In re: VISION OPTICS COMMUNICATIONS, d/b/a VISION COM GROUP, Debtor.	)	Case No. 97-5233 (SHAW) Chapter 11

REPLY OF THE DEBTOR TO THE OBJECTION OF THE UNITED STATES TO THE MOTION FOR AN ORDER AUTHORIZING THE DEBTOR TO MAKE AN INTERIM DISTRIBUTION TO THE JUNIOR SUBORDINATED SECURED NOTEHOLDERS AND OBJECTION TO THE UNITED STATES MOTION FOR A STAY PENDING APPEAL AND REQUEST FOR AN IMMEDIATE HEARING ON MOTION FOR A STAY PENDING APPEAL

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Vision Optics Communications, the debtor and debtor in possession herein, by and through its counsel Goldberg, Ruge, Anwar & Cadet, L.L.P. and Azalia & Orcel, P.C. hereby (i) replies to the Objection of the United States to the Debtor's Motion (the "Motion")[1] for an Order Authorizing the Debtor to Make An Interim Distribution to the Junior Subordinated Secured Noteholders (the "Objection") and (ii) objects to the United States' Motion for a Stay Pending appeal and Request for An Immediate Hearing on Motion for a Stay Pending Appeal (the "Stay Motion"), and in support thereof respectfully represents as follows:

PRELIMINARY STATEMENT

The Objection lacks merit. The United States asserts that the Motion should be denied because (i) "there are no extraordinary circumstances that would justify deviating from the rule that a distribution on pre-petition debt in a chapter 11 case should not take place except pursuant to a confirmed plan of reorganization," (ii) the competing interests of the United States and the Junior Noteholders favors a stay of the distributions and (iii) the Debtor would not be entitled to the relief requested in the Motion pursuant to Bankruptcy Code § 362(d)(2). In addition, in the event this Court is inclined to grant the relief requested in the Motion, the United States seeks a stay pending appeal.

The United States' arguments are wrong. First, courts have uniformly allowed interim distributions to secured creditors. Such distributions are supported where, as here, the estate has been liquidated and the Court has resolved competing interests to the sale proceeds. Second, the

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[1] Capitalized terms used but not defined herein shall have the meaning ascribed to them in the Motion.

competing interests of the Junior Noteholders and the United States do not favor a stay. The United States liberally alleges that there is a great risk that it will not be able to recover money once it is disbursed. The distribution, however, shall be made by the Debtor to State Street Bank & Trust Co. (the "Indenture Trustee"), a reputable, solvent bank, which, in turn, if it so chooses, shall distribute the money to the Junior Noteholders. The estate's obligation is satisfied by paying the Indenture Trustee. Thus, there is minimal or no risk that the Indenture Trustee will not be around in the event the United States prevailed on its appeal. In addition, the Junior Noteholders are generally large investment partnerships that are unlikely to dissipate to avoid suit. Third, because this Court has made clear that the Debtor is unable to confirm a plan of reorganization, the Junior Noteholders would be entitled to relief from the stay. The sales proceeds are not necessary to reorganization and the Debtor does not have any equity in the proceeds.

Finally, the United States cannot sustain its burden for the issuance of a stay pending appeal and as such, the Stay Motion should be denied. First, the United States shall not suffer irreparable harm as a result of distribution. The distribution to the Junior Noteholders shall be made to the Indenture Trustee, a reputable, solvent banking concern. In the event the Indenture Trustee distributes the proceeds to the Junior Noteholders, the United States can seek redress from the Indenture Trustee if it were to prevail on its appeal. In addition, the Junior Noteholders are large funds that are unlikely to dissolve overnight to avoid a collection suit. Second, the Junior Noteholders shall be prejudiced by the delay occasioned by a stay in that they will not be able to maximize their investment. Now that the estate has been liquidated there is no reason why the Junior Noteholders cannot direct the Indenture Trustee to invest the funds in some security bearing more than 4.7% interest. Because the Debtor is precluded from investing the

