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UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

In re:

STATION CASINOS, INC.

☐ Affects this Debtor
☒ Affects all Debtors
☐ Affects Northern NV Acquisitions, LLC
☐ Affects Reno Land Holdings, LLC
☐ Affects River Central, LLC
☐ Affects Tropicana Station, LLC
☐ Affects FCP Holding, Inc.
☐ Affects FCP Voteco, LLC
☐ Affects Fertitta Partners LLC
☐ Affects FCP MezzCo Parent, LLC
☐ Affects FCP MezzCo Parent Sub, LLC
☐ Affects FCP MezzCo Borrower VII, LLC
☐ Affects FCP MezzCo Borrower VI, LLC
☐ Affects FCP MezzCo Borrower V, LLC
☐ Affects FCP MezzCo Borrower IV, LLC
☐ Affects FCP MezzCo Borrower III, LLC
☐ Affects FCP MezzCo Borrower II, LLC
☐ Affects FCP MezzCo Borrower I, LLC
☐ Affects FCP PropCo, LLC

Chapter 11

Case Nos. BK-N-09-52470-GWZ through BK-N-09-52487-GWZ

Jointly Administered Under BK-N-09-52477-GWZ

MOTION OF THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF STATION CASINOS, INC., ET AL., PURSUANT TO 11 U.S.C. §§ 105(a), 503(b), 1103(c), AND 1109(b), FOR ENTRY OF AN ORDER GRANTING LEAVE, STANDING, AND AUTHORITY TO PROSECUTE AND, IF APPROPRIATE, SETTLE CAUSES OF ACTION ON BEHALF OF THE DEBTORS' ESTATES

Hearing Date: January 25, 2010
Hearing Time: 10:00 a.m.
Place: 300 Booth Street
Reno, Nevada 89509

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TABLE OF CONTENTS

Page

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TABLE OF AUTHORITIES

Page

Cases

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Statutes

Greenberg Traurig, LLP
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Miscellaneous

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The Official Committee of Unsecured Creditors (the "Committee") of Station Casinos, Inc. ("SCI") and its affiliated debtors in possession (together with SCI, the "Debtors") in the above-captioned cases (the "Chapter 11 Cases"), by and through its undersigned counsel, hereby files this motion (the "Standing Motion"), pursuant to sections 105(a), 503(b), 1103(c), and 1109(b) of title 11 of the United States Code, 11 U.S.C. §§ 101, et seq. (the "Bankruptcy Code"), for entry of an order authorizing the Committee to pursue and, if appropriate, settle the Claims (defined below).

In support of this Motion, the Committee submits the "Declaration of Eric D. Winston" (the "Winston Declaration"), the "Declaration of Nathan Van Duzer" (the "Committee Chair Declaration") and the "Request for Judicial Notice" (the "RJN"), and respectfully submits as follows:

PRELIMINARY STATEMENT

By this Standing Motion, the Committee seeks entry of an order authorizing the Committee to pursue certain claims and causes of action (the "Claims") relating to the Debtors' leveraged buyout transaction that closed on November 7, 2007 (the "LBO Transaction") against the persons and entities named as defendants in the draft LBO Complaints attached to the Winston Declaration as Exhibit "A" (the "LBO Complaint") and Exhibit "B" (the "Lease Complaint" and, with the LBO Complaint, the "Complaints").[1]

The LBO Complaint demonstrates that the LBO Transaction saddled SCI with an additional $1.7 billion in interest-bearing debt, a crushing burden that offered virtually no value in return.[2] As a result of the LBO Transaction, the Debtors were rendered insolvent and were left with unreasonably small capital. Meanwhile, the Individual Defendants received hundreds of millions of dollars, by virtue of the cancelation of their owned shares of SCI common stock and the award of the Accelerated Stock Benefits, which the LBO Complaint refers to as the immediate vesting of

[1] To assist the Court with defined terms, the Committee has prepared an Appendix that lists all of the defined terms in this Motion and in the Complaints. Terms not otherwise defined herein have the same meanings as defined in the Appendix.

[2] The additional $1.7 billion in interest-bearing debt assumes full credit is given for any pre-existing debt that was paid off. Net of any purported benefit, the Debtors, and their innocent unsecured creditors, were $1.7 billion worse off. This debt crippled the company to the detriment of all of its stakeholders, including employees who looked to the insiders for protection, not self-dealing. See Winston Declaration at Ex. "C."

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Restricted Stock and the acceleration of Stock Options. The Bank Defendants profited handsomely as well – they received millions of dollars in fees, they lent funds at profitable rates, and they obtained liens on nearly all of the assets of the Debtors and the Debtors' non-debtor affiliates, thereby leapfrogging the pre-existing unsecured claims of innocent creditors.

The Lease Complaint demonstrates that the so-called Master Lease Transaction is really a disguised debt financing between SCI and PropCo. Notwithstanding the obvious efforts to obfuscate the economic substance of the Master Lease Transaction by creating various corporate entities and executing numerous documents that purported to transfer assets, the economic substance cannot be ignored – SCI borrowed approximately $2.475 billion, funneled through PropCo, to help fund the LBO Transaction. The security for that borrowing was the Four Casinos. Slapping a "lease" label on a loan does not make it a lease.

The Committee has investigated the LBO Transaction, including the Master Lease Transaction, over the last three months. This investigation included a careful review of the "Report of Investigation" (the "SLC LBO Report") prepared by the Special Litigation Committee (the "SLC") and review of information made available to the Committee. The SLC is a committee created by the Debtors when they were planning to file for bankruptcy and when they were scrambling to ward off the threat of potential fraudulent transfer claims. The SLC concluded that the Debtors should oppose any efforts for the Debtors' estates to prosecute any claims relating to the LBO Transaction.[3]

Nonetheless, regardless that (1) the SLC purports to give the Debtors' management something to point this Court to as an asserted justification to deny the Committee standing, and regardless that (2) the Committee has not been provided critical information it believes should still be reviewed pertaining to the LBO Transaction, including documents and interviews of key persons with personal knowledge of the LBO Transaction, the Committee firmly believes that the Claims,

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[3] The SLC LBO Report did not even address lease recharacterization claims. Apparently the SLC began investigating such claims in late September or early October, long after the Committee commenced its investigation. On December 22, 2009, the SLC publicly filed a report that addresses recharacterization of the Master Lease Transaction (the "SLC Lease Report").

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which are assets of the Debtors' estates, are valuable and viable causes of action under the Bankruptcy Code and applicable state law.

The LBO Complaint alleges Claims as follows:

- Actual fraudulent transfer claims and constructive fraudulent transfer claims under Bankruptcy Code sections 544(b), 548(a)(1)(A), and 548(a)(1)(B) concerning the avoidance of transfers and the incurrence of obligations relating to the conversion of shares of SCI stock, including Restricted Stock and Stock Options into a contractual right to receive payment equal to $90.00 per share;

- Actual fraudulent transfer claims and constructive fraudulent transfer claims under Bankruptcy Code sections 544(b), 548(a)(1)(A), and 548(a)(1)(B) concerning the avoidance of liens and security interests, and the incurrence of obligations, relating to the LBO Transaction;

- Actual fraudulent transfer claims and constructive fraudulent transfer claims under Bankruptcy Code sections 544(b), 548(a)(1)(A), and 548(a)(1)(B) concerning the avoidance of payments of certain fees relating to the LBO Transaction;

- Constructive fraudulent transfer claims under Bankruptcy Code §548(a)(1)(B)(ii)(IV) against insiders who were employed by the Debtors concerning the avoidance of non-ordinary course transfers and the incurrence of non-ordinary course obligations relating to the conversion of shares of SCI stock into a contractual right to receive payment equal to $90.00 per share;

- Breach of fiduciary duty claims against directors and officers arising under applicable nonbankruptcy law; and

- Equitable subordination claims against Deutsche Bank and JP Morgan.[4]

The Lease Complaint alleges Claims to have the Master Lease Transaction recharacterized as a disguised debt financing between SCI, as borrower, and PropCo, as lender or as a lending vehicle for the PropCo Lenders. The Lease Complaint further alleges that the obligations that SCI incurred under the Master Lease Transaction are avoidable fraudulent transfers.

As discussed more fully below, all of the legal requirements for granting the Committee derivative standing (as necessary) to pursue the Claims on behalf of the Debtors' estates have been

[4] As discussed below, the Committee is not required to request standing to prosecute equitable subordination claims. The Committee discusses the merits of the equitable subordination claims solely out of abundance of caution.

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satisfied. Prosecution of the Claims is critical in these cases because the benefits that can be derived from the Claims likely will produce a substantial recovery source for innocent unsecured creditors who are owed billions. See Committee Chair Declaration at ¶¶ 12, 13. Indeed, even the Debtors' employees have demanded that a true, unconflicted fiduciary bring the enriched insiders to justice. See Winston Declaration at Ex. "C." Pursuant to this Court's instruction on November 20, 2009, the Committee has formally demanded the Debtors' consent to the Committee having standing to prosecute the Claims (the "Demand Letter"). See Winston Declaration at Exhibit "D." The Debtors have unjustifiably delayed responding to the Demand Letter. See Winston Declaration at Exhibits "E"-"H." Given the Debtors' obvious inability (due to an overwhelming array of disabling conflicts) and unwillingness to prosecute the Claims (or any claims against the Individual Defendants or Bank Defendants), the Committee is the only party in interest qualified and sufficiently vested to prosecute the Claims. Accordingly, the Committee seeks authority to prosecute the Claims on behalf of the Debtors' estates.

JURISDICTION

This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409. The predicates for the relief sought herein are 11 U.S.C. §§ 105(a), 503(b), 1103(c)(5), and 1109(b).

BACKGROUND

Procedural Background

On July 28, 2009 (the "Petition Date"), the Debtors filed with this Court voluntary petitions for relief under chapter 11 of the Bankruptcy Code. The Debtors are continuing to operate their businesses and manage their properties as debtors in possession, pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed in these Chapter 11 Cases.

On August 13, 2009, the Office of the United States Trustee for the District of Nevada (the "UST") appointed the following entities to the Committee: (i) Fidelity Management & Research Company ("Fidelity"); (ii) Law Debenture Trust Company of New York; (iii) Serengeti Asset

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Management, LP; and (iv) Western Asset Management Company.[5] On August 24, 2009, Fidelity was elected chair of the Committee. On August 25, 2009, the UST appointed Wilmington Trust Company to the Committee.

The Committee, through the undersigned counsel and with the assistance of Sierra Consulting, LLC ("Sierra") as consulting expert, undertook a review of the SLC LBO Report and an analysis whether the estates held any colorable and valuable claims arising under or relating to the LBO Transaction. The Committee was under significant time pressure to conduct its investigation because, pursuant to cash collateral stipulations entered into with Deutsche Bank, as agents under the OpCo Loan and the PropCo Loan, the Debtors waived any rights to challenges the liens and claims of the Bank Defendants, and the Committee had only until January 15, 2010, to seek to challenge such liens and claims.[6]

Consistent with this Court's directive to undertake its investigation at a measured pace, the Committee conducted its investigation in a manner to avoid the need for judicial intervention. Thus, after the SLC LBO Report was published in late September 2009, starting in October 2009, the Committee received and began reviewing documents made available to the Committee by the SLC, the Debtors (including documents never provided to the SLC), Deutsche Bank, and Colony (though, in the case of Colony, only non-confidential information). While the Committee sought to interview witnesses on an informal basis, no party has permitted the Committee to interview witnesses on a voluntary, informal, basis.

