Docket #0043 Date Filed: 4/23/2013

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	Case No. 12-12020 (MG)
RESIDENTIAL CAPITAL, LLC, *et al.*,	Chapter 11
Debtors.	Jointly Administered
RESIDENTIAL CAPITAL, LLC, *et al.*, Plaintiffs, v. ALLSTATE INSURANCE COMPANY, *et al.*, Defendants.	Adv. Case No. 13-01262 (MG)

OPPOSITION OF AIG ASSET MANAGEMENT (U.S.), LLC, THE ALLSTATE ENTITIES, MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, AND THE PRUDENTIAL ENTITIES TO DEBTORS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

AIG Asset Management (U.S.), LLC and affiliated entities ("AIG"), Allstate Insurance Company and affiliated entities ("Allstate"), Massachusetts Mutual Life Insurance Company ("MassMutual"), and Prudential Insurance Company of America and affiliated entities ("Prudential," and, with AIG, Allstate, and MassMutual, the "Investors"), holders of general unsecured claims against Residential Capital, LLC and its debtor-subsidiaries ("the Debtors"), by and through their undersigned counsel, hereby oppose the Debtors' Motion for Summary Judgment filed on April 2, 2013 (Dkt. #25) ("Motion" or "Br.") seeking summary judgment awarding all relief requested by the Debtors in their Complaint filed on February 19, 2013 (the "Complaint"). Unless otherwise noted, citations to documents in this Opposition are citations to exhibits to the Local Rule 7056-1 Statement of Stipulated Undisputed Facts and Agreed-to Exhibits (Dkt. #23) (the "Joint Stipulation" or "Joint Stip.").

PRELIMINARY STATEMENT

Although it is clear from the Joint Stipulation and procedural posture that the parties believe summary judgment is appropriate, the Debtors' and Investors' respective motions are like ships passing in the night. The Debtors contend that the RMBS were securities of the Debtors (or close enough) or alternatively securities of an affiliate of the Debtors, and the Investor Claims are accordingly subordinated under section 510(b) of the Bankruptcy Code. Ignoring the very effect of securitizing mortgage loans and removing them from the Debtors' balance sheet, the Offering Materials' statements to the contrary, and the Debtors' own correspondence with the SEC, the Debtors first say the RMBS are "securities of" the Debtors. The Debtors then urge the Court to read the securities laws with the promise that doing so will validate their position. The securities laws, however, provide no guidance (indeed, none is needed) on the meaning of the word "of." That the securities laws may define issuer to include

not only the entity in which an investment is made, but also an entity that is assigned certain duties, is irrelevant to the question before the Court.

Moving to the Debtors' "affiliate" argument, the Debtors assert they are entitled to judgment without even mentioning—let alone satisfying—the threshold requirement of the affiliate definition in the Bankruptcy Code. The Debtors cite and rely on a lone bankruptcy court decision from Oklahoma, but they neglect to apprise the Court of controlling Second Circuit precedent that the Oklahoma court chose not to follow. On the undisputed facts contained in the Joint Stipulation, the Trusts here fall squarely within the type addressed by the Second Circuit and, accordingly, cannot be affiliates of the Debtors under the Bankruptcy Code.

The remainder of the Debtors' Motion consists of kitchen-sink arguments from asking the Court to subordinate fraud and statutory claims under section 510(a) to re-ordering all such claims categorically under section 510(c). The Investors anticipated and addressed these arguments in their Cross-Motion, and focus their efforts here on correcting some of the Debtors' most flawed contentions and arguments (such as the alleged "double recovery" and tortured view of equitable principles). At bottom, for the same reasons that the Investors' Cross-Motion should be granted, the Debtors' Motion must be denied.

ARGUMENT

I. SECTION 510(b) DOES NOT APPLY BECAUSE THE CERTIFICATES ARE NOT SECURITIES "OF" THE DEBTORS OR SECURITIES OF "AFFILIATES" OF THE DEBTORS

Section 510(b) provides for the subordination of "a claim arising from rescission of a purchase or sale of ***a security of the debtor or of an affiliate of the debtor***, [or] ***for damages arising from the purchase or sale of such a security***." 11 U.S.C. § 510(b) (emphasis added). Picking and choosing definitions from other laws (without regard for whether there is any basis to do so) on the one hand, and completely ignoring the definitional requirements imposed by the

Bankruptcy Code on the other hand, the Debtors attempt to argue that the Certificates are either securities "of" the Debtors, Br. at 8-14, *or*, if not, they are securities of the Debtors' affiliates, Br. at 14-19. The Debtors are wrong on both counts.

A. <u>There Is No Support for RMBS Being Securities "Of" the Debtors</u>

It is undisputed that the Certificates are securities "of" the Trusts holding the pools of mortgage loans that support the securitized obligations. *See* Joint Stip. ¶¶ 3-6 (Certificates entitle holders to share of principal and interest collected on mortgage loans held by applicable Trust and "represent interests only in the trust, as the issuing entity, and do not represent interests in or obligations of" sponsor or depositor). The Debtors, however, contend these securities are simultaneously securities of theirs.[1] In defiance of both common sense and plain English, the Debtors undertake a series of legal contortions to defend their position.

The first such contortion is the Debtors' contention that "securities are securities 'of a debtor' if the securities were 'issued by the debtor.'" Br. at 9. The Debtors then cite cases for this premise. Not one of those cases even comes close to saying any such thing, however. In fact, none of the courts in these cases was called upon to determine whether a security that was deemed "issued by" the debtor was in fact a security "of" the debtor under section 510(b) at all.

In *Allen v. Geneva Steel Co. (In re Geneva Steel Co.)*, 281 F.3d 1173 (10th Cir. 2002), the court was "confronted with the question whether [s+ection 510(b)'s subordination of claims 'arising from the purchase or sale' of a debtor's security] also reaches claims alleging fraud in the retention of a security." 281 F.3d at 1174. There was no question that the bonds at issue in *Geneva Steel* were securities "of" the debtor or that the investor had invested *in the debtor itself*,

[1] The Investors incorporate their discussion of the affirmative evidence that the Certificates are securities "of" the *Trusts*, not the Debtors, in their own motion for summary judgment. Motion of AIG Asset Management (U.S.), LLC, the Allstate Entities, Massachusetts Mutual Life Insurance Co. & the Prudential Entities for Summary Judgment, filed Apr. 2, 2013 (Dkt. #27) ("<u>Cross-Motion</u>") at 11-13.

as opposed to in some separate entity for which the debtor was statutorily charged with some duty. Similarly, in *Brown v. Owens Corning Investment Review Committee*, 541 F. Supp. 2d 958, 970 (N.D. Ohio 2008), the only subordination issue presented was whether the plaintiffs' ERISA claims were claims "arising from the purchase or sale" of a security, not whether the security was actually a security of the debtor. 541 F. Supp. 2d at 970 ("The issue turns on the construction of the phrase 'arising from the purchase or sale of . . . a security.' Plaintiffs argue this subordination provision does not reach ERISA claims for breach of fiduciary duty, while Fidelity argues it applies with equal force to ordinary shareholder claims and ERISA claims.").

The Debtors take these passages and cite them for propositions nowhere to be found in those cases. A court may refer colloquially to a security of a company as a security that was issued by the company, but that hardly supports an argument that a security that does *not* represent an investment in a company is nonetheless a security "of" the company because the securities law assigns issuer obligations to that company. A Certificate either is, or is not, an investment in the Debtors. It is not. *E.g.*, Joint Stip. ¶¶ 29 ("The Certificates represent only interests in the Trust . . . and do not represent any voting rights or equity interest in any Debtor."), 38 ("Certificateholders have exclusive rights to the proceeds of a pool of mortgage loans held by the Trusts, which are not part of the assets available to the Debtors' creditors.").

The Debtors also cite *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp.*, 422 B.R. 423 (S.D.N.Y. 2009), *aff'd*, 651 F.3d 329 (2d Cir. 2011), apparently for the proposition that the Court should rely on the securities laws and regulations to define the "issuer" of the Certificates. Br. at 9 (quoting *Alfa* as stating "The securities laws, and their interpretations, are thus a natural and logical place to turn for definitions of terms within the Bankruptcy Code that are otherwise undefined."). Not only does this tactic sidestep the real issue, the Debtors' reliance on this case

for this particular proposition is inexplicable, since the district court in *Alfa reversed* the bankruptcy court for *improperly* relying on the securities laws to interpret the Bankruptcy Code:

> The securities law, and their interpretations, are thus a natural and logical place to turn for definitions of terms within the Bankruptcy Code that are otherwise undefined. ***But the Supreme Court has counseled against overreliance on the definition of a term for purposes of one statute when interpreting another. . . . The Supreme Court's cautionary language about statutory 'borrowing' is instructive here.*** The overlapping subject matter between the various laws designed to regulate securities does not confer judicial license to treat requirements under different statutory schemes employing alternate sets of statutory language as interchangeable.