proceeds in a higher risk security, each day the estate holds the funds, the Junior Noteholders are prejudiced and not adequately protected. Courts have recognized the rights of litigants to seek damages for injury occasioned by a stay pending appeal. Third, the United States cannot establish a "substantial possibility" of success on appeal. Because the United States' entitlement to the funds at issue is dependent on its success in the IRS Adversary Proceeding, this Court should determine not only whether the interim distributions order would be reversed but also whether the IRS has a "substantial possibility" as to the IRS Adversary Proceeding. As a preliminary matter, the order allowing interim distribution has a clear basis in law and fact. Further, as this Court has determined the terms of a confirmation order are res judicata as to all claims and interests treated under the governing plan. Thus, because the United States was a party in interest in the previous bankruptcy who received notice of potential tax consequences of a subsequent plan, this Court has granted summary judgment in favor of the Debtor and the Indenture Trustee. Accordingly, the United States would need to prevail in two (or a consolidated) appeals to have claim to the funds. Finally, the public interest favoring finality to litigation weighs in favor of denying the stay. As discussed above, there is no irreparable harm to the United States whereas the Junior Noteholders lose money every day. Accordingly, the Stay Motion should be denied.

BACKGROUND

The Debtor incorporates by reference the facts set forth in the Motion as if fully set forth herein.

BASIS FOR REPLY AND OBJECTION

The United States asserts that the Motion should be denied because (i) "there are no extraordinary circumstances that would justify deviating from the rule that a distribution on pre-

petition debtor in a chapter 11 case should not take place except pursuant to a confirmed plan of reorganization," (ii) the competing interests of the United States and the Junior Noteholders favors a stay of the distributions and (iii) the Debtor would not be entitled to the relief requested in the Motion pursuant to Bankruptcy Code § 362(d)(2). The Objection, however, lacks merit.

A. INTERIM DISTRUBUTION TO A SECURED CREDITOR IS PERMITTED OUTSIDE OF A PLAN OF REORAGNIZATION

Courts have routinely allowed interim distributions to secured creditors, particularly where disputes over priority to the funds has been resolved in the first instance by the court and despite the threat of an appeal. Century Brass Prods., Inc. v. Colonial Bank (In re Century Brass Prods., Inc.), 95 B.R. 277 (D. Conn. 1989) (Cabranes, J.) (discussing that proceeds of sale were ordered turned over to the secured creditor with prior security interest; bankruptcy court had determined and district court agreed that senior secured creditor was not subject to marshalling thus it was entitled to sales proceeds); United States v. Valley Nat'l Bank (In re Decker), 199 B.R. 684 (B.A.P. 9th Cir. 1996) (court affirmed distribution of sale proceeds, in part, because bankruptcy court properly concluded secured creditor's interest in proceeds was superior to lien held by IRS); In re LMS Holding Co., 197 B.R. 915, 916-17 (Bankr. N.D. Okla. 1996) (court authorized distribution of all sales proceeds to undersecured creditor upon determination that IRS' claim was junior to undersecured creditor); Nat'l Bank of Commerce v. McMullan (In re McMullan), 196 B.R. 818, 835 (Bankr. W.D. Ark. 1996), aff'd, 162 F.3d 1164 (8th Cir. 1998) (court directed chapter 11 trustee to sell debtor's assets and make interim distributions according to Bankruptcy Code priorities); In re Ridgely Commc'ns, Inc., 139 B.R. 374 (Bankr. D. Md.

1992) (granting secured creditor's motion to distribute sale proceeds from sale of FCC license despite dispute that debtor did not have property interest in FCC license); In re Vernon-Linden Assocs., 117 B.R. 934, 941 (Bankr. C.D. Ill. 1990) (court discussed interim payment of proceeds to secured creditor prior to plan confirmation); In re San Jacinto Glass Indus., Inc., 93 B.R. 934 (Bankr. S.D. Tex. 1988) (court authorized interim distribution of sales proceeds to secured creditor where creditor held undisputed claim, would inevitably receive the proceeds at some point in the future and other creditors will still have the benefit of the chapter 11 protections; court denied application of marshalling doctrine in determining that secured creditor held undisputed claim). See Tenn. Valley Steel Corp. v. B.T. Commercial Corp. (In re Tenn. Valley Steel Corp.), 186 B.R. 919 n.5 (Bankr. E.D. Tenn. 1995) (court discussed its prior order authorized distribution of sales proceeds to undersecured creditor); G-K Dev. Co., Inc. v. Broadmoor Place Invs., L.P. (In re Broadmoor Place Invs., L.P.), 157 B.R. 34, 35 (D. Kan. 1993) (upholding distribution of sale proceeds); but see The Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299 (4th Cir. 1987) (court denied pre-confirmation payments to unsecured creditors, in part, because pending the confirmation of a plan the effect of pre-confirmation payments to some creditors would be disparate treatment of similarly situated creditors).

