of all MCI creditors in the bankruptcy proceeding.

37. The mere fact that these motions have been filed, together with the impact on all creditors should the motions, or one of them, be granted, must be disclosed along with the potential impact on the proposed distributions under the Plan. Creditors and interest holders must be apprised of such significant events and their potential effect in order to properly evaluate the Plan.

38. Additionally, the consequences of substantive consolidation - pro and con - must be disclosed in order to provide claimants and interest holders sufficient information to make an informed judgment about the Plan. *See* 11 U.S.C. § 1125(a).

39. In the absence of such disclosure, the Disclosure Statement is inadequate and should not be approved.

## CONCLUSION

40. Based on the foregoing, Lead Plaintiff respectfully requests that an Order be entered denying approval of the Disclosure Statement, unless the clarifications and modifications requested herein are made, and granting such other and further relief as the Court deems just and proper.

41. As no novel issue of law is raised by the within Objection and the relevant authorities relied upon by Lead Plaintiff are set forth herein, Lead Plaintiff respectfully requests that the Court waive the requirement of filing a separate memorandum of law in support of the Objection pursuant to L.B.R. 9013-1(b).

Dated: May 13, 2003

Respectfully submitted,


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