On November 18, 2009, the Committee filed with this Court a Status Report [Dkt. No. 580] that, among other things, indicated that there may be colorable and viable claims associated with the LBO Transaction. At the omnibus hearing on November 20, 2009, this Court commented:

> I read your report. Candidly, the report exceeds generally a motion I see for standing in most of the cases that I ever had presided over. I'll just tell you bluntly. Whether you agree or disagree with the report, it is well written. It's cogent. I understand it. And I think it could easily be converted into a demand upon the debtor, and then we can go from there

[5] On August 13, 2009, the UST also appointed Oaktree Capital Management, LP ("Oaktree") to the Committee. However, Oaktree has since resigned from the Committee.

[6] The initial deadline to challenge the liens and claims of the Bank Defendants under the OpCo Loan was December 11, 2009; however, that was extended to January 15, 2010, by consent of Deutsche Bank, as agent under the OpCo Loan.

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> regarding standing. And then I can conduct all those tests that I need to conduct. I frankly, based upon that and without seeing the other side, as I've already indicated, I see some issues.

RJN at Ex. "7" (Nov. 20, 2009 H'rg Tr. at 51, lns. 12-23).

The Committee followed the directive of this Court. After the November 20, 2009 hearing, the Committee finalized its investigation. Notwithstanding its limited access to information,[7] the Committee has concluded that there are colorable and valuable claims. The Complaint presents those claims, and by this Motion the Committee seeks standing to commence an action to prosecute such claims.

Factual Background Relating to the Claims

The LBO Complaint provides a detailed factual background of the LBO Transaction – the history of negotiations, the structuring of the LBO Transaction, and the financial projections SCI allegedly relied upon as support for the LBO Transaction. The LBO Complaint also provides a detailed review of SCI's financial performance in 2007 prior to the LBO Transaction, how SCI prepared budgets, and what economic factors SCI considered critical to its financial performance. The LBO Complaint provides numerous examples of how SCI's management and Deutsche Bank were well aware of the substantial declines in key economic factors in the Las Vegas area, obvious signs that industries materially impacting "locals" gaming – the subprime mortgage and homebuilding markets – were in significant decline. The LBO Complaint further illuminates the financial difficulties SCI faced in 2007, all of which were ignored by the insiders that engineered their payoff.

The Lease Complaint provides additional factual details specifically concerning the Master Lease Transaction. Specifically, the Lease Complaint alleges facts concerning the chronology of the negotiation of the Master Lease Transaction and describes the Master Lease Transaction's material terms.

The factual backgrounds set forth in each Complaint are incorporated herein by reference.

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[7] Shortly after the November 20, 2009, hearing, both the Debtors and the SLC refused to permit the Committee to interview any witnesses, even though the parties had been discussing such interviews prior to the hearing. Further, Colony had been prepared to produce confidential information in its possession, but went "radio silent" within a short time following the November 20, 2009 hearing.

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ARGUMENT

A. STANDARD FOR DERIVATIVE STANDING

1. The Test for Determining Whether To Grant A Committee Standing.

Although a creditors' committee does not have an independent right to bring affirmative claims, such as avoidance actions, typically brought by a trustee or debtor in possession, many courts have held that an official creditors' committee has an implied right to sue on behalf of a bankruptcy estate pursuant to sections 105(a), 503(b), 1103(c)(5) and 1109(b) of the Bankruptcy Code "in appropriate circumstances." In re First Capital Holdings Corp., 146 B.R. 7, 10 (Bankr. C.D. Cal. 1992) (citing In re STN Enterprises, 779 F.2d 901, 904 (2d Cir. 1985)); see also In re The Gibson Group, 66 F.3d 1436, 1442 (6th Cir. 1995); In re Curry & Sorensen, 57 B.R. 824, 828 (B.A.P. 9th Cir. 1986); see also Official Committee of Unsecured Creditors of Cybergenics Corp. ex rel., 330 F.3d 548 (3rd Cir. 2003) (discussing history of Bankruptcy Code and textual underpinnings of derivative standing).

The Bankruptcy Code provides for the creation of creditors' committees for the express purpose of protecting the rights of its constituents and similarly situated creditors. See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977), U.S.C.C.A.N. 1978. p. 5787. In furtherance of this purpose, section 1103(c) of the Bankruptcy Code, which enumerates the statutory functions of a creditors' committee, authorizes creditors' committees to "perform such other services as are in the interest of those represented." 11 U.S.C. § 1103(c)(5).

To that end, Bankruptcy Code section 1109(b) provides that a creditors' committee "may raise and may appear and be heard on any issue in a case under this chapter." 11 U.S.C. § 1109(b). This general right to be heard would be rendered meaningless unless creditors' committees were also given the right to act, on behalf of the estate, if a trustee or debtor in possession unjustifiably fail to do so. See In re iPCS, Inc., 297 B.R. 283, 290 (Bankr. N.D. Ga. 2003) ("[I]f a debtor has a cognizable claim, but refuses to pursue that claim, an important objective of the Code [the recovery and collection of estate property] would be impeded if the bankruptcy court has no power to authorize another party to proceed on behalf of the estate in the debtor's stead."); In re Joyanna Holitogs, Inc., 21 B.R. 323, 326 (Bankr. S.D.N.Y. 1982) (holding that the general right to be heard

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would be an empty grant unless those who have such a right are also given the right to do something where the debtors will not).

Courts in the Ninth Circuit have granted creditors' committees with derivative standing to pursue litigation on behalf of debtors' estates where the trustee or debtor in possession fails to do so. See In re Valley Park, Inc., 217 B.R. 864, 867-68 (Bankr. D. Mont. 1998) (holding that creditors' committee had standing to bring adversary proceeding to avoid transfers to the debtor's president and president's family members which were allegedly fraudulent under state law); First Capital, 146 B.R. at 13 (permitting creditors' committee to prosecute action against officers, directors, and principal shareholder of the debtor on behalf of the debtor's estate).

In determining whether to confer standing on a creditors' committee, courts in the Ninth Circuit consider whether the following four requirements have been met: "(1) A demand has been made upon the statutorily authorized party to take action; (2) The demand is declined; (3) A colorable claim that would benefit the estate if successful exists, based on a cost-benefit analysis performed by the court; and (4) The inaction is an abuse of discretion ('unjustified') in light of the debtor-in-possession's duties in a Chapter 11 case." In re Yellowstone Mountain Club, LLC, 2009 WL 982207, *6 (Bankr. D. Mont. Jan. 16, 2009) (citing Valley Park, 217 B.R. at 866).

The Bankruptcy Court for the District of Montana characterized the standard for conferring derivative standing in the Ninth Circuit as "lenient," as set forth in In re Spaulding Composites Co., Inc., which provides:

> It is well settled that in appropriate situations the bankruptcy court may allow a party other than the trustee or debtor-in possession to pursue the estate's litigation. Louisiana World Exposition v. Federal Ins. Co., 858 F.2d 233, 247-52 n. 19 (5th Cir. 1988) (and cases cited therein); In re STN Enterprises, 779 F.2d 901, 904 (2d Cir. 1985); In re Curry and Sorensen, Inc., 57 B.R. 824, 827-29 (9th Cir. BAP 1986). In Curry, the panel held that a creditor dissatisfied with the lack of action on the part of the debtor-in-possession may petition the court to compel the debtor-in-possession to act or gain court permission to institute the action itself. Id. at 828.

Valley Park, 217 B.R. at 866 (quoting In re Spaulding Composites, Co., Inc., 207 B.R. 899, 903-04 (B.A.P. 9th Cir. 1997)).

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2. Courts In Several Recently Filed Chapter 11 Cases Have Granted Standing Over The Objections Of Debtors And Secured Creditors.

Consistent with the Valley Park court's statement that the test in the Ninth Circuit is lenient, recent trends in similarly situated cases strongly suggests that bankruptcy courts should favor granting derivative standing to creditors' committees where debtors have voluntarily disarmed themselves from bringing colorable claims – which is precisely what has occurred here. As discussed in detail below, the bankruptcy court in TOUSA granted derivative standing over the objections of the debtors and secured lenders. See also RJN at Exs. "1"-"3."

Similarly, the bankruptcy court in the Fontainebleau chapter 11 cases granted derivative standing to the creditors' committee over the objections of secured lenders who were the targets of litigation. RJN at Ex. "4."

In Fedders North America, Inc., the bankruptcy court granted derivative standing to a creditors' committee, over the objections of the debtors, lenders, and individual defendants, to bring fraudulent transfer, breach of fiduciary duty, equitable subordination, and other nonbankruptcy law claims. RJN at Ex. "5." In a number of recent large chapter 11 cases, such as Lyondell and SemGroup, L.P., the debtors have simply consented to the creditors' committee standing to pursue claims in cases where the debtors waived rights under cash collateral stipulations or were conflicted from suing insiders. Recognizing the fiduciary role of statutory committees and the appropriate division of labor in Chapter 11 cases, the debtors in those cases appropriately delegated the power to the committees whose interests were most aligned with the estates. See Winston Declaration at Ex. "I" (excerpt of tr. of h'rg on standing motion in In re SemGroup, L.P.). Regrettably, the Debtors here are controlled by the very targets of the LBO Complaint and advised by the law firm that represented the Debtors in connection with the challenged transaction.

3. Committees Are Not Required To Obtain Derivative Standing To Assert Claim Objections Or To Seek Equitable Subordination.

Even though a creditors' committee must obtain derivative standing to bring affirmative estate claims, a creditors' committee is not required to obtain derivative standing to object to claims,

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including objections based on Bankruptcy Code section 502(d). See 11 U.S.C. § 502(a) (any party in interest may object to claims).[8]

And, while the Bankruptcy Code does not expressly provide that any party in interest may seek equitable subordination, because equitable subordination is a creditor-specific remedy, courts have held that creditors who would benefit from equitable subordination are authorized to bring equitable subordination actions without seeking derivative standing. See Unsecured Creditors' Committee v. Banque Paribas (In re Heartland Chem., Inc.), 103 B.R. 1012, 1014 (Bankr. C.D. Ill. 1989) ("Since the Committee represents the unsecured creditors, it has standing to file an equitable subordination claim against the Bank."); cf. In re Vitreous Steel Prods., 911 F.2d 1223, 1231 (7th Cir. 1991) Thus, because a creditors' committee already has standing to object to claims and to seek equitable subordination, efficient use of resources and case administration suggest that creditors' committees should be granted affirmative estate claims related to the claim objections and equitable subordination claims.

4. This Court Should Follow the Lead of the Bankruptcy Court in TOUSA.

In its Status Report, the Committee noted the recent decision in TOUSA, in which case the court wrote a 182-page opinion that concluded that a July 2007 transaction, involving a debtor engaged in the home-building industry, was a constructive fraudulent transfer. See In re TOUSA, Inc., 2009 WL 3519403 (Bankr. S.D. Fla., Oct. 30, 2009). There are a number of aspects of TOUSA that suggest a much less obvious case of constructive fraud as compared to the facts here – there was no massive blowout of cash to insiders on account of accelerated stock benefits and, unlike the facts here, the debtors in TOUSA did obtain a solvency opinion from an independent professional.