Here, the dispute as to entitlement to the monies has been resolved by this Court in favor of the Indenture Trustee. As a result of the Adversary Opinion, all objections that were or could have been brought to challenge the Junior Noteholders' claims have been resolved. This Court determined that the United States was barred by the res judicata effect of the Debtor's prior confirmation order which clearly provided for the possibility of a post confirmation sale of Debtor's property and which indicated that in the event such a sale occurred and sales proceeds proved inadequate, the Junior Noteholders would have priority as secured creditors over the

United States for any liability arising out of the subsequent sale. Thus, the entitlement of the Junior Noteholders to the remaining proceeds is settled and distribution should be authorized.

The United States, however, contends that absent extraordinary circumstances, a court should not permit a deviation from the rule that a distribution on pre-petition debt in a chapter 11 case should not take place except pursuant to a confirmed plan of reorganization. Objection at ¶ 7. In addition, the United States asserts that those cases allowing interim distribution are limited to instances where there was no dispute as to the validity of the pre-petition claim, or a plan was proposed or the creditor was fully secured and denied adequate protection.[2]

The cases relied upon by the United States are inapposite. The few courts that have denied interim distributions to creditors have done so in the limited circumstances where there was an unresolved dispute as to entitlement to proceeds. Accordingly, these courts have concluded that to allow interim distributions would allow a debtor to circumvent the requirements attendant to confirmation of a chapter 11 plan and provide little incentive for parties in interest to prosecute the case in an expeditious manner. In re Conroe Forge & Mfg. Corp., 82 B.R. 781, 785 (Bankr. W.D. Pa. 1988) ("[i]f distribution is made to creditors in a liquidating [c]hapter 11 before confirmation of a plan there will be little incentive for parties . . . to prosecute the case in an expeditious manner much less to perform the work required to issue and obtain approval of a disclosure statement and plan"); Rosenberg Real Estate Equity Fund Ill. v. Air Beds, Inc. (In re Air Beds, Inc.), 92 B.R. 419, 422 (B.A.P. 9th Cir. 1988) (by distributing assets prior to confirmation, "there is [a] potential for circumventing the requirements attendant to the confirmation of a [c]hapter 11 plan." i.e., proposal, disclosure and confirmation of a plan).

In Conroe, for example, a secured bank sought immediate payment of proceeds from the sale of equipment. In denying the distribution of the proceeds, the court held that (i) there was a pending adversary proceeding concerning the ownership of the funds as more than one creditor claimed priority, Id. at 788, (ii) the allowed claim of the bank had not been determined, Id. at 785, (iii) because the case was only a few weeks old there was inadequate time to negotiate or form a plan of reorganization, Id. at 787, and (iv) a liquidating plan had been proposed which provided for distributions to other classes of creditors. Id. Thus, the court concluded that the funds from the sale would be required to fund, in part, a plan of reorganization.

Similarly, in Air Beds, the court refused to allow distributions to the Internal Revenue Service ("IRS"). A landlord objected to the distribution of sales proceeds to the IRS alleging a superior lien. The court denied distribution to the IRS because "[it] would allow the debtor to circumvent the provisions of [c]hapter 11 with respect to proposal, disclosure, and confirmation of a plan". Id. at 424. In addition, the court noted that there was considerable confusion over whether the IRS' claims were for pre-petition or post-petition taxes. The court noted that, in the event that the lien was for post-petition taxes, distribution would have allowed the IRS, a seventh priority claim, to be paid before a post-petition rent claim (which held first priority) in violation of Bankruptcy Code § 507. Further, in the event that the case was converted to chapter 7, the landlord's post-petition rent claim would have priority over the IRS' claim for pre-petition taxes pursuant to § 724(b). Thus, in light of the uncertainty concerning priority of distribution the court denied distribution to the IRS.