422 B.R. at 437 (emphasis added); *id.* at 441-42 (reversing bankruptcy court and adopting "plain meaning of the literal language of the Bankruptcy Code" in applying section 546(e)).[2]

Through a bit of bait and switch, the Debtors tell the Court that the securities laws inform the relevant definition—but the word in question is "of," and that hardly requires reference to a dictionary, let alone another statutory scheme (which, at best, informs on a distinct issue). Section 510(b) does not use the word "issuer" and thus reference to the securities laws to understand how *that* term may be used for a distinct purpose is inappropriate.

Even if the Court were nevertheless to consider the securities laws and regulations on which the Debtors rely for the meaning of "of," there is no support for the Debtors' contention that the Trust's securities are securities "of" a debtor. First, the cited sections of the Securities

[2] Indeed, the legislative history of the 1933 Securities Act demonstrates that the definition of "issuer" under that Act varies by purpose. *See, e.g.*, *SEC v. N. Am. Research & Dev. Corp.*, 424 F.2d 63, 72 (2d Cir. 1970) (in excluding "underwriters" from exception to provisions of 1933 Securities Act prohibiting certain sales of unregistered securities, underwriter is defined broadly to include "anyone who directly or indirectly participates in a distribution of securities from an 'issuer' to the public," and for this purpose "the term 'issuer' is defined to include not only the issuer but also affiliates or subsidiaries of the issuer and 'any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer'"). The Securities Act's broader definition of "issuer," which includes both the "issuer" and its affiliates, would render section 510(b)'s application to securities of the debtor or the debtors' affiliates redundant and nonsensical if, as the Debtors contend, a security is a security "of" a debtor if it was issued by the debtor. This further calls into question the Debtors' unprincipled borrowing from the securities laws for definitions that suit them.

Act and Securities Exchange Act make clear that deeming the depositor to be the "issuer" of asset-backed securities is an artificial construct for the unique purposes of those acts. For example, the Securities Act provides:

> (a) . . . When used in this subchapter, unless the context otherwise requires— . . . (4) The term "issuer" means every person who issues or proposes to issue any security; ***except that*** with respect to certificates of deposit, voting-trust certificates, or collateral-trust certificates . . . the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; ***except that*** in the case of a [limited liability] unincorporated association . . . or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers . . . ; ***except that*** with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is or is to be used; and ***except that*** with respect to fractional undivided interests in oil, gas, or other mineral rights, the term "issuer" means the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering.

15 U.S.C. § 77b(a)(4) (emphasis added).[3] Thus, the plain language of the statute makes clear that for purposes of the Securities Act and Securities Exchange Act, the "issuer" is (not surprisingly) the actual issuer of the security ***except that***, in four limited circumstances, an entity *other than the actual issuer* shall be *deemed* the issuer of the security for purposes of compliance with the securities laws. Indeed, the very purpose of "except that" is to expand or contract a foregoing statement or definition.[4] In any event, whether one of the Debtors is the "issuer" of

[3] The Securities Exchange Act's definition is identical except that it does not include the second or fourth exception clauses. 15 U.S.C. § 78(c)(8).

[4] Of the 20 state Blue Sky laws Debtors cite, all but two use the same structure of adopting the plain meaning definition of "issuer" and adding specific exceptions by the use of "except for" clauses. *See* Ariz. Rev. Stat. § 44-1801(13); Cal. Corp. Code § 25010; Conn. Gen. Stat. § 36b-3(13); Ill. St. ch. 815 § 5/2.2; Iowa Code § 502.102(17) ("subject to the following" instead of "except for" clauses); Ky. Rev. Stat. § 292.310(13); La. Rev. Stat. § 51:702(8); Mass. Gen. Laws ch. 110A, § 401(f); Miss. Code § 75-71-105(i); Mont. Code § 30-10-103(13); Neb. Rev. Stat. § 8-1101; Nev. Rev. Stat. § 90.255(1); N.J. Stat. § 49:3-49(h); N.D. Cent. Code § 10-04-02(12); Wash. Rev. Code § 21.20.005(10); W. Va. Code § 32-4-401(i); Wyo. Stat. § 17-4-113(vi).

the Trust's Certificates is irrelevant because section 510(b) subordinates claims arising from the purchase or sale of securities "of the debtor," not securities of which the debtor is an issuer.[5]

A similar point is made by the federal regulations the Debtors cite and quote only partially: These regulations expressly distinguish between asset-backed securities for which a depositor is *deemed* an issuer and the securities of the depositor itself. For example, the Debtors cite to section 230.191(a) of Title 17 of the Code of Federal Regulations for the proposition that "[t]he depositor for the asset-backed securities acting solely in its capacity as depositor to the issuing entity is the 'issuer' for purposes of the asset-backed securities of that issuing entity." Br. at 9. Subsection (b) of the same regulation, however, expressly cautions against confusing those securities as the depositor's *own* securities. 17 C.F.R. § 230.191(b) ("The person acting in the capacity as the depositor specified in paragraph (a) of this section is a different 'issuer' from that same person acting as a depositor for another issuing entity or ***for purposes of that person's own securities***.") (emphasis added); *see also* 70 Fed. Reg. 1506-01, 1526 (Jan. 7, 2005) ("By clarifying that the person acting as the depositor in its capacity as depositor to the issuing entity is a ***different 'issuer' from that person in respect of its own securities***, we are making clear our longstanding position that any applicable exemptions from registration that person may have ***with respect to its own securities*** are not applicable to the asset-backed securities.") (emphasis added); *see also id.* at 1526-27 ("Similarly, the reporting history with respect to a particular class of asset-backed securities does not affect Form S-3 eligibility ***with respect to the depositor's or sponsor's own securities***[.]") (emphasis added). The Debtors' efforts to conflate an entity's status as a deemed "issuer" of securities with those securities being that "of" the entity itself is completely misguided and contrary to the regulations relied upon.

[5] The Debtors also repeatedly suggest that the Investors somehow conceded that the Certificates are securities of the Debtors by suing them for fraud. This, of course, is unsupported by any facts and amounts to the Debtors' hope that the Court adopt some circular version of the "gotcha" principle of law.

B. Security "Of" a Company Has Plain Meaning

The Debtors do not cite to one case standing for the proposition that securities which may be said to be "issued by" an entity other than the entity in which such securities represent an interest in are therefore securities "of" the "issuer." A recent decision from the U.S. District Court for the Central District of California, *Impac Mortgage Holdings Inc. v. Houston Casualty Company*, Case No. SACV 11-1845-JST (JCGx) (C.D. Cal. Feb. 26, 2013) (attached hereto as Attachment A), squarely rejects the Debtors' argument and supports the Investors' position on the plain meaning of the clause in section 510(b). In *Impac*, the plaintiff asserted it was entitled to access an insurance policy that covered "Securities Claims," defined as "claim[s] 'brought by any person or entity alleging, arising out of, based upon or attributable to . . . the purchase or sale of or offer or solicitation of an offer to purchase or sell any securities *of the Organization*.'" The plaintiff urged that "securities of" the Organization included securities issued by a securitization trust for which the Organization was a statutory issuer under the very same securities regulations on which the Debtors rely. The Court accorded the language its plain meaning and rejected this argument, instead embracing the position set forth in the Investors' Cross-Motion, stating: "The regulations defining 'issuer' for the purposes of the Securities Acts of 1933 and 1934 state that '[t]he depositor for the asset-backed securities acting solely in its capacity as depositor to *the issuing entity* is the 'issuer' for purposes of the asset backed securities *of that issuing entity.*' 17 C.F.R. § 230.191(a); 17 C.F.R. § 240.3b-19(a) (emphasis added)." *Impac* Order at 13. *Impac* thus supports the Investors' position that assigning issuer obligations to the Debtor depositor does not transform securities issued by a Trust into securities "of" the depositor; rather, the securities remain what they undeniably are: securities of the securitization trust that is the issuing entity.