TOUSA is relevant here, but not only because of the bankruptcy court's detailed analysis. TOUSA is important because it all would have been for naught had the court agreed with the debtors and secured creditors and denied the committee's motion for standing. As the Committee anticipates will occur here, the debtors and the secured lenders in TOUSA vigorously opposed the

[8] The PropCo Lenders have already objected to certain scheduled claims against PropCo, even though the claims bar date has not run. Thus, they must concede that parties in interest other than the Debtors have standing to object to claims.

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committee's standing motion. The debtors and secured lenders relied heavily on the fact that a solvency opinion was obtained (none was obtained here), that the debtors' board of directors "carefully" considered the transaction (which did not occur here during October 2007), and that the debtors should not be distracted from reorganizing in the face of "scorched earth" litigation. This Court will likely hear variations on the same themes but, like the bankruptcy court determined in TOUSA, administrative expediency did not justify unsecured creditors being tossed aside.

In order for the TOUSA committee to have been able to present its winning case, it first had to obtain standing. At the time that the TOUSA committee sought standing, it does not appear that it possessed much of the critical evidence that that the court ultimately relied on, yet the court saw through the debtors' and lenders' self-serving rhetoric, and granted standing. The TOUSA court did not sacrifice the need for a full and fair testing of colorable and valuable claims simply because there was the risk that the litigation would interfere with their reorganization. This Court should do the same.

B. THE COMMITTEE CLEARLY SATISFIES THE REQUIREMENTS FOR DERIVATIVE STANDING

1. The Claims Raised by the Committee are Colorable.

In order to obtain derivative standing, the Committee must demonstrate that the Claims are colorable. The case law construing the requirement that claims be "colorable" explains that the requisite showing is a relatively low threshold to satisfy. See, e.g., In re Adelphia Communications Corp. 330 B.R. 364, 376 (Bankr. S.D.N.Y. 2005) (noting that the requisite standard for presenting a "colorable" claim is relatively easy to meet); In re America's Hobby Center, Inc., 223 B.R. 275, 288 (Bankr. S.D.N.Y. 1998) (observing that only if the claim is "facially defective" should standing be denied); In re Colfor, Inc., 1998 WL 70718 *1, *2 (Bankr. N.D. Ohio Jan. 5, 1998) (stating that consistent with the common meaning of "colorable," that the proposed claims to be asserted need only be "plausible" or "not without some merit").

In determining whether a claim is colorable, the Court is not required to conduct a "mini-trial." STN Enterprises, 779 F.2d at 905. Instead, the Court should apply the standard applied in

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considering a motion to dismiss a complaint for failure to state a claim[9] rather than the more stringent standard employed in considering a motion for summary judgment. See America's Hobby Center, 223 B.R. at 282. As set forth in the attached proposed LBO Complaint, the Claims are colorable.

Constructive Fraudulent Transfers Claims Based on Insolvency/Unreasonably Small Capital:

The LBO Complaint asserts and sufficiently pleads claims, pursuant to 11 U.S.C. §§ 548(a)(1)(B), 544(b), and applicable Nevada law, to avoid transfers and the incurrence of obligations on the grounds that the LBO Transaction rendered the Debtors insolvent or with unreasonably small capital.

Both types of claims require the LBO Complaint to allege that the Debtors did not receive reasonably equivalent value. This element is easily satisfied; the LBO Complaint alleges that the LBO Transaction was funded by SCI's incurrence of an additional $1.7 billion in interest-bearing debt, which debt funded the LBO Transfers for which SCI received no benefit. Indeed, as the SLC LBO Report admits, and as alleged in the LBO Complaint, SCI "did not receive reasonably equivalent value as measured against the collapsed [LBO] Transaction." SLC LBO Report at 41.

The "balance sheet" solvency test is straightforward – at the time of the LBO Transaction, did the fair value of the Debtors' assets exceed the fair value of the Debtors' liabilities? The LBO Complaint alleges facts demonstrating that the LBO Transaction rendered the Debtors insolvent. The LBO Complaint alleges that, as of September 30, 2007, SCI's third-quarter financial statements disclose that SCI on a balance sheet was insolvent. The financial statements for the quarter ending September 30, 2007, revealed that SCI's liabilities significantly exceeded assets, and demonstrated increasingly poor financial performance.[10] This alone should satisfy the "colorable" claim requirement for showing insolvency.

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[9] While the "colorable" claim standard is a relatively low threshold, the LBO Complaint is drafted to account for the Supreme Court's "plausibility" standard in Twombley. See Bell Atlantic Corp. v. Twombley, 550 U.S. 544, 555 (2006); Ashcroft v. Iqbal, 129 S.Ct. 1937, 1949 (2009).

[10] SCI's balance sheets as disclosed in its Form 10-K for the fiscal year in 2006 and the Form 10-Qs for the first two quarters of 2007 show that SCI was insolvent. However, the Form 10-K for the 2005 fiscal year and the Form 10-Q for the first quarter of 2006 show that SCI on a consolidated basis was solvent.

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But the LBO Complaint does not rest merely on pointing this Court to SCI's published financial statements. The LBO Transaction closed at a time when it was obvious that SCI's business – operation of "locals" casinos in the Las Vegas market – was suffering, SCI's undeveloped land holdings were declining in value, and the Las Vegas market as a whole faced tremendous economic pressure.

Further, the LBO Complaint is replete with allegations that the economic factors most important to the "locals" gaming industry were in decline for months prior to the closing of the LBO Transaction, which bear directly on the value of the Debtors' assets.

The LBO Complaint alleges facts demonstrating that projections allegedly relied upon by SCI in support of the LBO Transaction were unreasonable, and which, when appropriately adjusted, revealed that SCI was insolvent. Further, the LBO Complaint amply demonstrates that the "goodwill" valuation was grossly overinflated. In addition, the LBO Complaint alleges facts that the value of land held for development – which purportedly accounted for 15% of the value as of the LBO Transaction closing - was in substantial decline long before the LBO Transaction. This indicates that the value of the land held for development at the time of the LBO Transaction, once properly adjusted, pushed the Debtors to the brink of insolvency.

Significantly, each and every one of the foregoing facts was known or knowable at the time of closing. This is not a request for hindsight analysis. Immediately upon the closing of the LBO Transaction, the Debtors' unsecured bond debt was downgraded, evidencing the economic injury they suffered. It is well-settled that a fraudulent transfer claim exists where, as here, a debtor is saddled with debt as part of a transaction in which the borrowed money is immediately paid over to a third party, leaving the debtor without reasonably equivalent value in exchange for the repayment obligation. See TOUSA, 2009 WL 3519403, at *56-*62. All of these well-pleaded factual allegations easily satisfy the "colorable" claim standard for constructive fraudulent transfer claims based on insolvency.

Further, the LBO Complaint alleges that the Debtors were left with unreasonably small capital. The test for determining whether SCI was left with unreasonably small capital is measured by what was reasonably foreseeable at the time of the LBO Transaction. Thus, the reasonableness

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of the Final Projections is considered at the time of the LBO Transaction. See ASARCO LLC v. Americas Mining Corp., 396 B.R. 278, 397 (Bankr. S.D. Tex. 2008). [redacted]

Thus, there are colorable constructive fraud claims against the Individual Defendants to avoid transfers made to them, and against the Bank Defendants to avoid transfers (including liens) made and the obligations owed to such Bank Defendants.

The SLC LBO Report indicates that any claims to avoid as constructive fraudulent transfers payments made to holders of SCI stock are likely to be precluded by Bankruptcy Code section 546(e), even though the Ninth Circuit has not "squarely addressed" the issue. SLC LBO Report at 62-64. Of course, Bankruptcy Code section 546(e) is an affirmative defense that is fact-intensive in nature, and thus it bears little relevance to this Court's inquiry as to whether the Committee has demonstrated that colorable constructive fraudulent transfer claims exist. See Official Committee of Unsecured Creditors v. ASEA Brown Boveri, Inc. (In re Grand Eagle Cos., Inc.), 288 B.R. 484, 495 (Bankr. N.D. Ohio 2003) (Bankruptcy Code section 546(e) is an affirmative defense). Further, the defense has no bearing on any actual fraudulent transfer claims[11] or on claims to avoid liens or challenge the obligations incurred by SCI and owed to the Bank Defendants. See 11 U.S.C. § 546(e).

But because the SLC spent nearly three pages of the SLC LBO Report on this one defense, the Committee provides the Court the following observations that strongly suggest that the

[11] Even though the Committee does not believe that Bankruptcy Code section 546(e) has any application here, if the Individual Defendants knowingly structured the LBO Transaction to take advantage of Bankruptcy Code section 546(e) so as to prevent any claim for constructive fraudulent transfers, it could give rise to a separate actual fraudulent transfer claim.

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Individual Defendants will not be able to succeed in asserting any such defense. It is true that several circuit courts have held that Bankruptcy Code section 546(e) bars constructive fraudulent transfer claims to avoid payments made to selling shareholders in leveraged buy-out transactions, on the theory that such payments constitute "settlement payments" in connection with "securities contracts." While the holdings of such courts have not yet been addressed in the Ninth Circuit, this Court is not going to be faced with addressing the issue, because the Claims relating to constructive fraudulent transfers alleged in the LBO Complaint do not implicate Bankruptcy Code section 546(e).

To be clear, the Committee does not at this time seek standing to sue any former shareholders of SCI other than the Individual Defendants. Rather, the LBO Complaint alleges constructive fraudulent transfer claims against the Individual Defendants, all of whom are alleged to be directors, officers, and/or insiders of the Debtors. Each Individual Defendant received payment purportedly relating to certain contractual obligations SCI allegedly owed to them, but those payments are not "settlement payments" and were not made in connection with any "securities contract" (as would be required under Bankruptcy Code section 546(e)).

For example, the LBO Complaint alleges claims to avoid the Accelerated Stock Options, which consist of immediate vesting of Restricted Stock and Stock Options, the cancellation thereof in exchange for a contractual right to $90.00 per cancelled share, and the payment thereon. The Accelerated Stock Options were provided to the Individual Defendants, by virtue of their employment status unrelated to their status as stockholders; indeed, <u>only</u> directors, officers of SCI, key employees of SCI and others in management-type roles were ever afforded the benefit of the Accelerated Stock Options.

Further, pursuant to the Merger Agreement (as approved by SCI's shareholders), all SCI common stock was cancelled <u>prior</u> to the LBO Transaction closing. All that SCI shareholders received was a contractual right to receive $90.00 per cancelled share. The form employed here is materially different than used in LBO transactions where courts have applied Bankruptcy Code section 546(e) to bar constructive fraudulent transfer claims. <u>See</u> <u>QSI Hldgs, Inc. v. Alford (In re QSI Hldgs., Inc.)</u>, 571 F.3d 545 (6th Cir. 2009) (financial institution that delivered cash to selling

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shareholders and obtained from such selling shareholders shares of debtor's stock; transaction required selling shareholders to tender stock in order to receive cash).

Even if Bankruptcy Code section 546(e) did apply here, as recognized by the Ninth Circuit Bankruptcy Appellate Panel in Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.), 321 B.R. 527 (B.A.P. 9th Cir. 2005), Bankruptcy Code section 546(e) applies only to non-public trades. Grafton Partners remains good law within the Ninth Circuit. Here, while shares of SCI were publicly traded, the consideration provided to the Individual Defendants was strictly private – public shareholders were not eligible to obtain the kinds of consideration that the Individual Defendants did receive. Avoiding the payments to the Individual Defendants will in no way disrupt any public securities markets.