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[2] As demonstrated above, courts have regularly allowed distributions to secured creditors despite competing interests to the proceeds. These courts allow distribution because the dispute has been decided, notwithstanding the likelihood of an appeal.

Here, (i) the dispute regarding entitlement to the sales proceeds has been resolved and (ii) there is no concern that this case will not be expeditiously prosecuted or the requirements of chapter 11 subverted. As discussed above, the Adversary Opinion resolved the Junior Noteholders' rights to the proceeds. Further, the Debtor has consistently moved this case through Chapter 11. Initially, the Debtor proposed a prepackaged plan of reorganization. Once the Court determined that the plan could not be confirmed, the Debtor promptly moved to sell substantially all of its assets outside of a plan. Promptly upon the closing of the sale, the Debtor proposed to pay off the senior secured creditors to prevent accrual of interest and other charges. On April 26, 1999, this Court issued the Adversary Opinion granting summary judgment in favor of the Debtor and the Indenture Trustee and against the United States. Promptly upon that determination and a finding that the Junior Noteholders' liens could not be subordinated the Debtor moved this Court to distribute the remaining proceeds. The Debtor's conduct in this case makes clear that the Debtor shall not languish in bankruptcy. Further, in light of this Court's denial of confirmation, it is clear that the Debtor cannot confirm a plan of reorganization. Thus, because a reorganization plan cannot be proposed, there is no concern that the Debtor is attempting to short-circuit the claim allowance, notice and disclosure requirements of the Bankruptcy Code.

B. THE COMPETING INTERESTS OF THE UNITED STATES AND THE JUNIOR NOTEHOLDERS MILITATE IN FAVOR OF INTERIM DISTRIBUTION

The United States alleges that "the competing interests of the United States and the Junior Noteholders balances in favor of staying distribution pending a final appeal." Objection at

¶ 8. The United States adds that (i) there is a great risk it will not be able to collect in the event the proceeds are disbursed and (ii) the pecuniary interests of the Junior Noteholders has not diminished since the Petition Date and they are adequately protected by their liens against the sale proceeds.

These contentions are unsupported. As discussed above, there is minimal or no risk that the United States, if it were to prevail on the appeal, would be unable to collect. The distribution to be made by the Debtor shall be to the Indenture Trustee, a large, solvent financial institution. Further, in the event the Indenture Trustee thereafter disburses the proceeds to Noteholders, it is likely that the Indenture Trustee would require indemnity from the Junior Noteholders if disgorgement is sought. In any event, the Noteholders are typically large sophisticated institutions, which are unlikely to dissolve to avoid suit. Moreover, the Junior Noteholders are prejudiced by a denial of the Motion. In the event the proceeds were turned over to the Junior Noteholders, they would invest in a security with an interest rate higher than 4.7%. Because the Debtor is unable to confirm a plan and the distribution to the Junior Noteholders is inevitable, there is no way to adequately protect the interests of the Noteholders absent prompt turnover of the proceeds.

Also, denial of distribution is tantamount to granting a stay pending appeal without requiring the United States to prove the elements necessary to granting of a stay. Although the United States is not required to post security when it seeks a stay, if a stay is granted the Debtor and the Indenture Trustee shall seek damages against the United States occasioned by the stay. [cites]

It is well-established that "the reason for requiring a bond is to secure the prevailing party against any loss that might be sustained as a result of an ineffectual appeal." 9 Collier on