The balance of the Debtors' arguments regarding "securities of" are addressed in the Investors' Cross-Motion at pages 11-17, and the Investors incorporate by reference that analysis without repeating it here. However, the Investors briefly correct the Debtors' erroneous representations regarding the Bankruptcy Court of Delaware's reasoned decision in *In re Washington Mutual*, 462 B.R. 137 (Bankr. D. Del. 2011). *See* Br. at 13. As set forth in the Investors' Cross-Motion, the *Washington Mutual* court rejected contentions similar to the Debtors' that securities of a non-debtor trust should be treated as securities "of" the depositors' and sponsors' debtor parent. Cross-Motion at 13-14.

The Debtors contend that *Washington Mutual* "was subsequently called into question by the court that issued it" and is "factually inapposite." Br. at 13. There is no merit to either contention. First, in the subsequent proceedings to which Debtors refer, Judge Walrath only rejected the notion that her earlier decision with respect to the Tranquility Fund was the law of the case with respect to another group of investors and made *no* decision with respect to the latter group. *See, e.g.*, *In re Washington Mutual, Inc.*, No. 08-12229 (MFW), Order Denying MBS Plaintiffs' Motion to Classify Asserted Class Claim as a Class 12 Claim (Dkt. #10182) (Bankr. Del. May 16, 2012) (attached hereto as Attachment B) at 3 (allowing class to re-file proof of claim "either as a Class 12 General Unsecured Claim or a Class 18 Subordinated Claim . . . , it being determined by the Court that the Stipulation does not require any such re-filed proof of claim to be classified in [the subordinated class] under the Plan[.]"); *id.* (finding that the court's earlier decision is "not dispositive" with respect to the status of the class's proof of claim, if re-filed, "and the Court need not rule on the classification of any such claim at this time" because the issue was prematurely raised). That the court declined to apply its earlier decision as law of the case with respect to other investors is unsurprising since a motion for reconsideration of that decision was pending when the Tranquility Fund's claim was settled by the estate; that does not

mean, however, that the court "called into question" its prior decision. *See id.*, May 7, 2012 Hearing Tr. (Dkt. #10154) (attached hereto as Attachment C) at 88:22-89:1.

Second, the Debtors fail to explain why the sole factual distinction they draw between this case and *Washington Mutual*—that here the Debtors are the depositors/deemed issuers, whereas in *Washington Mutual* the depositors/issuers were subsidiaries of the debtors—has any significance at all. Br. at 13. In any event, there was no dispute in *Washington Mutual* that the depositor/issuer was an "affiliate" of a debtor within the meaning of the Bankruptcy Code. *Washington Mutual*, 462 B.R. at 146 n.4. Thus, the "distinction" the Debtors identify makes no difference under section 510(b), which applies to securities "of" a debtor or its affiliate.

C. The Certificates Are Not Securities of "Affiliates" of the Debtors and Cannot Be Subordinated Under Section 510(b) on That Basis

1. *The Trust Is Not an "Affiliate" of the Debtors Because It Is Not a Person and No Further Analysis of this Argument Is Required*

The Debtors next contend that the Investors' claims should be subordinated under section 510(b) "because the Trusts were 'affiliates' of the Debtors when the Investor Claims arose" under the Bankruptcy Code's definition of "affiliate" in Section 101(2)(C). Br. at 14. That subpart defines "affiliate" to include "a ***person*** whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor." 11 U.S.C. § 101(2)(C) (emphasis added). *Nowhere* in their Motion (or even the Complaint), however, do the Debtors attempt to satisfy the threshold requirement that the Trust be "a person." This omission is fatal.

Unlike the term "entity," the Bankruptcy Code more narrowly defines "person" to include an "individual, partnership, and corporation," but not a trust. *Compare* 11 U.S.C. § 101(41) *with* 11 U.S.C. § 101(15). In turn, the Bankruptcy Code defines "corporation" to include a "business trust." 11 U.S.C. § 101(9)(A)(v). Thus, in order for the Trust to fit within

the definition of "person," the Trust must be a business trust. Considering the undisputed facts of this case in light of controlling Second Circuit precedent, the Trust is not a business trust.

In *Shawmut Bank Connecticut v. First Fidelity Bank (In re Secured Equipment Trust of Eastern Air Lines)*, 38 F.3d 86, 87-88 (2d Cir. 1994), the court was confronted with the "sole issue" of whether a "trust created in order to secure the payment of certificates issued in connection with a secured financing" was a "business trust" under the Bankruptcy Code. The court was not persuaded by the fact that the trust's collateral trustee "carried on the business of leasing and selling the [collateral sold to it by the debtor]." *Id*. at 89. Nor was the court concerned with the legal possibility—which it determined unnecessary to its analysis—that the interest the certificate holders were entitled to could be considered "profit," because, in any event, the trust was not responsible for "generat[ing]" such payment. *Id.* at 90. Rather, it was confined to "preserv[ing]" such right to payment. *Id.* The court went further, finding that the trust was not designed to "transact business" in view of the fact that it was created merely as a vehicle to facilitate financing for the debtor. *Id.*; *see also In re Gurney's Inn Corp. Liquidating Trust*, 215 B.R. 659, 668-669 (Bankr. E.D.N.Y. 1997) (holding that trust which was "established to collect mortgage payments" on account of mortgage received at time of formation and which had issued "freely transferable" certificates was not a business trust under the Bankruptcy Code); 2 Collier on Bankruptcy ¶ 101.41, at 101-176 ("It is important to note that the definition of 'person' does not include an estate or nonbusiness trust. . . . An estate and nonbusiness trust are included in the definition of 'entity.'").

Shawmut and *Gurney's Inn* are directly on point. The Trust here was designed simply to preserve the certificateholders' right to payment, not to "transact business." Moreover, *Shawmut* instructs that the "inquiry must focus on the trust documents and the totality of the circumstances, not solely on whether the trust engages in a business," which the Trust here does

not do in any event. 215 B.R. at 90-91. Nowhere in the relevant documents is it provided that the Trusts are business trusts. Indeed, the Debtors have not even asserted as much and, to the contrary, emphasize the passivity of the Trusts. *See, e.g.*, Br. at 13 ("The Trusts were passive vehicles that the Debtors' used to structure the RMBS."). The Trusts operated no business. Under *Shawmut*, because the Trust is not a business trust, and therefore not a corporation, it cannot be an affiliate of the Debtors under section 101(2). The analysis should end there.

Nevertheless, despite failing to address this dispositive requirement at all (or even to cite this controlling precedent and attempt to distinguish it), the Debtors spend several pages of their Motion trying to touch the other bases of the "affiliate" definition by attempting to recast the Trusts as "operat[ing]" businesses (which they are not) that were "operated by" the Debtors (which they were not) pursuant to the PSA (which is not an "operating agreement" at all). *See* Br. at 14-19. The Investors incorporate by reference the analysis at pages 20-31 of their own Cross-Motion, which responds fully to each of the arguments raised by the Debtors on these points, and do not repeat it here.

2. Commercial Financial Services *Does Not Override* Shawmut

The Debtors rely heavily on an unpublished order issued by the Bankruptcy Court for the Northern District of Oklahoma in *Nationsbank, N.A. v. Commercial Fin. Servs., Inc. (In re Commercial Fin. Servs., Inc.)*, Adv. Pro. 98-0356 (Bankr. N.D. Okla. July 11, 2003) (attached hereto as Attachment D) (the "*CFS* Slip. Op."), for the proposition that the Trusts are affiliates of the Debtors. Br. at 18-19. The *CFS* court was not bound by *Shawmut* and chose not to follow the test enunciated by the Second Circuit, citing the dissent instead.[6] The Investors incorporate by reference their discussion of *CFS* in their own motion for summary judgment. Cross-Motion

[6] The *Shawmut* dissent does not help the Debtors. Rather, the dissent only confirms that the Second Circuit duly considered and ultimately rejected the Debtors' anticipated, belated argument, and the reasoning of *CFS*, that the Trusts are somehow "persons" under the Bankruptcy Code.

at 28-31. As set forth there, *CFS* not only disregards the controlling law of this Circuit, but it is also highly factually distinguishable because, among other things: (1) the trust at issue was expressly intended to be and registered as a business trust; (2) it was undisputed that the debtor not only serviced the loans but also managed all operations of the securitizations and, with its affiliate, retained far greater rights in and exercised far greater control over the trust at issue than the Master Servicer does here; and (3) the only property interest held by the trust in *CFS* was its interest in the pool of receivables, whereas here the property of the Trust includes valuable put-back rights as well. *CFS* Slip Op. at 14-15, 19, 28-29, 57, 59-61, 76 & n.37, 78. Thus, despite the undue prominence the Debtors afford this unpublished, out-of-circuit decision (particularly in contrast to their complete failure to mention *Shawmut*), *CFS* sheds no light on this case.