Constructive Fraudulent Transfer Claims Based On Insider Employment Agreements:

In addition to traditional constructive fraudulent transfer claims based on insolvency and/or unreasonably small capital, the LBO Complaint alleges claims pursuant to Bankruptcy Code section 548(a)(1)(B)(ii)(IV). Added in 2005 to the Bankruptcy Code, section 548(a)(1)(B)(ii)(IV) provides that any transfer or obligation incurred by a debtor for which it "received less than a reasonably equivalent value in exchange" may be avoided if the debtor "made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business." 11 U.S.C. § 548(a)(1)(B)(ii)(IV).

Unlike other forms of constructive fraudulent transfers, this provision has no insolvency requirement. A major directive of the 2005 BAPCPA amendments to the Bankruptcy Code, of which section 548(a)(1)(B)(ii)(IV) was a part, was to curb abuses perpetrated by insiders which lead to or occur in the wake of a company's bankruptcy filing. See In re Global Home Products, LLC, 369 B.R. 778, 784 (Bankr. D. Del. 2007). Prior to the addition of section 548(a)(1)(B)(ii)(IV), the statute made a debtor's insolvency necessary to a claim for any constructive fraudulent transfer. However, as stated above, section 548(a)(1)(B)(ii)(IV) has no requirement of insolvency with respect to transfers to insiders under employment agreements. See In re Pilgrim's Pride Corp., 401 B.R. 229, 237 (Bankr. N.D. Tex. 2009) (noting that section 548(a)(1)(B)(ii)(IV), directed toward the incestuous relationship between a debtor and its insiders, provides that prepetition transactions with

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insiders will be subject to avoidance if the debtor did not receive reasonably equivalent value); In re Rosen Auto Leasing, Inc., 346 B.R. 798, 805 (8th Cir. 2006) (noting that the BAPCPA added an additional *alternative* to the second prong of the fraudulent conveyance test by adopting section 548(a)(1)(B)(ii)(IV)).

The LBO Complaint alleges that the Individual Defendants, other than the Sartinis, were insiders of SCI under employment agreements.[12] The LBO Complaint further alleges that each Individual Defendant received Accelerated Stock Benefits, which are clearly non-ordinary course transfers for which SCI did not receive reasonably equivalent value. Each such transfer occurred within two years of the Petition Date. Accordingly, the LBO Complaint demonstrates that "colorable" claims exist under Bankruptcy Code section 548(a)(1)(B)(ii)(IV).

Actual Fraudulent Transfer Claims:

There is sufficient detailed information alleged in the LBO Complaint to indicate that the LBO Transaction was intended to hinder, delay, or defraud SCI's existing unsecured creditors, namely its existing Note holders who were owed in excess of $2 billion at the time of the LBO Transaction. Among other flaws, the LBO Transaction was intended not to trigger mandatory prepayments under the Indentures to these Notes resulting from a "change in control." Many of the Individual Defendants also had written employment contracts that contained similar "change in control" provisions providing for the acceleration of Restrict Stock and Stock Options, which meant that these could not be triggered without a likelihood of triggering the Indenture's change in control provisions. Yet the Individual Defendants made sure that they received the economic benefits of their employment agreement change in control provisions while at the same time preventing the Note holders from being repaid.

[redacted]

[12] The term "employment contract" as used in section 548 has not been defined. Interpreted broadly, similar to the use of the term in section 502(b)(7), employment contracts are considered any contract (oral or written) that establishes terms and conditions of compensatory relationship between a debtor corporation and individuals who provide services to such debtor corporations. In re The Charter Co., 82 B.R. 144, 146 (Bankr. M.D. Fla. 1988). Under this interpretation, Dr. Nave, who served as a director of SCI for which he received compensation and served on the special committee analyzing whether the LBO Transaction was fair to SCI's public shareholders, should qualify as an insider under an employment agreement.

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[redacted]

Finally, SCI's management, knowing that they would make millions of dollars, went forward with the LBO Transaction even though they were armed with data over at least a year's worth of financial declines and SCI's board of directors had expressed concerns about changes in the LBO Transaction structure that placed more pressure on SCI's financial flexibility. Further, SCI never obtained a solvency opinion from an independent expert, even though SCI did arrange for numerous other "fairness" opinions and opinion letters on various issues, and even though SCI, in the OpCo Credit Agreement, made a solvency representation.

These allegations easily establish that there are "colorable" claims to avoid the LBO Transaction's transfers and obligations as actual fraudulent transfers. Actual fraud claims are expressly exempted from any defense set forth in Bankruptcy Code section 546(e).

Equitable Subordination Claims:

There are colorable claims to equitably subordinate the claims of Deutsche Bank and JP Morgan.[13] The well-settled test for demonstrating equitable subordination under 11 U.S.C. § 510(c) requires the Committee to show that Deutsche Bank and JP Morgan engaged in inequitable conduct, which misconduct either caused injury to unsecured creditors or conferred an unfair advantage on Deutsche Bank and JP Morgan, and that equitable subordination is consistent with the provisions of the Bankruptcy Code. See, e.g., In re Baker & Getty Fin. Servs., 974 F.2d 712 (6th Cir. 1992).

The LBO Complaint alleges that Deutsche Bank and JP Morgan were instrumental in working with the Individual Defendants to set up and finance the LBO Transaction to the detriment of innocent unsecured creditors. These Bank Defendants were richly rewarded for their efforts. [redacted]

[13] As discussed above, the Committee is not required to seek derivative standing to bring equitable subordination claims.

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[redacted]

Breach of Fiduciary Duty Claims:

The LBO Complaint asserts colorable claims for breach of fiduciary duty against the Individual Defendants (excluding the Sartinis). These Individual Defendants owed duties of care, loyalty and good faith to the Debtors. By virtue of acting in their self-interest, including arranging to receive the LBO Transfers and ensuring that the LBO Transaction would close without considering whether the LBO Transaction would harm unsecured creditors of at least SCI, such Individual Defendants breached at least their fiduciary duties of loyalty owed to SCI. See Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.), 208 B.R. 288 (Bankr. D. Mass. 1997) (chapter 7 trustee asserted claims for breach of fiduciary duty owed to corporation resulting from decision to vote in favor of LBO). Such breaches of their fiduciary duties substantially harmed SCI by rendering SCI insolvent and with unreasonably small capital in order to satisfy obligations owed to unsecured creditors of SCI. Such allegations state a cause of action. See Official Comm. of Asbestos Claimants of G-1 Holding, Inc. v. Heyman, 277 B.R. 20, 37 (S.D.N.Y. 2002) ("The Committee has adequately alleged that a breach of fiduciary duty existed because GAF either was insolvent or rendered insolvent by the transfer or was operating in the vicinity of insolvency at the time of or immediately after the transfer."); Weiboldt Stores, Inc. v. Schottenstein, 94 B.R. 488, 510 (N.D. Ill. 1988) (cause of action existed for breach of fiduciary duty against directors based on having approved transaction that resulted in the company's insolvency).

Lease Recharacterization/Avoidance of the Master Lease Transaction:

The Committee seeks standing by separate complaint which addresses a declaratory claim seeking the recharacterization of the Master Lease as a disguised financing and the avoiding SCI's obligations under the Master Lease. The Committee has pled sufficient facts to demonstrate that these claims are colorable.

The Ninth Circuit has instructed that courts are to determine whether a transaction is a lease or a debt financing based on the economic substance of the transaction. See In re Moreggia & Sons, Inc., 852 F.2d 1179 (9th Cir. 1988)(quoting S. Rep. No. 989, 95th Cong., 2d Sess. 64, reprinted in

1978 U.S.C.C.A.N. 5787, 5850) ("The distinction between a true lease and a financing transaction is based on the economic substance of the transaction and not, for example, upon the locus of title, the form of the transaction or the fact that the transaction is denominated as a 'lease'"). Not surprisingly, a recharacterization analysis is highly factual, looking to the substance of a transaction over its form, and examining a number of factors. Factors considered by courts in such an analysis include:

> 1. The relationship between the lessor and the lessee. See In re Best Products, 157 B.R. 222, 229-30 (Bankr. S.D.N.Y. 1993) (finding that a leasing arrangement between a parent and subsidiary, in which the subsidiary "was formed for the purpose of acquiring, financing and leasing" the properties, supported a finding of a secured financing);
>
> 2. Whether the subject property was purchased by the lessor specifically for the lessee's use. See Id. at 229-30 (finding a secured financing existed, in part because the sublease back to the parent was not only part of the transaction, but was a prerequisite for the loan);
>
> 3. Whether rent payments were computed to provide the lessor with a particular return on investment rather than as a payment for use of the property/based on market rates. See In re Hotel Syracuse, Inc., 155 B.R. 824 (Bankr. N.D.N.Y. 1993) (finding rental payments were not calculated to compensate lessor for use of premises, but rather were indicative of a financing, because, inter alia, the "purchase price of the Hotels was unrelated to the actual market value of those premises" but "was calculated to be the amount necessary to finance the development project");
>
> 4. Whether the lessee has assumed many of the obligations normally associated with outright ownership, including responsibility for paying property taxes and insurance. See In re PCH Assocs., 804 F.2d 193, 200-01 (2d Cir. 1986);
>
> 5. Whether there is a "hell or high water" provision. See United Air Lines Inc. v. HSBC Bank USA, 416 F.3d 609, 617 (7th Cir. 2005)(noting that "[t]he hell or high water clause demonstrates the lack of connection between the maintenance base's rental value and United's financial obligation" in finding lease was a secured financing);
>
> 6. Whether the lessor retains the residual risks and benefits associated with property ownership. See In re PCH Assocs., 804 F.2d at 196 n. 3 (noting that landlord could not recognize any benefit from appreciation in the value of the land);

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> 7. Whether the term of the lease at issue extends for the entire useful life of the property. See HSBC Bank USA v. United Air Lines Inc., 322 B.R. 347, 349 (N.D. Ill. 2005); and
>
> 8. Whether the lessor's rights in an event of default, including those related to deficiencies, resemble those of secured creditors or of landlords. See In re Pacific Express, Inc. 780 F.2d 1482, 1485 (9th Cir. 1986)(finding, in part, because in the event of default, the "[lessor] would have the right to sell the equipment, with [lessee] liable for any deficiency after application of the sales proceeds to the payments due" the parties created a security interest rather than a true lease).

The Committee has pled in the Lease Complaint an abundance of facts supportive of a finding of recharacterization in consideration of these factors. PropCo and SCI are under common control and management. Similar to the lessor in Best Products, PropCo was not actually formed until October 12, 2007, less than one month prior to the execution of these agreements, but long after the original structure was proposed. PropCo had no participation in any negotiations regarding the terms of the Master Lease, and yet the execution of the Master Lease Agreement was a condition precedent to the Lenders' assent to enter into the PropCo Loan. In addition, PropCo allegedly "purchased" the Real Property from SCI for SCI's specific use, but due to the "hell or high water" provision in the Master Lease, SCI cannot terminate the lease even where, *inter alia*, the leased property is damaged or destroyed, by whatever cause, or if PropCo defaults or breaches any warranty under the Master Lease Agreement. Moreover, because SCI directly or indirectly owns one hundred percent of the equity interests of PropCo, PropCo does not retain the residual risks and benefits associated with ownership of property. Further, SCI, like the lessee in PCH Assocs., has assumed many of the obligations associated with property ownership, including the responsibility for paying taxes and insurance on the subject property. Finally, the Master Lease arguably is for the useful life of the property extending for a term up to twenty five years, and the present value of total rent payments is greater than the original cost of the Real Property.