Bankruptcy ¶ 8005.07(2) (1993); see also In re Theatre Holding Corp., 22 B.R. 884, 885 (Bankr. S.D.N.Y. 1982). The "[loss that] might be sustained" id., must be "compensable damages [which] are those which are shown to be the 'natural and proximate' result of the stay." Id. at 885-86 (citations omitted); see also Plachter v. United States (In re Platcher), 1997 U.S. DIST. LEXIS 12856 *7 (S.D. Fla. July 28, 1997) (debtor required to post bond for damages suffered by the Internal Revenue Service as a result of the issuance of the stay); Hartigan v. Pine Lake Vill. Apartment Co. (In re Pine Lake Vill. Apartment Co.), 21 B.R. 395, 397 (Bankr. S.D.N.Y. 1982) (a bond was necessary to protect a secured creditor against any decline in value that the collateral could suffer if the automatic stay was in effect because, absent the stay pending appeal, the creditor could foreclose, thus preventing any further loss in the value of the security).

Here, there is no way adequately to protect the Junior Noteholders absent immediate turnover of the sale proceeds. The denial of distribution, which in turn acts as a stay pending conclusion of the appeal of the IRS Adversary Proceeding, denies the Junior Noteholders the opportunity to invest the sale proceeds elsewhere, thereby preventing them from maximizing their return. Because the Junior Noteholders would be entitled to seek damages from the United States as a result of an ineffectual appeal, the only way to protect adequately and eliminate these damages is to allow interim distribution.

C. THE REMAINING PROCEEDS ARE NOT NECESSARY TO AN EFFECTIVE REORGANIZATION AND SHOULD BE DISTRBUTED

The United States contends that in a liquidating case all sale proceeds are necessary to fund an effective reorganization. Objection at ¶ 9. The United States, however, is incorrect.

Pursuant to Bankr. Code § 362(d)(2), a secured creditor is entitled to relief from the automatic stay if (i) the debtor has no equity in the property at issue, and (ii) the property is not necessary for an effective reorganization. 11 U.S.C. § 362(d)(2). Although the party seeking relief from the automatic stay bears the burden of proving that the debtor has no equity in the subject property, the debtor has the burden of proving that the property is necessary for an effective reorganization. See 11 U.S.C. § 362(g). See also In re Diplomat Elecs. Corp., 82 B.R. 688, 691-92 (Bankr. S.D.N.Y. 1988). If a court determines that the debtor lacks any equity in the property sought to be foreclosed and has no need for the property to reorganize effectively, the automatic stay must be lifted. See In re Kleinman, 156 B.R. 131, 136 (Bankr. S.D.N.Y. 1993); In re Diplomat Elecs. Corp., 82 B.R. at 692.

It is routinely held that when liens on the property exceed its value, there is no equity in the property, and thus the first prong of § 362(d)(2) to lift the automatic stay is satisfied. If the debt is greater than or equal to the value of the collateral, the stay may be properly lifted. Estate Constr. Co. v. Miller & Smith Holding Co., 14 F.3d 213, 219 (4th Cir. 1994); See, e.g., In re Garsal Realty, Inc., 98 B.R. 140, 155 (Bankr. N.D.N.Y. 1989); In re Diplomat Elecs. Corp., 82 B.R. at 693; In re Roxrun Estates, Inc., 74 B.R. 997, 1002 (Bankr. S.D.N.Y. 1987); In re Neutgens, 87 B.R. 128 (Bankr. D. Mont. 1987). S. REP. NO. 95-989 at 5 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5791.

As explained by the Supreme Court, a debtor confronted with a request to lift the automatic stay under Bankr. Code § 362(d)(2) is required to demonstrate that the property at issue "is essential for an effective reorganization that is in prospect" and "that there must be a 'reasonable possibility of a successful reorganization within a reasonable time'." United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 376 (1988) (citation omitted).