3. *If the RMBS Trusts Are "Affiliates," They Are Also Insiders*

One final and very significant issue that the Debtors also completely ignore warrants mention: In attempting to shoehorn the Investors' claims into the ambit of section 510(b) any way they can, the Debtors risk opening the door to any number of unintended consequences. By arguing that the Trusts are the Debtors' "affiliates," the Debtors are also necessarily arguing that the Trusts are "insiders." Section 101(31) of the Bankruptcy Code defines "insider" to include an "affiliate, or insider of an affiliate as if such affiliate were the debtor." 11 U.S.C. § 101(31)(E). The "affiliate" in the definition of "insider" is the same "affiliate" in sections 101(2) and 510(b). If the Trusts are affiliates, they are also insiders.

Treating the Trusts, which the Debtors have repeatedly referred to as the largest general unsecured creditors of the Debtors' estates, as insiders of the Debtors will have far-reaching effects. Most significantly, the Trusts' votes would *not* count as acceptances of any chapter 11 plan. *See* 11 U.S.C. § 1129(a)(10). In other words, the Debtors could not propose a plan that depended on the Trusts voting as the impaired consenting class. That the Debtors have never

indicated that they consider the Trusts to be insiders,[7] yet are now contending that the Trusts are their "affiliates," confirms that the Debtors are trying to apply section 510(b) to the Investors' claims as a complete afterthought and not based on any principled application of the statute.

II. SECTION 510(a) DOES NOT APPLY BECAUSE THERE IS NO SUBORDINATION AGREEMENT THAT APPLIES TO THE INVESTORS' CLAIMS TO ENFORCE

The Debtors also contend that the Investors' claims must be subordinated under section 510(a), which provides that "[a] subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a). This argument fails for a simple reason: There is no applicable *subordination agreement* to enforce, notwithstanding the Debtors' attempt to manufacture one from "(i) the express subordination agreements among senior and junior tranches of Certificates (including the corollary agreement that holders of the same tranche are not subordinate to each other); and (ii) the implied subordination of former Certificateholders to subsequent purchasers, inherent in the sale of the Certificates." Br. at 24. Whatever application these alleged express or implied subordination agreements may have to *contractual* claims of the Certificateholders, they do not apply to the Investors' extracontractual fraud claims.[8]

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[7] Indeed, in a publicly-filed draft plan, the Debtors sought to separately classify the $8.7 billion settled put-back claim (if the settlement were approved), with the full expectation that the Trusts would be an impaired consenting class. Under the Debtors' theory, the separate classification of the allowed settled "put back" claim is virtually meaningless, because it is a class whose acceptance must be ignored.

[8] It is unclear if the Debtors are contending that a contractual arrangement agreeing to subordinate *any* claim should be enforced as an agreement to subordinate *all* claims. *See* Br. at 24 ("Current and former holders of Certificates should not be able to avoid subordination provisions to which they previously agreed through the current pursuit of securities claims."). To the extent the Debtors are taking this unorthodox position, they provide no legal support for this provision. The cases the Debtors cite certainly say nothing of the sort. *See, e.g., In re Best Prods. Co.*, 168 B.R. 35, 69 (Bankr. S.D.N.Y. 1994) (stating definition of subordination agreement where only dispute regarding subordination was whether there was a debt to trigger subordination); *Minority Equity Capital Co. v. Jackson*, 798 F. Supp. 200, 202 (S.D.N.Y. 1992) (applying clear and unambiguous terms of subordination agreement to junior creditor's claim). Neither case provides any basis to suggest that an agreement to subordinate a contract-based claim can be construed as an agreement to subordinate an extra-contractual claim (*e.g.*, fraud).

Much like an inter-creditor agreement among lenders with rights to the same collateral, the tranches and waterfall structure invoked by the Debtors as an applicable subordination agreement relate solely to payments from the Trust's assets based on ownership of the Certificates. *See, e.g.*, Br. at 24; Joint Stip. Ex. 1 (PSA) §§ 1.01, 4.02, 4.05 (defining and describing classes and contract-based payment and loss hierarchy among them); *id.* Ex. 3 (Pro. Supp.) at S-10-13 (describing priority of distributions on the offered certificates); *id.* at S-64-69 (describing distribution of principal and excess cash flow and coverage of realized losses). The tranches and waterfall structure do not apply to any extra-contractual claims an investor might have and to treat them otherwise would be to rewrite the Investors' agreements.[9]

The "implied subordination" that the Debtors contend "is a natural consequence of warranties and duties that the common law and New York's Uniform Commercial Code . . . impose on all sales of securities" similarly does not apply to the Investors' fraud-based claims. Under New York law, "implicit in all contracts is a covenant of good faith and fair dealing in the course of contract performance." *Dalton v. Educ. Testing Serv.*, 87 N.Y.2d 384, 389 (1995). "The covenant includes 'any promises which a reasonable person in the position of the promisee would be justified in understanding were included.'" *Times Mirror Magazines, Inc. v. Field & Stream Licenses Co.*, 294 F.3d 383, 394 (2d Cir. 2002).

The covenant, however, is limited and "defined by the parties' intent and reasonable expectations in entering the contract." *Cross & Cross Props. Ltd. v. Everett Allied Co.*, 886 F.2d

[9] Here, too, the Debtors cite a series of cases that provide no support for ignoring the important distinction between contractual and extracontractual claims; in each case, the court was describing merely how subordination works with respect to paying investors pursuant to a contractual agreement. *See Wyo. State Treasurer v. Moody's Investors Serv., Inc. (In re Lehman Bros. Mortg.-Backed Secs. Litig.)*, 650 F.3d 167, 171 n.1 (2d Cir. 2011) (footnote describing how losses in normal course are ascribed to subordinated classes; claims were asserted against credit rating agencies, not debtors); *Republic Bank & Trust Co. v. Bear Stearns & Co.*, 683 F.3d 239, 244 (6th Cir. 2012) (background discussion of how mortgage backed securities are created and structured; no bankruptcy issue in case); *Anchor Sav. Bank, FSB v. United States*, 597 F.3d 1356, 1359 n.1 (Fed. Cir. 2010) (footnote explaining business of asset sold by plaintiff in suit against government for breach of contract arising from passage of new legislation).

497, 502 (2d Cir. 1989). Therefore, "'no obligation can be implied that would be inconsistent with other terms of the contractual relationship.'" *Times Mirror*, 294 F.3d at 394; *see also Frutico S.A. v. Bankers Trust Co.*, 833 F.Supp. 288, 300 (S.D.N.Y. 1993) ("[T]he duty of good faith . . . cannot be used to create new contractual rights between the parties."); *Banco Espanol de Credito v. Sec. Pac. Nat'l Bank*, 763 F.Supp. 36, 44 (S.D.N.Y. 1991) (same). Thus, "[c]ourts have generally been reluctant to find a breach of the implied covenant of good faith when doing so reads so much into the contract as to create a new term or when alleged misconduct is expressly allowed by the contract." *Keene Corp. v. Bogan*, No. 88 Civ. 0127 (MBM), 1990 WL 1864, *14 (S.D.N.Y. Jan. 11, 1990).

In the present case, there is no basis for asserting that payments made on account of a claim that is *not owned* by the Trust, is personal to the investor, and is *outside* the PSA waterfall are subject to the waterfall's subordination provisions. Neither the Joint Stipulation nor anything else in the record indicates that the parties intended the PSA waterfall to apply to payments arising from an investor's fraud or statutory consumer protection or rescission claims. Had the parties intended to subordinate the Investors' personal tort and statutory claims, there is no doubt that the parties could have and would have documented the transaction in that manner (including insisting that each Investor sign a subordination agreement with respect to its personal claims). Instead, it is clear from the record before the Court and the plain meaning of the PSA that the subordination provisions therein apply only to payments that flow through the Trust, including on account of claims that could be pursued by the Trustee. The Court thus should reject the Debtors' misguided arguments concerning the implied covenant of good faith and fair dealing.