Indeed, the opinion letters that were obtained in connection with the Master Lease Transaction that opine that the Master Lease Transaction is a true lease are so qualified that they themselves demonstrate that the Claims asserted in the Lease Complaint are at least colorable. Although the opinions address a few reasons why the Master Lease may not be subject to

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recharacterization, they also fully admit that such determination is based on a weighing of factors but that there is no clear formula for how many or which factors in particular will weigh in favor of the recharacterization. Indeed these opinions are highly qualified, presenting additional factors, many identical to those listed above, which would support a finding for recharacterization.

Accordingly, the Committee has established that each of the Claims is colorable.

2. The Claims Would Benefit the Estates.

In order to obtain standing, the proposed claims, if successful, must benefit the estate. In analyzing whether this requirement is satisfied, courts essentially perform a cost-benefit analysis. "If the outcome of the case may result in a benefit to the estate, and the costs of pursuing the matter do not outweigh that benefit, the court may authorize a party in interest to pursue it." 7 COLLIER ON BANKRUPTCY ¶ 1109.05[2][c] (15th ed. rev.). In STN Enterprises, the court observed that one inquiry will be "a determination of probabilities of legal success and financial recovery in event of success." STN Enterprises, 779 F.2d at 905. However, a court need not undertake a "mini-trial . . . to determine likelihood of success in such a suit or the attendant fees and expenses involved. But it should assure itself that there is a sufficient likelihood of success to justify that the anticipated delay and expense to the bankruptcy estate that the initiation and continuation of litigation will likely produce." Id. at 905-06 (internal citations omitted). The Committee has determined that the benefit of commencing litigation substantially outweighs any costs. As described in detail above, the Claims are colorable and the time to bring them is now.[14]

The anticipated recovery on account of the Claims asserted in the LBO Complaint (including the value associated with equitably subordinating claims) represents a very significant source of recovery for the estates' unsecured creditors, who are owed over $2 billion.[15] Specifically, *inter*

[14] In the spirit of negotiation, the Committee was willing to defer filing this Motion if the Debtors, among other things, (a) were able to obtain extensions of the challenge deadlines from Deutsche Bank, as agents and (b) agreed to have meaningful discussions regarding a consensual reorganization that provided value to unsecured creditors, but the Debtors did not desire to engage in such discussions. See Committee Chair Declaration at ¶ 10.

[15] Because no plan has been proposed, much less filed, it is impossible to tell at this time what recovery unsecured creditors may receive through a reorganization. Moreover, the Committee is concerned that insiders of the Debtors will attempt to "low ball" the reorganization value of the Debtors and then re-invest in the reorganized Debtors with existing secured lenders. This Court may even see such a "low ball" before the hearing on this Motion.

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alia, the Bank Defendants stand to lose their senior priority status, and the Individual Defendants may be held liable for hundreds of millions of dollars on account of fraudulent transfer claims, and even more on account of breach of fiduciary duty claims.

Separately, recharacterization of the Master Lease Transaction substantially benefits the general unsecured creditors of SCI by avoiding the need to comply 11 U.S.C. § 365 and to pay administrative "rent" to PropCo. At the same time, recharacterization permits the Debtors' estates to continue to operate the casinos under the umbrella of a single enterprise, and avoids any hardships resulting from lease rejection. Indeed, a potential purchaser of the Debtors' assets recently publicly filed its offer, which offer indicates that there is value in the synergies that have developed by keeping the Debtors' estates' operations together.

The potential recovery far outweighs the costs attendant to litigating the Claims. While litigation costs are likely to be significant,[16] such litigation costs pale in comparison to the value of the Claims to the estates' general unsecured creditors. Although litigation costs are a factor to consider, the Committee must only provide the Court with comfort that the prosecution of the Claims represents "a sensible expenditure of the estates' resources." See Adelphia Communications, 330 B.R. at 386 (explaining that the party proposing to pursue litigation must provide the court "with a predicate for concluding that the claims will, if proven, provide a basis for recovery, and that the proposed litigation will not be a hopeless fling" and that, "as a practical matter, that the prospective rewards can reasonably be expected to be commensurate with the litigation's foreseeable cost," but no more).[17]

Courts have approved derivative standing where, notwithstanding the likelihood of substantial litigation costs, the benefits were obvious. See RJN at Ex. "1" (TOUSA order granting derivative standing). While the Committee certainly acknowledges that the costs associated with

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[16] The Committee, through its legal counsel and with the assistance of Sierra, has already conducted a significant amount of analysis and research over the past three months, which provides some savings in future litigation costs. The Committee's professionals have been mindful of litigation costs, and will continue to be so. Moreover, the Committee's professionals file monthly fee applications with the Court, thereby providing a check on any unnecessary expenditures.

[17] The Debtors are hard pressed to complain about future litigation costs, since they spent over $3 million, after being apprised of the Claims, to hire the SLC to conduct a purportedly "independent" review.

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litigating the Claims likely will not be insignificant, these costs are *de minimis* in comparison with the potential benefits to the Debtors' estates and their unsecured creditors, which exceed hundreds of millions of dollars, and potentially billions of dollars. As such, the benefits of prosecuting the Claims clearly outweigh any costs incurred in connection therewith.

In order to further minimize costs or any impact on the reorganization efforts, the Committee would be willing to consider, promptly upon the filing of the LBO Complaint, deferring any immediate litigation and commencing mediation.

This case is easily distinguishable from In re Zante, Inc. (BK-N-09-50746), in which this Court denied the official committee of unsecured creditors (the "Zante Committee") standing to assert certain claims on behalf of the debtors' estates.[18] In that case, the proposed plan, which was scheduled for a confirmation hearing approximately one month following the hearing on the Zante Committee's standing motion, provided unsecured trade creditors 100% recovery. However, the plan released claims against the secured creditors, including those claims that the Zante Committee sought to prosecute. Therefore, in order to result in a net benefit to the estate's unsecured creditors who were not receiving 100% payment, the Zante Committee would have to successfully recover several hundreds of millions of dollars – the amount necessary to achieve a recovery for apparently subordinated bondholders, the sole creditor constituency not fully recovering under the proposed plan – while risking payment in full to trade creditors.

The general unsecured creditors of the Debtors' estates in this case, in contrast, do not stand to obtain full recovery under a plan of reorganization, by "gift" or otherwise. The unsecured creditors are owed in excess of $2 billion. No plan is even on file. The general unsecured creditors in these cases are virtually certain to not be paid any substantial recovery absent prosecution of the Claims.

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[18] Because counsel to the Debtors here was counsel to certain secured lenders in Zante who were potential targets of litigation, the Committee anticipates that the Debtors' counsel will try to paint theses cases as similar to Zante as a model for denying this Motion.

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3. The Committee Made an Adequate Demand upon the Debtors to Take Action.

In general, a committee must make a demand upon the trustee or debtor in possession to pursue the particular cause of action. If the trustee or debtor in possession's response indicates that it will not take action, the court may then confer standing on another party in interest, provided the other elements of the test are met. COLLIER ¶ 1109.05[2][a].

There are exceptions to the demand and refusal requirement, generally in which demand is considered "presumptively futile" under the circumstances. Id.; see also In re G-1 Holdings, Inc., 313 B.R. 612, 630 (Bankr. D. N.J. 2004) (despite never making a formal demand on debtor in possession, asbestos claimants committee satisfied the demand and refusal requirement where positions taken by the debtor previously in the bankruptcy case and conflicts of interest demonstrated that any formal demand would have been refused).

Here, any demand was always going to be futile. The Debtors are controlled by certain of the Individual Defendants. The Debtors' counsel was counsel in the LBO Transaction to several of the Debtors and Individual Defendants and issued several opinion letters. Such counsel also represented Individual Defendants in shareholder derivative litigation that occurred in connection with the public announcement of the LBO Transaction in late 2006. The Debtors arranged for the hiring of the SLC, long after the closing of the LBO Transaction and only while in the midst of bankruptcy planning and after the Debtors apparently were informed that the LBO Transaction easily could be challenged as fraudulent transfers. The SLC issued its SLC LBO Report, recommending to the Debtors' board of directors (controlled by certain Individual Defendants) that the Debtors "oppose any request by creditors or others that they may be authorized to bring claims on behalf of [the Debtors'] bankruptcy estates." The SLC made a similar recommendation in the SLC Lease Report. In cash collateral stipulations with the Bank Defendants, including the PropCo Lenders, the Debtors waived any right to assert any of the Claims asserted in the LBO Complaint. There is simply no reason to think that the Debtors will make an about-face and seek to litigate the Claims on behalf of the Debtors' estates.

Despite the presumptive futility of making a formal, written demand upon the Debtors, based on the directives of this Court set forth on the record of the November 20, 2009 hearing, the

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Committee's counsel sent the Demand Letter to the Debtors' counsel on December 8, 2009, attached to the Winston Declaration as Exhibit "D," requesting that Debtors consent to the Committee commencing and prosecuting (including compromising) the Claims. The Demand Letter requested a response by December 11, 2009, but on that day, the Committee granted (without being asked) an extension to December 21, 2009. See Winston Declaration at Exhibit "E." This amount of time was sufficient. See RJN at Ex. "2" (TOUSA standing motion, describing length of time provided to Debtors to respond was one week).

Not surprisingly, the Debtors have unjustifiably refused to act; indeed, as evidenced in a letter dated December 16, 2009, the Debtors intentionally refused to state in writing when they would respond and sought to intimidate the Committee and its professionals by threatening to object to fees. See Winston Declaration at Exhibit "F." This type of hostile response (one far harsher than the response letter of the debtors in TOUSA) is just further evidence that the Debtors really have no intention to ever consent to the Committee's standing. Nonetheless, on December 21, 2009, the Committee sent a response letter. Winston Declaration at Exhibit "G." The Debtors responded again on December 23, 2009, and again failed to identify when they would provide an answer.

As such, the demand and refusal requirement has been satisfied.

4. The Debtors' Refusal to Assert the Claims Was Unjustified.

A debtor's refusal of a party's demand to bring a suit on behalf of the estate must be unjustifiable in order for such party to be granted derivative standing. In determining whether a debtor unjustifiably refuses to pursue a particular action, courts consider the following factors: (1) whether conflicts of interest exist between the debtor and the parties against whom the action would be brought; (2) whether the creditors' interests are protected despite the debtor's refusal; (3) whether allowing the party to pursue the action on the debtor's behalf will benefit the estate; and (4) whether appointing a trustee and allowing the trustee, as opposed to the demanding party, to pursue the action or converting the chapter 11 case to a chapter 7 case would be more beneficial to the estate. G-1 Holdings, 313 B.R. at 643; Louisiana World Exposition, 858 F.2d at 248-53 (debtor in possession's refusal to pursue action was unjustifiable where committee outlined colorable claim

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which had the potential to bring significant value to the estate, even though such refusal was understandable given the conflict of interests).