Once a court determines that a plan cannot be confirmed as a matter of law, the stay must be lifted. One Times Square Assocs. Ltd. P'ship v. Banque Nationale De Paris (In re One Times Square Assocs. Ltd. P'ship), 165 B.R. 773, 774 (S.D.N.Y.), aff'd, 41 F.3d 1502 (2d Cir. 1994); John Hancock Mut. Life Ins. Co. v. Route 37 Bus Park Assocs., 987 F.2d 154 (3d Cir. 1993) (undersecured creditor appealed bankruptcy court's refusal to lift stay barring foreclosure. The Third Circuit reversed finding that the debtor's plan was unconformable and the stay should have been lifted). If a debtor cannot show that reorganization is possible, that debtor cannot show that the property is necessary for an effective reorganization. In re 1567 Broadway Ownership Assocs., 202 B.R. 549, 554 (Bankr. S.D.N.Y. 1996)

Here, there is no dispute that the liens of the Junior Noteholders exceed the value of its collateral. Thus, the Debtor has no equity in the sale proceeds. In addition, the administrative expense liability owed to the United States precludes confirmation. Thus, there is no possibility of a confirmable plan. Accordingly, the sales proceeds are not necessary to an effective reorganization. The Indenture Trustee has demanded relief from the stay and the Debtor believes such relief is warranted. The net effect of lifting the stay would be a turnover of the proceeds to the Indenture Trustee. Accordingly, interim distribution is warranted.

D. THE UNITED STATES' MOTION FOR A STAY PENDING APPEAL SHOULD BE DENIED

The United States asserts that in the event this Court allows interim distribution to the Junior Noteholders, this Court should grant a stay pending appeal. The United States, however, cannot sustain its burden.

The Court of Appeals for the Second Circuit has set forth the factors for a stay pending appeal, as follows:

> (1) whether the movant will suffer irreparable injury absent a stay, (2) whether a party will suffer substantial injury if a stay is issued, (3) whether the movant has demonstrated "a substantial possibility, although less than likelihood, of success" on appeal, and (4) the public interests that may be affected.

Hirschfeld v. Bd. of Elections, 984 F.2d 35, 39 (2d Cir. 1993) (citation omitted); Country Squire Assocs., L.P. v. Rochester Cmty. Sav. Bank (In re Country Squire Assocs., L.P.), 203 B.R. 182, 183 (2d Cir. B.A.P. 1996). Each factor need not be given equal weight but rather should be used as guides. In re City of Bridgeport, 132 B.R. 81 (Bankr. D. Conn. 1991). The proponent of the stay, however, must satisfy all four requirements. In re 1567 Broadway Ownership Assocs., 202 B.R. 549, 557 (S.D.N.Y. 1996); In re Leibinger-Roberts, Inc., 92 B.R. 570 (E.D.N.Y. 1988).

1. Irreparable Injury

A showing of probable irreparable harm is the principal prerequisite for the issuance of a stay. Under that test, the moving party must demonstrate that such injury is likely before the other requirements will be considered. In re City of Bridgeport, 132 B.R. 81 (Bankr. D. Conn. 1991) (denying stay because debtor failed to prove irreparable injury); Reuters Ltd. v. United Press Int'l, Inc., 903 F.2d 904, 907 (2d Cir. 1990); Bell & Howell: Mamiya Co. v. Masel Supply Co. Corp., 719 F.2d 42, 45 (2d Cir. 1983). The moving party is required to show that injury is imminent, not remote or speculative. Reuters Ltd., 903 F.2d at 907; Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969, 975 (2d Cir. 1989). Further, the Court of Appeals for the Second Circuit has held that a party seeking injunction relief must prove that the alleged injury "is not capable of being fully remedied by money damages." Nat'l Ass'n for Advancement of Colored People, Inc. v. Town of East Haven, 70 F.3d 219, 224 (2d Cir. 1995) (citing Tucker Anthony Realty Corp. v. Schlesinger, 888 F.2d 969, 975 (2d Cir. 1989); Bateman v. Grover (In

re Berg), 45 B.R. 899 (B.A.P. 9th Cir. 1984) (award of damages could remedy injury). Where the order appealed involves the distribution of funds and the party who received the funds is a party to the appeal, the injury is not irreparable because the appellate court has the power to fashion effective relief by requiring the secured party to repay the funds. United States v. Valley Nat'l Bank (In re Decker), 199 B.R. 684, 687 (9th Cir. B.A.P. 1996); Spirtos v. Moreno (In re Spirtos), 992 F.2d 1004, 1006-07 (9th Cir. 1993).