Finally, the Debtors also argue that subordination of the Investors' Claims is appropriate to ensure that any recovery flows to current certificateholders, on the theory that current certificateholders "reasonably expect[] to have purchased such right." Br. at 28. There is

nothing in the governing documents that supports such an "expectation" nor in the Joint Stipulation that speaks to the expectations of current certificateholders. If those expectations included acquiring the Investors' causes of action for *fraud* related to the purchase and sale of the Certificates, their expectations were not reasonable and are without legal foundation because it is well-established that a contract providing for the sale of an asset does not effect a transfer of tort claims relating to the asset unless the parties explicitly manifest their intent to do so.[10] Fraud claims can only be assigned if the contractual language indicates the parties' clear intent to effect a transfer,[11] thereby ensuring that fraud victims will not be denied their right of recovery absent an affirmative abandonment of that right.[12]

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[10] For example, as early as 1913, the New York Appellate Division held that a plaintiff who has assigned to a third party "all [his] right, title, and interest in and to" a contract was nonetheless entitled to assert a claim for its fraudulent inducement because it "was not appropriate to assign a cause of action arising, not under the contract, *but for the fraudulent representations of the defendant*." *Fox v. Hirschfeld*, 151 A.D. 364, 366, 368 (1st Dep't 1913) (emphasis added); *see also Argyle Capital Mgmt. Corp. v. Lowenthal*, 261 A.D.2d 282, 283 (1st Dep't 1999) (claims not transferred where "there [was] no indication in the assignment that the transfer of any claim, much less one for fraud, was contemplated by the parties."); *Tycon Tower Investment Ltd. P'ship v. John Burgee Architects*, 234 A.D. 2d 748, 749 (3d Dep't 1996) (assignment of contract rights does not include "claims for fraud or negligent misrepresentation without express language to that effect in the assignment"); *OneWest Bank, FSB v. Joam LLC*, 2011 WL 6967635, at *4–5 (E.D.N.Y July 26, 2011) (language assigning "all . . . right, title and interest" in certain agreements was insufficient to transfer fraud claims); *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt., LLC*, 479 F. Supp. 2d 349, 374 n.128 (S.D.N.Y. 2007) (finding no assignment of fraud claims where the purchase agreement did not "expressly provide[] for assignment of claims"); *Royal Mortg. Corp. v. Fed. Deposit Ins. Corp.*, 20 F. Supp. 2d 664, 666–68 (S.D.N.Y. 1998) (language assigning "all . . . right, title and interest" in certain agreements was insufficient to transfer fraud claims).

[11] *See, e.g.*, *Momentive Performance Materials USA, Inc. v. AstroCosmos Metallurgical, Inc.*, 659 F. Supp. 2d 332, 338 (N.D.N.Y. 2009) (transferring "all . . . rights and *claims of any nature* against any third parties") (emphasis in original); *CDR Creances S.A.S. v. Cohen*, 2008 WL 2078673, at *6 n.10 (N.Y. Sup. Ct. N.Y. Cty. May 9, 2008) ("the Plan . . . explicitly recognizes CDR's right to pursue its fraud claims").

[12] As the Ninth Circuit explained in a case involving fraud claims under the federal securities laws: "A cause of action arising from reliance on misrepresentation is personal to those persons who relied; it does not [automatically] follow the security to remote purchasers who had no basis for reliance . . . . If we held otherwise, we would remove the remedy from those to whom the statute provides it, *i.e.*, those who were defrauded, by gratuitously giving it to those who were not defrauded and have suffered no injury under the securities law." *In re Nucorp Energy Sec. Litig.*, 772 F.2d 1486, 1490 (9th Cir. 1985) (citations omitted); *accord In re Nat'l Century Fin. Enters., Inc., Inv. Litig.*, 755 F. Supp. 2d 857, 867 (S.D. Ohio 2010) ("Ordinarily the injury remains with the first purchaser who was actually the victim of the fraud. If he has managed to sell the securities, in most cases they will have sold for far less than he paid for them

The Debtors have cited no evidence that any of the Investors intended to assign any causes of action related to the certificates to any party. Accordingly, there is no basis for the Court to conclude that the sale of a Certificate by any Investor transferred any Investor's right to bring claims against the Debtors based on fraudulent misrepresentations (or otherwise). Thus, any party that acquired a Certificate from an Investor could have had no *reasonable* expectation that it was acquiring the Investor's associated tort claims, and any such expectation (even if it exists beyond the Debtors' speculation) lends no support for subordinating the Investors' claims.

III. THERE IS NO BASIS FOR CATEGORICAL OR NO-FAULT EQUITABLE SUBORDINATION OF THE INVESTORS' CLAIMS UNDER SECTION 510(c)

Implicitly acknowledging the limitations of section 510(a), and the square peg these facts provide for the round hole of section 510(b), the Debtors argue that the Investors' Claims must be subject to equitable subordination under Bankruptcy Code section 510(c). However, the Debtors' equitable subordination claim is foreclosed by the Supreme Court's prohibition on categorical no-fault subordination. *See United States v. Noland*, 517 U.S. 535, 540-41 (1996) (prohibiting "general, categorical" equitable subordination); *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 227-29 (1996) (extending *Noland* to prohibit all categorical equitable subordination, regardless of class).

The Debtors do not allege that any Investor has engaged in inequitable conduct, and there are certainly no undisputed facts to that effect. The Debtors simply claim it would be "inequitable" to provide remedies to creditors who were defrauded by the Debtors when other creditors would be diluted by such claims. This Court has already rejected that argument. *See, e.g., In re BH S&B Holding, LLC*, 420 B.R. 112, 156-57 (Bankr. S.D.N.Y. 2009) (Glenn, J) (dismissing equitable subordination claim for failure to allege inequitable conduct such as fraud,

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precisely because of the fraud. If he is to be compensated for his loss, the right of action should ordinarily remain with him as well.") (internal quotations omitted).

breach of fiduciary duty, or exploitation of corporate form), *aff'd*, 807 F. Supp. 2d 199 (S.D.N.Y. 2011). In so holding, the Court noted that equitable subordination "is not a mechanism to be used by courts to alter the statutory scheme in an effort to reach a result the court considers more equitable than the distribution scheme provided for in the Bankruptcy Code." *Id.*

The Investors incorporate by reference the arguments on pages 35 to 40 of the Investors' own summary judgment motion, which demonstrate why section 510(c) has no application here. Nevertheless, the Investors briefly address here the very few cases that have discussed the alleged continued vitality of "no fault" equitable subordination despite the Supreme Court's pronouncements, on which the Debtors mistakenly rely.

A. The Debtors' Stock Redemption Cases Establish That "No Fault" Equitable Subordination—Even if It Were Still Viable—Does Not Apply Here

The Debtors rely heavily on *SPS Plastics Corp. v. Griffith (Structurelite Plastics Corp.)*, 224 B.R. 27 (BAP 6th Cir. 1998). *Structurelite*, a decision from the Sixth Circuit Bankruptcy Appellate Panel ("BAP"), however, provides thin support. As noted in the decision itself, *Noland* had reversed the Sixth Circuit's decision in *In re First Truck Lines, Inc.*, 48 F.3d 210 (6th Cir. 1995) on the basis that categorical equitable subordination was improper. Having already identified grounds for reversal, the *Noland* Court expressly declined to reach the Sixth Circuit's other holding in *First Truck* that equitable subordination could apply in the absence of creditor misconduct. Because *Noland* did not reach that other holding, the court in *Structurelite* concluded that "*First Truck* is controlling on the issue," 224 B.R. at 34 n.5, and thus opened the door for no-fault equitable subordination in that Circuit. Unlike the Sixth Circuit BAP, however, this Court is in no way bound by a pre-*Noland* ruling from the Sixth Circuit. *Structurelite* is also questionable authority because, save for one decision issued by the Bankruptcy Court for the District of Massachusetts, every case it cites was published prior to *Noland* and *CF&I*. *See* 224

B.R. at 35. Moreover, of the seven cases it cites for support, four are from the District of Massachusetts. *See id.* But in 2005, the First Circuit cast doubt on the precedential value of these authorities in *Merrimac Paper Co. v. Harrison (In re Merrimac Paper Co.)*, 420 F.3d 53 (1st Cir. 2005). Noting that *Noland* deemed *Mobile Steel* an influential decision, the First Circuit held that "equitable subordination demands that the claimant be found to have engaged in inequitable conduct." *Id.* at 59.[13]

The Debtors also cite *In re Emergency Monitoring Tech., Inc.*, 366 B.R. 476 (Bankr. W.D. Pa. 2007), and describe the case as one of "no-fault equitable subordination of [a] stock redemption claim that effectively elevated [the] equity interest to debt and diluted [the] distribution to other creditors." Motion at 28. *Emergency Monitoring* does not provide support to the Debtors' claim. The court in *Emergency Monitoring* held that under a 1990 Third Circuit decision, "no fault" equitable subordination was at least *possible*. *Emergency Monitoring* made clear, however, that a stock redemption claim could not be subordinated solely because it was a stock redemption claim and that the bankruptcy court must consider the equities of the individual case, utilizing seven fact-intensive factors.[14] The court found that *all seven factors* favored