The party making the demand has the initial burden of alleging facts showing that the refusal is "unjustified." In re Gibson Group, Inc., 66 F.3d 1436, 1439 (6th Cir. 1995). This burden may be met, however, through notice pleading by alleging the existence of the a colorable claim that would benefit the estate. Id. The demanding party need not plead facts alleging the reason or motive for inaction. Id. If this relatively low burden is carried, the burden then shifts to the debtor in possession to establish, by a preponderance of the evidence, that its reason for inaction is justified. Id. If the debtor in possession does not rebut by providing a reason for its inaction upon the demand, "the bankruptcy court may presume that its inaction is an abuse of discretion ('unjustified') if the complaint alleges a colorable claim." Id.

The factors listed above easily demonstrate that the Debtors' refusal to act is unjustified. There is no evidence to suggest that the Debtors will protect the interests of unsecured creditors if the Committee is denied standing; if anything, the opposite is true. The Debtors have gone out of their way not to involve the Committee in any substantive discussions, and the Committee believes that the Debtors will seek to propose a plan of reorganization that contains a "lowball" valuation that nonetheless keeps insiders in charge. By contrast, the Committee, which owes fiduciary duties to unsecured creditors, has every incentive to maximize value for that constituency.

While appointing a chapter 11 trustee to permit the trustee to pursue the Claims is in theory possible, it would be expensive and time-consuming for a chapter 11 trustee and its counsel to get "up to speed" understanding the LBO Transaction. Converting to chapter 7 is not a viable option, and that would only destroy value of the business and would increase the pool of unsecured creditors.

It appears that non-management employees of the Debtors would favor the Committee being granted standing. Just one day after the Committee published its Status Report, a union representing a significant number of the Debtors' employees issued a press release that was highly critical of the LBO Transaction and called on certain of the Individual Defendants to return value that the Individual Defendants had extracted.

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Last, but certainly not least, the conflicts of interest that exist between the Debtors and the Defendants are staggering. The Individual Defendants are, for the most part, still entrenched in the Debtors' ownership and management. Even the Debtors' counsel is hopelessly conflicted. Specifically, Debtors' bankruptcy counsel represented the Debtors, several Individual Defendants, and other interested parties in numerous capacities in connection with the LBO Transaction, including the representations set forth below:

- Counsel represented SCI in connection with the LBO Transaction and participated in numerous Board of Director meetings between November 2006 and November 2007;
- Counsel represented FCP and Fertitta Partners, LLC;
- Counsel represented PropCo;
- Counsel represented the various MezzCo debtors;
- Counsel has represented the Fertittas in their individual capacities in various matters, including representing the Fertittas in a shareholder lawsuit brought in connection with the LBO Transaction; and
- Counsel represents the Bank Defendants in numerous matters outside these bankruptcy cases.

5. The SLC LBO Report Is Entitled To No Weight Because It Contains Significant Flaws, It Failed To Address Material Claims, And It Lacked Independence.

This Court should expect that, in opposing this Motion, the Debtors (controlled by Individual Defendants) and the Bank Defendants will rely upon the conclusions of the SLC as set forth in the SLC LBO Report.

The SLC LBO Report should be entitled to no weight whatsoever. Putting aside the fact that it is just another pleading – filed by an entity created by the Debtors prepetition that has no standing, no significance and no recognition under the Bankruptcy Code – the SLC LBO Report suffers from many material flaws in its analysis of the potential claims of the estates which the SLC actually considered. Moreover, the SLC entirely missed discussing valuable claims. Finally, the SLC simply lacked independence.

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<u>The SLC LBO Report Made Numerous Errors and Failed to Disclose Material Facts Undermining Its Conclusions</u>:

There are significant errors in the SLC's factual and legal analysis with respect to the Claims the SLC actually considered (as opposed to the Claims it did not consider). These errors, discussed below, undermine the SLC LBO Report's reliability.

The SLC concluded that any constructive fraudulent transfer claims based on insolvency or unreasonably small capital would ultimately fail because the LBO Transaction did not render the Debtors insolvent and did not leave the Debtors with unreasonably small capital.[19] The SLC reached this conclusion even though it did conclude that the LBO Transaction did not provide reasonably equivalent value. <u>See</u> SLC LBO Report at 41-43.

In order for the SLC to have reached its conclusions on the constructive fraud/insolvency claims, it was necessary for the SLC to determine, among other things, that SCI's management was correct to view SCI's declining performance throughout 2007, and the declining economic indicators directly affecting the "locals" gaming market, as nothing more than a temporary "blip." <u>See</u> SLC LBO Report at 48. That determination lacks merit, based on documents that were in the hands of the SLC. [redacted]

Moreover, the SLC failed to acknowledge key factors in SCI's budgeting process that should have alerted the SLC to view the Final Projections with deep skepticism. SCI's actual performance substantially exceeded budgeted EBITDA in 2004 and 2005, but those years reflected substantial CapEx, meteoric rise in residential home prices, and spike in subprime mortgage originations. But starting in 2006 – with a particular focus on the second half of 2006 – SCI's actual EBITDA fell

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[19] The SLC refers to the "Company" in its discussion on this point, but the context of the report suggests that the SLC is referring to the Debtors. <u>See</u> SLC LBO Report at 42.

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below projections.[20] Then, prior to the closing of the LBO Transaction, SCI had three full quarters of performance, and knew it was far below EBITDA projections for 2007. These facts suggest that SCI had actual knowledge that it had missed its forecasts for numerous consecutive quarters, extending back to 2006.

Even though the Final Projections apparently did adjust downward 2007 projections by nearly 12%,[21] SCI assumed that 2008 would see an end to the accelerating decline and be as good a year, as measured by EBITDA as a percentage of revenues, as 2004 and 2005. The SLC LBO Report fails to account for this unreasonably rosy projection.

Moreover, the success SCI enjoyed in 2004 and 2005 also correlated with substantially higher CapEx. [redacted] In addition, not one independent professional appeared to have reviewed the Final Projections at or before the LBO Transaction closing. These facts are not included in the SLC LBO Report.

Further, the SLC LBO Report states that, even though SCI's balance sheet as of September 30, 2007 revealed that SCI was insolvent, that a balance sheet "is not relevant to a solvency analysis because [the carrying assets] are not stated at fair value." SLC LBO Report at 44. But even the cases cited by the SLC for support for this statement expressly provide that financial statements are relevant for a solvency analysis. See SLC LBO Report at 44 n 165 (citing cases, including Arrow Elec., Inc. v. Justus (In re Kaypro), 230 B.R. 400, 413 (B.A.P. 9th Cir. 1999)). The financial statements for the quarter ending September 30, 2007 revealed that SCI's liabilities significantly exceeded assets, and demonstrated increasingly poor financial performance.

Indeed, the relevance of SLC's financial statements takes on particular significance when

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[20] [redacted]

[21] The Committee has not been provided any evidence to suggest that SCI's board of directors actually considered these revised, downward, projections prior to the closing of the LBO Transaction. As noted below, the SLC ***never*** reviewed any Board of Director minutes other than one meeting in September 2007 and one meeting of an audit committee in August 2007.

examining the value of goodwill. As of September 30, 2007, SLC's financial statements reported goodwill as having a value of $154,498,000. On information and belief, SCI's goodwill was not subject to any impairment in 2005 or 2006. Yet at the LBO Transaction closing (dated six weeks after the date of the third quarter reporting), goodwill increased to $2,964,938,000, an astonishing 19.19 times greater than what was reported for September 30, 2007. The SLC LBO Report does not even raise any concerns about this treatment, even though multiple cases, including cases cited in the SLC LBO Report for other purposes, expressly criticize any solvency determination that, as was the case here, is heavily dependent on a high goodwill valuation. See Bay Plastics, Inc. v. BT Commercial Corp. (In re Bay Plastics, Inc.), 187 B.R. 315, 330 (Bankr. C.D. Cal. 1995) (stating that inclusion of goodwill increase following LBO was improper, since it could not be sold and was not reflected on financial statements prior to LBO); Kendall v. Sorani (In re Richmond Produce Co.), 151 B.R. 1012, 1019 (Bankr. N.D. Cal. 1993).

[redacted]

[redacted]

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Winston Declaration at Ex. "J" (emphasis added). It is astonishing that this e-mail – one of the few e-mails that the SLC actually obtained – was not disclosed in the SLC LBO Report.

There are additional concerns with the SLC LBO Report. For example:

- The SLC LBO Report states on page 39 that the "Company received an opinion from Milbank that the structure of the Transaction did not constitute a change of control under the indentures governing the Existing Notes." SLC LBO Report at 39. But the Milbank opinion letter referred to in the SLC LBO Report concerns only the issue whether the Master Lease Transaction between SCI and PropCo constituted a disposition of substantially all of the assets of SCI, which is one, but not all, of the means to trigger the change of control provisions in the Indentures. There is no opinion regarding whether the LBO Transaction itself constituted a "change of control";

- The SLC LBO Report heavily relies on a fairness opinion obtained from Bear Stearns, and makes the statement that "[n]either Bear Stearns nor any of the other financial advisors and investment banks involved in the Transaction ever suggested the projections were unreasonable at the time they were made." SLC LBO Report at 58. But the Bear Stearns fairness opinion was obtained in February 2007, and only concerned the issue whether the LBO Transaction was fair to SCI's public shareholders based on 2006 financial information;

- The SLC LBO Report states that the LBO Transaction attracted significant debt and equity investment, and that, when the LBO Transaction structure changed in October 2007, only two lenders withdrew commitments. SLC LBO Report at 58. Because the SLC obtained no documents from Deutsche Bank prior to its SLC LBO Report, it did not have access to [redacted][22]

- [redacted]

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[22] Since both the SLC and the Committee received very few documents from Colony, it is at this time pure speculation as to whether Colony recognized it was likely grossly overpaying for the equity in SCI or whether there were other, independent motivations for acquiring a majority stake in SCI. For example, Colony had co-investors, and Colony also had already made significant investments in gaming businesses, and thus there could have been strategic advantages to proceeding with the LBO Transaction. Further, Colony could have been liable up to $160 million if it backed out of the LBO Transaction.

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The Odyssey Report Lacks Merit. The SLC engaged Odyssey to review the reasonableness of the Final Projections and to "conduct an independent analysis of whether the Company was insolvent at the time of the Transaction or became insolvent as a result of the Transaction, with reference to the fair value of the assets reflected on the Company's balance sheet." SLC LBO Report at 44. Odyssey states that it used three approaches to determine that the LBO Transaction did not render SCI insolvent – the "income" approach, the "market comparables" approach, and the "market transactions" approach.

Based on its review of Odyssey's report, the Committee believes that Odyssey made numerous critical mistakes in its review of the Final Projections and Odyssey's determination of solvency, and that Odyssey's report should in no way be used to block the Committee from obtaining standing.

It appears that in analyzing the Final Projections and determining whether the Debtors were rendered insolvent, Odyssey relied almost exclusively on the work performed by D&P in connection with the Allocation. For example:

- [redacted]
- [redacted]
- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

The SLC's Information Gathering Protocols Were Inadequate.