Here, the United States shall not suffer irreparable harm as a result of interim distribution. The distribution to the Junior Noteholders shall be made to the Indenture Trustee, a reputable, financially solvent banking concern. In the event the Indenture Trustee distributes the proceeds to the Junior Noteholders, the United States can seek redress from the Indenture Trustee if it were to prevail on its appeal. In any event, the United States can collect from the Junior Noteholders, which are large funds that are unlikely to dissolve to avoid suit. Thus, any injury can be remedied by money damages against both the Indenture Trustee and the Junior Noteholders.

2. Substantial Injury

As to the second factor, this Court held in In re Hutter, 221 B.R. 648, 651 (Bankr. D. Conn. 1998), aff'd, 2001 WL 34778750 (D. Conn. Apr. 04, 2001), in denying a stay pending appeal that, "creditors holding allowed claims of this bankruptcy estate will suffer a substantial injury if a stay is issued," id. as significant secured, taxing and unsecured creditors had not been paid for many years.

Here, the Junior Noteholders shall suffer substantial injury. The Junior Noteholders shall be prejudiced by the delay occasioned by a stay in that they will not be able to maximize their

investment. Now that the estate has been liquidated there is no reason why the Junior Noteholders cannot direct the Indenture Trustee to invest the funds in some security bearing more than 4.7% interest. Because the Debtor is precluded from investing in a higher risk security, each day the estate holds the funds, the Junior Noteholders are prejudiced and substantially injured. Further, the Junior Noteholders have waited 8 months for any distribution.

3. Substantial possibility of success

As to the third factor, the Hirschfeld test requires that the movant demonstrate a "substantial possibility" of success on appeal. Although those words have not been specifically defined in this circuit, see Nostas Associates v. Costich (In re Klien Sleep Products, Inc.), No. 93 CIV 7599 (CSH), 1994 WL 652459, at *1 (S.D.N.Y. Nov. 18, 1994), rev'd, 78 F.3d 18 (2d Cir. 1996), Hirschfeld chose to eliminate the more onerous requirement of "likelihood of success on appeal." Hirschfeld, supra, 984 F.2d at 39. The result is that movant must show that there is more than a mere possibility of a successful appeal. Hirschfeld prescribes an intermediate level between possible and probable which is intended to eliminate frivolous appeals. Country Squire Assocs., L.P., 203 B.R. at 183 n.1-84.

Courts within this circuit have held that the failure to demonstrate a substantial possibility of success on the merits requires denial of a motion seeking a stay pending appeal. FFG-NH Vehicle Funding Corp. v. Holtmeyer (In re Holtmeyer), 229 B.R. 579, 581 (E.D.N.Y. 1999) (the single most important factor is success on the merits; court applied lesser standard of "serious question[s] going to the merits.") T.R. Acquisition Corp. v. Marx Realty & Improvement Co., Inc. (In re T.R. Acquisition Corp.), 208 B.R. 635, 637 (S.D.N.Y. 1997); In re 1567 Broadway Ownership Assocs., 202 B.R. 549, 553 (S.D.N.Y. 1996); In re Crosswinds

Assocs., No. 96 CIV. 4572, 1996 WL 350695, at *1 (S.D.N.Y. June 25, 1996). (Further, when an appeal lacks merit, a stay should be denied.) See generally In re Hutter, 221 B.R. at 651.

A bankruptcy court's findings of fact are reviewed by an appellate court under a "clearly erroneous" standard, while the bankruptcy court's conclusions of law are reviewed de novo. See Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere clubs, Inc.), 922 F.2d 984, 988 (2d Cir. 1990); see also Crosswinds Assocs., 1996 WL 350695 at *1.