[13] The *Merrimac Paper* court further stated that two of the cases relied on by the Sixth Circuit BAP in *Structurelite—Liebowitz v. Columbia Packing Co.*, 56 B.R. 222 (D. Mass. 1985), *aff'd*, 802 F.2d 439 (1st Cir. 1986), and *In re SPM Mfg. Corp.*, 163 B.R. 411, 413-16 (Bankr. D. Mass. 1994)—were suspect in light of *Noland* and *CF&I*. With respect to *Liebowitz*, the First Circuit stated that the 1985 district court decision provided "a very slender reed," stating that in addition to being an unpublished decision, "[m]ore importantly, two Supreme Court decisions decided subsequent to *Liebowitz* dispel any notion that a bankruptcy court must categorically impose equitable subordination merely because a claim arises out of a note taken in connection with a redemption of corporate stock." 420 F.3d at 60. As for *SPM Manufacturing*, the First Circuit similarly stated the opinion "fails to take into account the *Noland* Court's unambiguous repudiation of the legislative history upon which the *SPM Manufacturing* court relied." *Id.*

[14] Those factors were: (a) whether the redeeming corporation received anything in value in return for the redemption; (b) the manner in which the stock redemption claimant acquired the stock that was redeemed; (c) the presence of any affiliation between the redeeming debtor corporation and the stock redemption claimant, especially if the claimant was an insider; (d) who initiated the stock redemption; (e) the relative effect of subordination on other claims; (f) whether the stock redemption rendered the redeeming debtor corporation insolvent; and (g) whether such stock redemption was accompanied by other inequitable conduct. *Id.*

equitable subordination. Perhaps most significant was the fact that the defendant was the only stockholder and initiated the redemption at a time when he alone controlled the debtor, the redemption would have made the debtor immediately insolvent, and there was evidence of inequitable conduct that the court labeled abusive. *See id.* at 507-08; *see also BH S&B Holdings*, 420 B.R. at 156 ("As a result, "[w]hen a non-insider or non-fiduciary is involved, courts have required that a claimant's conduct be egregious and severely unfair to other creditors before its claim will be equitably subordinated.") (citation omitted).

Even if this Court were to follow the Pennsylvania bankruptcy court's decision, none of the *Emergency Monitoring* factors applies in this case. Most significantly, there is no affiliation between the Debtors and any Investor, there is no evidence that Investors' claims made any of the Debtors insolvent, the Investors did not initiate anything (other than assert claims for the Debtors' misconduct), and there are *no* allegations that any Investor engaged in inequitable conduct, much less is it an undisputed fact that any Investor did so.

B. Equitable Subordination of the Investors' Claims Results in Prohibited Categorical Subordination

Further, even if this Court were to reject the widely-accepted *Mobile Steel* approach and consider the possibility of "no fault" equitable subordination (in circumstances beyond stock redemption cases), in this case any such consideration must necessarily conclude that the Debtors are seeking categorical subordination, which is improper and prohibited under *Noland*.

The Debtors fail to identify any specific circumstances, as required by *Noland*, that justify equitable subordination of the Investors' Claims. Rather, the Debtors allege that a "failure to subordinate the Investor Claims, to the extent (if any) that they are ultimately allowed, would result in injury to other creditors and confer an unfair advantage on the Investors." Compl. ¶ 105; *see also* Br. at 30. This formulation completely misstates the requirements of

section 510(c), as this Court has previously articulated—it is the creditor's conduct, not the mere effect of allowing additional claims, that must be examined. *See BH S&B Holdings*, 420 B.R. at 156 ("The second prong requires a finding that ***the claimant's conduct*** injured the debtor or its creditors, or resulted in an unfair advantage to the claimant.") (emphasis added). Here, the Debtors have pointed to no specific factual allegations regarding any Investor's conduct; indeed, the Complaint's facts only suggest that the claims of the Investors and other entities that have sued, or may sue, the Debtors on similar theories must have their claims equitably subordinated because all such claims would dilute recoveries to other creditors.[15] *See* Compl. ¶¶ 10, 13. Further, every possible allegation in the Complaint justifying equitable subordination is in no way limited only to the Investors but instead must be applied to the entire ***category*** of similarly situated claimants. *See* Compl. ¶¶ 87-90. Under *Noland*, such treatment is impermissible.

Finally, the Debtors argue that failure to subordinate the Investors' claims would purportedly lead to "inequitable consequences." *See* Br. at 31. But each such "consequence" is merely an argument in favor of subordination under sections 510(a) and 510(b), which, as discussed above, fail as a matter of law.[16] Further, the same exact argument can be made against every single investor that has asserted a claim against the Debtors for common law fraud, securities law violations, or on account of consumer protection laws. If the Bankruptcy Code

[15] If equitable subordination could be imposed simply because a claim dilutes other creditors, *any* claim could be equitably subordinated (unless a debtor was actually solvent). There is *no* support for such a proposition. Similarly, there is no support for the notion that equitable subordination is appropriate wherever there may be another source of recovery. Were that the case, holders of claims against a debtor-obligor and a non-debtor guarantor would have their claims equitably subordinated merely because possible independent recovery sources existed. Such a result would be completely inconsistent with equitable subordination principles and would be extraordinarily disruptive to commercial lending.

[16] Tacitly recognizing that none of section 510's subsections applies to the Investors' claims, the Debtors resort at every turn to invoking equity generally as a basis for subordination, far beyond the scope of the delimited equitable subordination contemplated by section 510(c), and creditor dilution in arguing for the application of section 510(a) and 510(b). *See, e.g.*, Br. at 26, 28. That is simply a misuse of those subsections which provide specific grounds for subordination that are either present or not present irrespective of such considerations.

does not permit subordination under sections 510(a) or 510(b), the Debtors should not be permitted to use section 510(c) to end-run those provisions and reorder priorities.[17]

IV. THE INVESTORS' CLAIMS DO NOT PROVIDE A "DOUBLE RECOVERY"

Finally, unable to bend any of section 510's provisions to their will, the Debtors repeatedly contend that payment of the Investors Claims would, absent subordination, result in a double recovery. This is simply not true and lacks any support in the record.

If an Investor still owns a Certificate, that Investor may receive a partial recovery on account of such ownership. If the Investor can prove the necessary elements of an Investor Claim, that Investor could recover damages that are permitted under the law but in no event could *ever* recover more than its investment (let alone a "double" recovery). Indeed, for certain Investors that are proceeding under state blue sky rescission laws, the Certificate that is the subject of the Investor Claim must be tendered to the Debtors upon payment of the statutory damages. Thus, any recovery on the Certificate would be given *to the Debtors* upon payment of the damages in full or, alternatively, credited against any claimed damages. *E.g.*, Joint Stip. Ex. 20 at ¶ 4 (MassMutual proof of claim); Mass. Gen. Laws, ch. 110A, § 410(a)(2) (making seller of security by fraudulent means liable to innocent buyer "who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, *upon the tender of the security, or for damages if he no longer owns the security* [where damages equal amount recoverable upon tender minus proceeds of disposal plus interest]"). Similarly, for Investor Claims predicated on common law fraud where

[17] Indeed, one of the "inequitable consequences" alleged by Debtors is that secondary market purchasers—including purchasers of Investors' certificates at extremely distressed prices—could see their recoveries diluted. The Debtors, of course, cite no cases indicating that this potentiality is sufficient for subordination, and have submitted *no* evidence on this fact-intensive issue.

the Investor still owns Certificates, the Investor can only assert a claim for its losses, not the amount invested—thus, there is no risk of a double recovery on a Certificate. Joint Stip. Ex. 19 ¶ 3 (Allstate proof of claim); *id.* Ex. 21 ¶ 3 (Prudential proof of claim).

The Debtors' argument also ignores the Investors' sales of a significant portion of the Certificates underlying their claims. *See* 56.1 ¶ 89 ("The Investor Claims have been asserted by both current *and former* Certificateholders.") (emphasis added). To the extent an Investor has sold Certificates, such Investor would receive *no* distribution through the PSA waterfall for those Certificates, and *no recovery on account of its claims* through the Trust. Thus, the Debtors propose to deny such a divested Investor any recovery, despite the undeniable and significant losses suffered. Joint Stip. Ex. 18.