Another significant flaw in the SLC LBO Report was its reliance on a materially incomplete information-gathering process. First, the SLC gathered very few e-mails from the Company's management, and obtained no e-mails from Frank Fertitta or Lorenzo Fertitta. See Winston Declaration at Ex. "K." Company e-mails obviously would be highly relevant to examining

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management's understanding of SCI's economic performance between the time of the announcement of the LBO Transaction and its closing in November 7, 2007, the state of the economy, the intentions regarding the manner and timing of the LBO Transactions, and numerous other issues directly relevant to claims that were considered by the SLC.

The only e-mails from the Company that the SLC was able to obtain came from a few officers who voluntarily caused their e-mails to be stored on a Company "H" drive. None of the critical officers and directors, including the Fertittas, did so, meaning that the e-mails and other documents of individuals who were the closest to the LBO Transaction were never reviewed. The SLC LBO Report does not disclose these material facts, and the SLC apparently never considered whether nearly a year's worth of potentially missing e-mails might have had any impact on the SLC's conclusions.[23]

To compound its errors, the SLC apparently failed to obtain e-mails from most of SCI's professionals involved in the LBO Transaction, including Milbank Tweed Hadley & McCloy ("Milbank"), counsel to SCI, PropCo, and the Fertittas.[24] The SLC certainly could have obtained such e-mails, since the SLC was given access to, for example, a key Milbank lawyer for a witness interview. To the extent that Milbank or other professionals refused to disclose information, the SLC could have sought relief under Bankruptcy Rule 2004.

Moreover, the SLC apparently failed to obtain, review, and/or consider other material documents of SCI. For example:

- [redacted]

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[23] [redacted]

[24] See Exhibit "L" to the Winston Declaration.

[25] [redacted]

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[redacted]

- The SLC did not obtain any player tracking and marketing information, which information would be highly relevant for understanding the "real time" performance of the casino operations;[26]
- The SLC did not interview any general manager of any SCI casino during the relevant time frame;
- Several of the directors and officers who received millions of dollars in connection with the LBO Transaction were not interviewed;
- None of the real estate appraisers were interviewed;
- The SLC reviewed transcripts of proceedings before Nevada gaming regulators, but did not obtain copies of the documents provided to the regulators; and
- [redacted]

Second, the SLC obtained no information from Deutsche Bank. It is therefore entirely without basis for the SLC to make conclusions about Deutsche Bank's due diligence and its allegedly equitable conduct. The SLC LBO Report discloses that the SLC asked for, but did not obtain, any information from Deutsche Bank, but fails to disclose two critical facts. One, according to Deutsche Bank's counsel, the SLC did not even approach Deutsche Bank for information until a few weeks prior to September 11, 2009. See RJN at Ex. "6" (Sept. 11, 2009 Tr. h'rg at page 79, lines 23-25). This means that, by the time that the SLC requested information from Deutsche Bank, it had already substantially completed the SLC LBO Report, and it remains shocking that the SLC waited so long to approach Deutsche Bank. Two, the SLC LBO Report does not disclose that the

[redacted]

[26] See Exhibit "N" to the Winston Declaration.

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SLC easily could have sought information under Bankruptcy Rule 2004, though it never availed itself to this option.[27]

Third, the SLC apparently obtained very little information from Colony – just a handful of documents and a single witness interview. There is a strong possibility that relevant e-mails prior to and up to the closing of the LBO Transaction that allegedly are no longer in the possession of the Debtors may be in the possession of Colony. These emails may provide insight as to how Colony's views of the LBO Transaction evolved over time.

Fourth, the witness interview process was flawed. The SLC spent generally only 1.5 to 2.5 hours with each witness. See Winston Declaration at Ex. "O." The SLC did not record the interviews or arrange for the interviews to be transcribed. Witness summaries were not prepared the same day as the interviews. A portion of the small amount of interview time was spent asking the witnesses whether they believed they engaged in, or were aware of, any fraudulent activity.[28] Not surprisingly, the witness summaries reveal few details and leave many questions unanswered. [redacted]

The SLC LBO Report Missed Significant and Valuable Claims, and on this Basis Alone the Committee Must be Given Standing:

The SLC completely failed to address significant claims of the estates arising out of or relating to the LBO Transaction. As already noted in the Committee Status Report, the SLC did not

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[27] Further, the SLC could have found out pertinent information by using Rule 2004 to obtain information from the title insurers who underwrote the PropCo Loan. The SLC did not avail itself to this option.

[28] [redacted]

address claims arising under Bankruptcy Code section 548(a)(1)(B)(ii)(IV). These claims are without a doubt valuable because they alone concern more than $360 million in transfers to insiders who were employed by SCI and were richly awarded with the Accelerated Stock Benefits.

Further, while the SLC LBO Report addressed breach of fiduciary duty claims, it did so only from the perspective of SCI's shareholders. The SLC's analysis should be summarily rejected. First, the proper analysis is whether there was a breach of fiduciary duty owed to creditors. That was not addressed. Second, in connection with evaluating any breach of fiduciary duty claims, the SLC LBO Report gave considerable weight to the February 2007 Bear Stearns fairness opinion, but the Bear Stearns opinion clearly states that it was a fairness opinion regarding the interests of SCI's public shareholders, not a solvency opinion. It is also entirely irrelevant because it was issued in February 2007, based on late 2006 financial data, and thus did not and could not take into account SCI's dramatic financial declines in 2007. The SLC LBO Report does not address these facts.

The SLC Lease Report Is Flawed:

Although the Committee has been afforded the opportunity for only an initial review of the SLC Lease Report, the flaws and lack of independence that plagued the SLC LBO Report are equally apparent. Not surprisingly, the SLC concluded that the Debtors should refuse the Committee's demand for consent to seek recharacterization of the Master Lease as a disguised secured financing. See SLC Lease Report at p. 30. However, like the SLC LBO Report, the SLC Lease Report is entitled to virtually no weight.

Again, both the substance of the SLC Lease Report, and the process by which the SLC arrived at its conclusions are incomplete, rely on misguided, outdated and/or incorrect data and analysis, are highly qualified based on the highly factual and discretionary legal precedent on recharacterization,[29] and stem from a body which has every incentive to conclude that no claims should be brought on behalf of the Debtors' estates.

More specifically, the SLC Lease Report is flawed in the following ways:

- First and foremost, the SLC Lease Report does answer the question why the Master Lease was contemplated, negotiated, and executed, if not for the specific purpose of financing the LBO Transaction. According to the

[29] See SLC Report at 11-12, and In re Moreggia & Sons, Inc., 852 F.2d 1179, 1182 (9th Cir. 1988).

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SLC, "[a]t the time of the LBO Transaction, accessing the CMBS market allowed SCI to obtain the most favorable financing terms from the assets it collateralized. The Sale and Leaseback was an integral feature of the LBO Transaction." SLC Lease Report at p. 26. No other purpose is discussed;

- There is virtually no discussion of PropCo. There is no explanation of why PropCo came into existence in October 2007, one month before the LBO Transaction closed, and long after the Master Lease Agreement had been negotiated. There is no discussion regarding why PropCo - as a "landlord" - saw it fit to purchase and lease certain casino properties in the first instance, and no discussion why the identity of the Four Casinos ultimately leased changed shortly before the Master Lease Transaction closed without PropCo's input.[30] One is hard pressed to find any reference to PropCo's identity, direction or purpose, apart from it's subsidiary relationship with SCI and status as a vehicle to access the CMBS market (which only supports the proposition that the Master Lease Transaction is a debt financing);[31]

- It is precisely because of the relationship between SCI and PropCo that the SLC's consideration of other factors in support of a finding that the Master Lease is a true lease is flawed. The SLC gives little consideration to the fact that SCI and PropCo are closely related entities when examining other factors, such as whether there is a reversionary interest, and who retains the risks of ownership.[32] At the end of the day, PropCo has no ability to operate or maintain the Four Casinos without SCI, and thus SCI, even through the facade of PropCo, will continue business as usual at the Four Casinos after the lease term. This alone is highly indicative of a secured financing;

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[30] According to the SLC Lease Report, "the final rent figures included in the Master Lease came from Deutsche Bank." See SLC Lease Report at p. 16. Specifically, "as part of the ongoing negotiations concerning the structure of the LBO Transaction, including the Sale and Leaseback, SCI and Deutsche Bank agreed in October 2007 to substitute Red Rock for Fiesta Henderson, Fiesta Rancho, and Santa Fe Station in the Sale and Leaseback." Id. at 17. It is hard to imagine a legitimate landlord being told by its bank and/or its prospective tenant which properties it is going to buy and lease rather than the other way around.

[31] Even as to PropCo's existence as a subsidiary of SCI, the SLC dismisses the relevance of this relationship to a lease recharacterization analysis without providing any legal support. Yet cases cited in the SLC Lease Report do in fact take as significant the closely related nature of a landlord and tenant in a recharacterization analysis. See In re Best Products, 157 B.R. 222, 229-30 (Bankr. S.D.N.Y. 1993).

[32] By the SLC's own admission, the factors often considered by courts in the determination of whether a purported lease should be recharacterized as a disguised financing must be evaluated together. See SLC Lease Report at p. 13 (citing In re Lansing Clarion Ltd. Partnership, 132 B.R. 845, 851 (Bankr. W.D. Mich. 1991) ("There are really no direct factors which always and regularly apply to each and every transaction in dispute. Therefore, a court must look at all of the factors, including the factors set forth in the legislative history of § 502(b), to determine the key factor of the economic substance of the transaction.") Despite this acknowledgment, the SLC Lease Report nevertheless considers the relevant factors in isolation.

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- Similarly, the SLC Lease Report's discussion regarding the useful life of the property is wholly inadequate. The SLC relies in part on its expert's, Global Gaming and Hospitality, Inc. ("GGH"), identification of "numerous properties in the Las Vegas area that were more than 40 years old on or around October 2007 but which demonstrated significant business value either by their actual sale price or their financial performance," to conclude that the Master Lease is a true lease. See SLC Lease Report at p. 24. Yet, the SLC completely ignores any other indicators of useful life. The Internal Revenue Service has determined that non-residential real property depreciates over the course of 39 years.[33] More specifically, decorative facades (which includes decorative exterior wall coverings) of a hotel/casino complex also depreciate over the course of 39 years.[34] Boulder Station, which opened in August 1994, will be have been open for 38 years after the Master Lease's initial term and the two possible renewal terms have expired. Therefore, the Master Lease arguably extends for the useful life of that property, a factor indicative of a secured financing;[35]

- The SLC Lease Report relies heavily on the fact that the rent payments under the Master Lease Agreement are reflective of fair market value rents. See SLC Lease Report at p. 14-19. However, according to the SLC Lease Report, Mark Capasso, a Managing Director of Cushman & Wakefield, the firm retained by Deutsche Bank in 2007 to perform the appraisals of the leased properties, noted that "there was no standard methodology for determining a fair market rent for gaming properties because it was rare for gaming properties to be leased." Id. at p. 14. Not only does the SLC leave unanswered the question, "if casino leases were rare, why is it acceptable that one occurred here?" but the SLC also does not test the veracity of this statement. Indeed, casino lease agreements may not be as rare as depicted, meaning relevant comparable data was ignored in favor management contract data that was only relevant by analogy. See id.;

- The SLC has seemingly relied on a materially incomplete information-gathering process in its conclusion that seeking to recharacterize the Master Lease would be unsuccessful and inappropriate. Specifically, the SLC has gathered very few e-mails from the parties involved in the conception, negotiation, and execution of the Master Lease. In so doing, the SLC has failed to investigate what was likely the true intent of the

[33] See Internal Revenue Service, Instructions for Form 4562, Depreciation and Amortization (Including Information on Listed Property (2009)).