Case law clearly supports the proposition that the provisions of a confirmed plan of reorganization are binding upon creditors under principles of res judicata, even where the provisions are beyond the jurisdiction of the bankruptcy court. See, e.g., Stoll v. Gottlieb, 305 U.S. 165, 171-72 (1938) (barring creditor from suing on guaranty because bankruptcy court's contested jurisdiction was irrelevant to the application of res judicata doctrine; creditor neither raised the issue of the bankruptcy court's jurisdiction nor objected to the offending plan provision at the confirmation hearing); Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1053 (5th Cir. 1987) (applying the doctrine of res judicata, the Fifth Circuit found that an improper release of a non-debtor third party was binding on a creditor notwithstanding the fact that the bankruptcy court lacked subject matter jurisdiction to release a nondebtor via plan confirmation); Fed. Deposit Ins. Corp. v. O'Donnell, 136 B.R. 585, 587 (D.D.C. 1991) (barring FDIC from subsequently attacking jurisdiction in the district court because of FDIC's failure to raise jurisdictional objection during confirmation hearing; thus, FDIC was precluded from enforcing its guaranty because the discharge of a non-debtor's guaranty under the confirmed plan was given res judicata effect regardless of whether the discharge exceeded statutory authority); see also In re Szostek, 886 F.3d 1405, 1413 (3d Cir. 1989) (recognizing the propriety of Shoaf and applying res judicata principles to a chapter 13 plan). Cf. e.g., Sun Fin. Co., Inc. v. Howard (In

re Howard), 972 F.2d 639, 641 (5th Cir. 1992) (limiting the res judicata effect of Shoaf by stating, in dictum, that Shoaf "stands for the proposition that a confirmed . . . plan is res judicata as to all parties who participate in the confirmation process") (emphasis in original); but see Union Carbide Corp. v. Newboles, 686 F.2d 593, 595 (7th Cir. 1982) (not barring a creditor from suing a non-debtor on an obligation purportedly released under a debtor's confirmed reorganization plan). See **Margaret Gladman video deposition at 00:10:36:12 - 00:10:36:54**

The United States cannot establish a "substantial possibility" of success on appeal. Because the United States' entitlement to the funds at issue is dependent on its success in the IRS Adversary Proceeding, this Court should determine not only whether the interim distribution order would be reversed but also whether the IRS has a "substantial possibility" of success as to the IRS Adversary Proceeding. **Qwest Exh. 538 (Demonstrative Exhibit).** The order allowing has a clear basis in law and fact. Further, as this Court has determined, courts have uniformly held that the terms of a confirmation order are res judicata as to all claims and interests treated under the governing plan. Thus, because the United States was a party in interest in the previous bankruptcy, this Court has granted summary judgment in favor of the Debtor and the Indenture Trustee. Accordingly, the United States would need to prevail in two (or a consolidated) appeals to have claim to the funds. Because of the overwhelming case law supporting the Adversary Opinion and the interim distribution, the United States cannot sustain its "substantial possibility" burden. See Timeline of Events (Flash Animation)

4. Public interests.

As to the final factor, courts have regularly denied stays pending appeal where no public policy would be negatively impacted. See generally P.Transmision (Animated Exhibit File) S.D.N.Y. 1992) (public policy would not be served by granting stay); In re Beswick, 98 B.R.

904, 907 (N.D. Ill. 1989) ("there appears to be no harm to any recognized public interest if the stay is not issued."). Further, public policy favors finality in litigation. In re Liggett, 118 B.R. 219, 223 (Bankr. S.D.N.Y. 1990).

Here, the United States posits that the public interest would be served by a stay because it would insure that funds are available if it were to prevail on the appeal. The United States, however, ignores that if it is ultimately successful on appeal it can seek damages from the Indenture Trustee and the Junior Noteholders. Further, because the Adversary Opinion has resolved entitlement to the proceeds, the public policy favoring finality in litigation would be served by denying the stay pending appeal. Thus, the public interest factor weighs in favor of denying the stay. As discussed above, there is no irreparable harm to the United States whereas the Junior Noteholders lose money every day.

Accordingly, because the United States cannot sustain its burden for the issuance of a stay pending appeal the Stay Motion should be denied.

CONCLUSION

WHEREFORE, the Debtor respectfully requests that the Court (a) grant the Motion and authorize the Debtor to distribute the remaining proceeds to the Junior Noteholders, (b) deny the United States' Motion for a stay pending appeal and (c) grant such other and further relief as this Court may deem just and proper.

Dated: New York, New York

February 14, 1999

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