The Debtors' position also ignores the fact that with respect to their common law tort and statutory claims, the Investors are *involuntary* creditors. In purchasing the Certificates, the Investors did not agree that in the event they were defrauded, they would waive their rights to statutory and common law protection and only seek payments through the PSA waterfall. To the contrary, the Governing Documents contain no provision limiting the Investors' ability to recover directly from the Debtors by way of statutory and common law remedies. Courts in this district universally hold that the availability of a put-back remedy in a PSA does not eliminate an investor's ability to bring direct claims against a sponsor or other party that has engaged in fraud or violated a statute. *See, e.g., Emps.' Ret. Sys. of the Gov't of the Virgin Islands v. J.P. Morgan Chase & Co.*, 804 F. Supp. 2d 141, 155 (S.D.N.Y. 2011) (contractual put-back claims did not deprive investors of rights to bring claims for securities violations); *accord New Jersey Carpenters Health Fund v. Residential Capital, LLC*, Nos. 08 CV 8781(HB), 08 CV 5093(HB), 2011 WL 2020260, at *6 (S.D.N.Y. May 19, 2011) (same). In none of these instances was it found that permitting an investor to bring extracontractual claims constituted a double recovery,

just as there is no double recovery here. This false specter of a double recovery is no basis to ignore the statutory confines of section 510.[18]

CONCLUSION

For all of the foregoing reasons, the Investors respectfully request that the Court deny the Debtors' Motion in its entirety.

Dated: April 23, 2013
New York, New York

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[18] Finally, the Debtors devote an entire section of their brief to the classification of the Investors' claims. The ultimate classification of the Investors' claims is beyond the scope of this adversary proceeding, *e.g.*, Compl. (Dkt. #1) ¶ 1, and depends on factual questions not resolved by the undisputed facts in the Joint Stipulation. These extraneous arguments should not be considered but, to the extent they are, the Investors incorporate by reference their analysis at pages 11-16 of their Motion for an Order Under Bankruptcy Rule 3013, *In re Residential Capital, LLC*, No. 12-12020 (MG) (Bankr. S.D.N.Y. Nov. 27, 2012) (Dkt. #2284).

ATTACHMENT A

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

Impac Mortgage Holdings Inc., et al.,

Plaintiffs,

vs.

Houston Casualty Company, et al.,

Defendants.

CASE NO. SACV 11-1845-JST (JCGx)

ORDER (1) GRANTING DEFENDANT HOUSTON CASUALTY COMPANY'S MOTION FOR PARTIAL SUMMARY JUDGMENT, (2) DENYING PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT REGARDING COVERAGE FOR MAIDEN LANE'S LETTER AND CITIGROUP'S ACTION AS TO DEFENDANT HOUSTON CASUALTY COMPANY, AND (3) DENYING PLAINTIFFS' MOTION FOR PARTIAL SUMMARY JUDGMENT REGARDING COVERAGE FOR FEDERAL HOME LOAN BANK OF BOSTON'S ACTION AS TO DEFENDANT HOUSTON CASUALTY COMPANY (DOCS. 31, 49, 80)

Before the Court are cross-motions for partial summary judgment filed by Plaintiffs (collectively, "Impac") and Defendant Houston Casualty Company ("Houston"). (Impac's MPSJ re. ML/Citi, Docs. 31, 32; Impac's MPSJ re. FHLBB, Docs. 49, 50; Houston's MPSJ, Docs. 80, 81.) Each party seeks summary judgment in its favor regarding the duty to advance defense costs to Impac in three underlying actions (two lawsuits and one demand letter).[1] Having considered the briefing and supporting documentation submitted by the parties, heard oral argument, and taken the matters under submission, the Court DENIES Impac's motions as to Houston and GRANTS Houston's motion.

I. BACKGROUND

This dispute arises out of "Directors and Officers" ("D&O") policies issued by Houston for the periods August 1, 2009 – August 1, 2010 and August 1, 2010 – August 1, 2011 ("Policies"). (Morrison Decl. in Supp. of Impac's MPSJ Re. Coverage for Maiden Lane's Letter and Citigroup's Action ("First Morrison Decl.") Ex. 2 ("A9823"), Ex. 1 ("A10307"); Docs. 38-2, 38-1.) Impac argues that the terms of the Policies obligate Houston to advance defense costs for the three underlying claims, all of which arise out of Impac's mortage-backed securities business.

A. Impac's Mortgage Securitization Business

Until mid-2007, Impac funded, sold, and securitized non-conforming residential mortgages. (Houston's Appx. in Supp. of MPSJ Ex. A "Impac 2007 10-K" at 12-13.) (Doc. 82-1.)[2] Because the mortgages that Impac funded were non-conforming, Impac was unable to sell

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[1] Houston moves for partial summary judgment because Impac's First Amended Complaint ("FAC") also sought coverage for another underlying claim, a lawsuit originally styled *Mass Mutual v. Impac Funding Corp*., which is not addressed in Houston's motion. Impac was dismissed as a defendant in *Mass Mutual*, and counsel subsequently agreed to dismiss without prejudice as to Houston all claims in the FAC that relate to that suit. Houston therefore understands that if granted, its motion would resolve all disputed issues. (Houston's MPSJ at 3 n.2, 17-18.) Impac has filed two motions for partial summary judgment, one as to two of the underlying actions, and one as to the third underlying action.

[2] All citations are to exhibit page numbers.

them to Fannie Mae or Freddie Mac.[3] (*Id*. at 13) Instead, Impac primarily obtained the money it used to fund its mortgages through securitizing mortgages. (*Id*. at 3.)

One Impac company, Impac Funding Corporation ("IFC"), was the originator of the mortgages, deciding which mortgages were appropriate to issue to residential borrowers. (First Morrison Decl. Ex. 29 at 1258, Doc. 46-1.) It was also the sponsor of the mortgages, deciding what mortgages to send to a trust for eventual securitization. (*Id*. at 1216, 1237.) Another Impac company, Impac Secured Assets Corporation, would buy the mortgages that IFC deemed appropriate for securitization and deposit them in a trust ("Trust") operated by Deutsche Bank, an independent trustee. (*Id*. at 1216, 1270.)

The Trust—defined in the Trust prospectus as the "Issuing Entity"—would in turn issue certificates ("Certificates") that "represent[ed] in the aggregate the entire beneficial ownership interest in the Issuing Entity." (*Id*. at 1216, 1219.) "Distributions of interest and/or principal" on the Certificates were made solely "from payments received from the Issuing Entity." (*Id*. at 1219.) The Certificates were issued to an underwriter, who then sold them to investors. (*Id*. at 1341, Doc. 47-1.)

B. The Policies

Houston issued Impac a D&O policy for 2008-09, (Guglielmo Decl. ¶ 26, Doc. 81-2), and subsequently issued two renewal policies (covering the period from August 1, 2009 through August 1, 2011). (A9823, A10307.) Those two renewal policies are the Policies at issue in this case.

In addition to covering suits against Impac's directors and officers, Policies also contained a provision stating that they would "pay the **Loss** of the **Organization** arising from a **Securities**

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[3] "Some of the principal differences between mortgages purchased by Fannie Mae and Freddie Mac and the [non-conforming mortgages were]: credit (FICO score) and income histories of the mortgagor; underwriting guidelines for debt and income ratios; loan to value ratios accepted; documentation required for approval of the mortgagor; and loan balances in excess of maximum Fannie Mae and Freddie Mac lending limits." (Impac 2007 10-K at 13.)

Claim . . . made against the **Organization** . . . for any **Wrongful Act** of such **Organization**." (A10307 at 3, A9823 at 87.)

"Organization" means Impac Mortgage Holdings—the named entity on the policies—as well as all its subsidiaries. (A10307 at 5, 7-8; A9823 at 89, 91-92.) "Insured" means the "**Organization**, but solely with respect to **Securities Claims**." (A10307 at 6, A9823 at 90.)

With respect to an Organization, "Wrongful Act" means "any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act by any such **Organization** in its capacity as such, but solely with respect to **Securities Claims**." (A10307 at 9; A9823 at 92-93.)

"Securities Claim" means

"a **Claim** . . . made against any **Insured**:

(1) alleging a violation of any federal, state, local or foreign regulation, rule or statute regulating securities . . . which is:

(a) brought by any person or entity alleging, arising out of, based upon or attributable to the purchase or sale of or offer or solicitation of an offer to purchase or sell any securities of an **Organization**; or

(b) brought by a security holder of an **Organization** with respect to such security holder's interest in securities of such **Organization**; or

(2) brought derivatively on the behalf of an **Organization** by a security holder of such **Organization**." (A10307 at 66, A9823 at 130.)