[34] See Internal Revenue Service, Asset Class and Depreciation for Casino Construction Costs, available at http://www.irs.gov/businesses/article/0,,id=171228,00.html (last accessed Dec. 25, 2009).

[35] Because PropCo is a wholly owned subsidiary of SCI that does not have its own ability to operate a casino and does not own any of the personal property contained in the Four Casinos, PropCo has little ability to capitalize on any potential excess useful life short of reselling the properties. The SLC dismisses without explanation any relevance this fact may have on the determination of whether the Master Lease is a true lease. See SLC Lease Report, note 92.

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parties.[36] Although the SLC reviewed "documents produced by counsel for Deutsche Bank to counsel for the [Committee] in the [Debtors'] bankruptcy case," SLC Lease Report at pp. 9-10, the documents produced by Deutsche Bank do not include any relevant emails and correspondence relating to the Master Lease Agreement. Such correspondence undoubtedly exists and should have been considered by the SLC in order to arrive at any reliable conclusion;

- The SLC arrived at its conclusion that any litigation seeking to recharacterize the Master Lease would be inappropriate and a waste of the Debtors' resources without any discussion of the potential benefits to SCI's estate (and possibly all Debtors' estates) should the Court recharacterize the Master Lease as a secured financing. For example, if the Master Lease is recharacterized as a financing, the property would constitute property of SCI's estate, and the Debtors would not be forced to decide whether to assume or reject the lease in order to retain possession and use of the property. Moreover, the Bankruptcy Code does not require a debtor to comply with secured claims' operative documents. Instead, it allows great variance from such terms and conditions. For example, particularly in a cramdown situation, a debtor may reduce principal and interest, as well as other maturity dates and/or repayment schedules. See 11 U.S.C. §§ 506(a) and 1123(a), (f), and (h); and

- Finally, permitting recharacterization avoids any need for SCI to reject the Master Lease, which may make it substantially easier to continue to operate the entire business enterprise. The SLC Lease Report does not address this.

Surprisingly, the SLC Lease Report contains virtually no discussion regarding Best Products. This case, although cited by the SLC, was not discussed in terms of its nearly analogous factual situation to the present circumstances. In Best Products, the Bankruptcy Court for the Southern District of New York held that a loan from a creditor to a subsidiary and a sublease from the subsidiary to the parent corporation could be "collapsed" to find that the sublease was not a true lease, but instead was a secured loan from the creditor to parent corporation. Best Products, 157 B.R. at 229-30. According to the court, the lender made the loan to a "shell company," deemed to

[36] Conveniently, the SLC notes that how the parties classify the transaction is given little weight in a lease reachacterization analysis. See SLC Lease Report at 26 (noting that the SLC believes "that affording a presumption to the parties' designation of an agreement as a lease is akin to attaching particular weight to the form of the agreement. . .). Yet this is true only to the extent that the parties claim the "lease" in question is a true lease. To the extent that there is evidence that the parties actually intended a secured financing, surely a court would listen. See In re Best Products, 157 B.R. at 229 (noting that courts "frequently look to the knowledge of the defendants of the structure of the entire transaction and to whether its components were part of a single scheme.").

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be the "technical borrower," and the transaction was structured so that if the subsidiary defaulted under the ground lease, the parent-"lessor" would still be obligated. Id. at 229. The subsidiary "was formed for the purpose of acquiring, financing and leasing" the properties, and had no assets, bank accounts, and no sources of revenue with which to repay the loan aside from the rental payments. Id. at 229-30. In fact, the sublease was not only part of the transaction, but was a prerequisite for the loan. Id. at 230.

Upon consideration of the foregoing facts, the Best Products court concluded that the parent and lender did not intend for the loan to be to the subsidiary, but rather, the transaction was a loan from the lender to the parent with the subsidiary. The sublease between the parent and the subsidiary "was not simply a triple net lease entered into between [the subsidiary] and an unrelated third party." Id.

The SLC failed to consider the numerous similarities between the Master Lease Transaction and the factual situation in Best Products. For example, PropCo, like the purported lessor in Best Products, was a subsidiary of the landlord, SCI, and was formed for the purpose of acquiring, financing, and leasing the properties. In addition, as in Best Products, the Master Lease Agreement was a prerequisite for the Lenders to enter into the Loan Agreement with PropCo, and the Master Lease Agreement is a triple net lease. That so many of the most critical factors to the Best Products' determination that a lease was a secured financing are present here, demonstrates, first that the Master Lease is really a secured debt of SCI, and second, that the SLC intended only to provide a counter point to the Committee's Standing Motion in its SLC Lease Report.

In another attempt to ignore Best Products, the SLC did not address the impact of collapsing the Master Lease into the LBO Transaction. The Master Lease Agreement was one of many aspects of the LBO Transaction that resulted in Colony, the Fertittas, and other insiders taking the Debtors private, and was clearly an integral part. As such, the Court may, in its discretion, collapse the series of steps comprising the LBO Transaction and Master Lease Transaction into one transaction. "In reality, collapsing transactions is little more than an effort on the part of the court to focus not on the formal structure of the transaction, but rather on the knowledge or intent of the parties involved in the transaction." In re Best Products Co., Inc., 157 B.R. B.R. 222, 229 (Bankr. S.D.N.Y. 1993)

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(citing Moody v. Security Pacific Business Credit, Inc., 127 B.R. 958, 992 (W.D. Pa.), aff'd, 971 F.2d 1056 (3d Cir. 1992) ("In analyzing the conveyances…we are convinced that we should 'collapse' the various steps in the…leveraged buyout and treat them as 'on integral transaction'"); In re O'Day Corp., c x, 394 (Bankr. D. Mass 1991) ("In view of the fact that all parties…were aware of the structure of the transaction and participated in implementing it, the Court will focus on the substance of the LBO as one transaction, not on its form."); In re Suburban Motor Freight, Inc., 124 B.R. 984, 998 (Bankr. S.D. Ohio 1990) (holding the court must look beyond the multicomponent transfers created by the parties to the essence of the transaction to assess its effect)). If the Court were to do so, the SLC Lease Report, having apparently examined recharacterization factors in isolation from one other, and in isolation from the LBO Transaction, will become even more irrelevant.

There Are Substantial Questions Concerning The SLC's Independence:

This Court should question the independence of the SLC. First, the SLC was formed by the Debtors' board of directors (including the Fertittas) only after the Debtors' management was threatened by potential fraudulent transfer claims.[37] It appears that the SLC was formed as the Debtors were contemplating commencing bankruptcy cases, which suggests that the Debtors would use (as they indeed have used) the SLC as weapon to block any meaningful investigation by truly independent parties.

Second, Dr. Nave served on the SLC and was a director of SCI. He headed up the 2006 committee, appointed by SCI's board of directors, to negotiate the terms of the LBO Transaction on behalf of the interests of public shareholders. In addition, he made over $3 million through the LBO Transaction. Under Nevada corporate law, it is questionable whether Dr. Nave could be considered independent given that he actively participated in the negotiation of the LBO Transaction and received approximately $3 million as a result of the closing of the LBO Transaction. See Shoen v. SAC Hldg. Corp., 137 P.3d 1171, 1182 (Nev. 2006). Dr. Nave attended many of the witness interviews, which likely had a chilling effect on candid and fulsome discussions.

[37] In TOUSA, the court criticized the debtors for relying on a solvency opinion that was arranged for and obtained only after the debtors were threatened with potential fraudulent transfer claims. See TOUSA, 2009 WL 3519403 at 80 n. 56.

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Third, as demonstrated above, while the SLC had far better access to documents and individuals and was in possession of evidence strongly suggesting significant problems with the LBO Transaction, the SLC LBO Report is a one-sided view of the LBO Transaction – certain obvious contrary evidence, obvious potential claims, and gaping holes in information gathering, are not disclosed. Such treatment is consistent with a task designed to provide cover for the Debtors' management, as opposed to a task to engage in providing an independent analysis.

In re THCR/LP, 2008 WL 3194056 (Bankr. D. N.J. Aug. 1, 2008) ("Trump"), stands for the proposition that a court should view with a healthy dose of skepticism an "independent" special committee appointed and paid for by a debtor in the midst of a restructuring to examine whether a proposed transaction favored by the debtor is fair to others. In Trump, prior to filing for bankruptcy, the debtors, their controlling shareholder, and their lenders negotiated a restructuring that would pay all unsecured creditors in full, leaving the controlling shareholder with a substantial stake in the reorganized company, but all but wipe out existing public, non-insider shareholders. Id. at *1. The debtors appointed a special committee to consider the transaction on behalf of public non-insider shareholders, which hired a nationally recognized law firm and financial advisors. The Trump special committee, armed with the advice of their counsel, determined that the shareholders should retain existing stock, subject to a 1,000-1 reverse stock split (worth approximately $300,000) and warrants to acquire an additional 3.4 million shares.

After the cases were filed, the debtors and the lenders attempted to expedite the confirmation process. They "highlighted the fact that the secured noteholders had invested upwards of $1.8 billion in the company and had agreed to substantial negative adjustments to their positions, the fact that the livelihood of 12,000 company employees was at stake, and the fact that thousands of trade creditors depended on the survival and continued viability of the company. They also noted that any significant delay would derail the plan, to the serious detriment of all parties in interest." Id. at *2. Over the vigorous objections of the debtors and noteholders, who cited to the fact that the debtors had engaged a special committee with skilled professionals, the court appointed an equity committee. Id. That equity committee immediately sought to slow down confirmation, but the debtors argued that equity committee's efforts should be rejected, again relying on the

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determinations of the special committee. Id. at *3. Nonetheless, in a short amount of time, the equity committee correctly determined that there were unencumbered assets that would flow to equity security holders. Once that position became public, the debtors and secured lenders changed their tune – the plan was amended and public non-insider shareholders received $40 million in cash plus warrants. Id. at *10.

In awarding a bonus to counsel to the equity committee, the Trump court remarked:

> The exceptional result is the recovery through the Chapter 11 process by public non-insider shareholders of a cash package worth approximately $40 million, plus one-year warrants to purchase stock in the reorganized company. When the case was filed, the Debtors expected that the recovery by the non-insider shareholders, as provided in the prenegotiated plan, would be worth approximately $300,000. The Debtors based their expectations on the fact that another sophisticated, highly skilled law firm had represented the Debtors' Special Committee, whose primary focus was the interests of the public non-insider shareholders. The law firm represented the Special Committee for nearly a year prior to the filing of the petition, had achieved a package for the non-insider shareholders worth about $300,000, and had cost the Debtors over $1 million in legal fees.

Id. Trump demonstrates that a special committee that is supposed to be independent is no panacea. Special committees, even after they hire skilled professionals, make mistakes. That is what has occurred here.

WHEREFORE, the Committee requests that the Court enter an order (i) granting the Committee leave, standing, and authority to commence, prosecute, and, if appropriate, settle the Claims on behalf of the Debtors' estates; and (ii) such other and further relief as the Court may deem just, proper, and equitable.

DATED: December 28, 2009

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