The Policies also contain various exclusions. The Errors and Omissions Exclusion excludes coverage for "**Loss** in connection with a **Claim** made against an **Insured** arising out of, based upon or attributable to any **Insured's** or **Organization's** performance of (or failure to perform) any professional services, or any act, error or omission relating thereto." (A10307 at 33, A9823 at 117.) The Predatory Lending Exclusion excludes coverage for lawsuits "arising out of, based upon or attributable to any predatory, abusive, unfair or deceptive mortgage lending practices," including "loans made despite the consumer's inability to repay." (A10307 at 28, A9823 at 111.) Finally, the Specific Events Exclusion excludes from coverage claims arising out

of (a) a number of specified preexisting claims, or Events; (b) "any fact, circumstance, situation, act or omission alleged in any **Event(s)**;" or (c) "any **Wrongful Act** which is the same as, similar or related to, or a repetition of any **Wrongful Act**, underlying fact, circumstance, situation, act or omission alleged or asserted in any **Event(s)**." (A10307 at 30-32, A9823 at 114-16.) Some of those preexisting claims involved allegations of misrepresentations in loan sales. (A10307 at 31.)

C. Underlying Claims

1. Federal Home Loan Bank of Boston Action

In April 2011, the Federal Home Loan Bank of Boston ("FHLBB") filed a complaint against Impac in the Commonwealth of Massachusetts Superior Court ("FHLBB's Complaint"). (Morrison Decl. in Supp. of Impac's MPSJ Re. FHLBB Action ("Second Morrison Decl.") Ex. 12 ("FHLBB Compl."), Docs. 58-1, 59-1, 60-1, 61-1. FHLBB's Complaint identifies IMH Assets Corp., Impac Secured Assets Corp., Impac Funding Corporation, and Impac Mortgage Holdings, Inc. as defendants in an "action aris[ing] from the sale . . . of over $5.9 billion in Private Label Mortgage-Backed Securities [("Certificates")] . . . . [which are] 'securities' within the meaning of the Massachusetts Uniform Securities Act . . ." (*Id*. at 346.) The complaint alleges violations of Massachusetts securities and "unfair or deceptive acts" statutes, as well as negligent misrepresentation, arising from alleged "false and misleading statements of material fact and omissions of material facts" in the Certificates' Offering Documents and from "material misrepresentations" made "in the course of [defendants'] business dealings" with FHLBB. (FHLBB Compl. at 651, 656, 660, 672, 677, 681-82, 687, 690-91.)

2. Maiden Lane Letter

On April 20, 2010, the Federal Reserve Bank of New York ("NY Fed") and Maiden Lane II (an entity formed by the NY Fed to facilitate American International Group's ("AIG's") restructuring) sent a letter to Impac ("Maiden Lane's Letter") regarding a "dispute concerning the payment priority provisions in four IMPAC securities offerings . . . (the 'IMSA Securities')" purchased by AIG. (First Morrison Decl. Ex. 13 ("ML Letter") at 1113-14, Doc. 43-2.) According to the Letter, AIG had relied upon the prospectus supplements of the four securities, which represented that "principal would be paid pro rata to *all* Class A certificateholders if and

when the Certificate Principal Balances of the subordinated tranches were reduced to zero . . . ." (*Id*. at 1114.) Approximately one year after Maiden Lane II purchased the four securities from AIG, it discovered that the securities' Pooling and Service Agreements (PSAs) actually stated that principal would be paid "sequentially, to the Class A-2A, Class A-2B and Class A-2C Certificates, in that order. . . ." (*Id*.) Maiden Lane's Letter alleges that as a result of this clerical error in the PSAs, "the senior IMSA Securities owned by [Maiden Lane II] are now shut out of principal payments until other Class A tranches are paid in full." (*Id.* at 1115.) The Letter states that Maiden Lane II has suffered and continues to suffer damages, and that it is "entitled to pursue appropriate rescissionary damage remedies under Section 11 of the Securities Act of 1933," which could amount to $668 million. (*Id*.)

3. Citigroup Action

On May 25, 2011, Citigroup Global Markets Inc. ("Citigroup") filed a complaint against Impac in the United States District Court for the Central District of California ("Citigroup's Complaint"). (First Morrison Decl. Ex. 14 ("Citigroup Compl."), Doc. 43-3.) Citigroup's Complaint involves the mortgage-backed trust IMSA 2007-3, one of the four securities at issue in the Letter. (ML Letter at 1113, Citigroup Compl. at 1123.) The complaint alleges that in March and April of 2010, Citigroup purchased Class A1-A certificates in IMSA 2007-3, relying on the Prospectus Supplement and other documents filed with the SEC, which referred to a PSA that stated that Class A1-A certificates would be paid certain distributions ahead of other Class A certificates. (*Id*. 1123-24.) The complaint further alleges that in late April 2010, after Citigroup had purchased the certificates, a new SEC Form 8-K/A was filed with the SEC, stating that the earlier PSA had been "inadvertently filed," and filing a new PSA. (*Id*. at 1125.) According to the terms of the new PSA, distributions would be paid to all Class A certificates concurrently and pro rata. (*Id*.) Citigroup alleges that this change caused its certificates to lose millions of dollars in market value. (*Id*. at 1126.) The complaint asserts causes of action for violation of Sections 18 and 20 of the Securities Act of 1934 and for negligent misrepresentation, and seeks damages, attorney's fees, and costs. (*Id*. at 1127-31.)

D. The Parties' Coverage Dispute

Impac notified Houston of Maiden Lane's Letter in June 2010, and Houston denied coverage of all claims asserted in the letter on August 4, 2010. (First Morrison Decl. ¶¶ 22-24.) Impac notified Houston of Citigroup's Complaint in May 2011, and Houston denied coverage of that claim on July 25, 2011. (*Id.* ¶¶ 27, 28.) In or around May 2011, Impac notified Houston about FHLBB's Complaint, and Houston denied coverage of that claim on or about July 22, 2011. (Second Morrison Decl. ¶¶ 17-19. Doc. 55.)

On September 7, 2011, Impac filed this action against Houston and co-defendant Those Certain Underwriters at Lloyds, London ("Lloyds") in Orange County Superior Court. (Notice of Removal Ex. A, Doc. 1.) Lloyds filed a notice of removal on November 30, 2011 on the basis of diversity jurisdiction. (Notice of Removal.) Plaintiffs filed a First Amended Complaint ("FAC") on March 21, 2012, seeking: "(1) declaratory relief as to the rights and obligations of all parties . . . with respect to three separate law suits alleging misrepresentations and omissions in the sale of approximately one-hundred and twenty million dollars of mortgage backed securities (identified . . . as MassMutual's Action, Federal Home Loan Bank of Boston's Action and Citigroup's Action) and a written demand letter (identified below as Maiden Lane's Letter) which bears a relationship to one of those lawsuits (Citigroup's Action), each of which names one [or] more of the Plaintiffs in this action as a defendant or responsible party, under four policies of insurance issued by Defendants to or for the benefit of Plaintiffs; and (2) recovery of policy benefits from the Defendants under policies of insurance issued by the Defendants to or for the benefit of Plaintiffs." (FAC ¶ 10, Doc. 22.)

II. LEGAL STANDARD

A. Motion for Summary Judgment

In deciding a motion for summary judgment, the court must view the evidence in the light most favorable to the non-moving party and draw all justifiable inferences in that party's favor. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986). Summary judgment is proper "if the [moving party] shows that there is no genuine dispute as to any material fact and the [moving party] is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A factual issue is "genuine" when there is sufficient evidence such that a reasonable trier of fact could resolve the

issue in the non-movant's favor, and an issue is "material" when its resolution might affect the outcome of the suit under the governing law. *Anderson*, 477 U.S. at 248.

The moving party bears the initial burden of demonstrating the absence of a genuine issue of fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). "When the party moving for summary judgment would bear the burden of proof at trial, it must come forward with evidence which would entitle it to a directed verdict if the evidence went uncontroverted at trial." *C.A.R. Transp. Brokerage Co. v. Darden Rests., Inc.*, 213 F.3d 474, 480 (9th Cir. 2000) (citation and quotation marks omitted). The burden then shifts to the non-moving party to "cit[e] to particular parts of materials in the record" supporting its assertion that a fact is "genuinely disputed." Fed. R. Civ. P. 56(c)(1); *see also In re Oracle Corp. Sec. Litig.*, 627 F.3d 376, 387 (9th Cir. 2010) ("non-moving party must come forth with evidence from which a jury could reasonably render a verdict in the non-moving party's favor").

B. The Duty to Defend Under California Law

Under California law, an insurer "owes a broad duty to defend its insured" against any suit "which *potentially* seeks damages within the coverage of the policy." *Ortega Rock Quarry v. Golden Eagle Ins. Corp.*, 141 Cal. App. 4th 969, 977 (2006) (citations omitted). "To prevail, the insured must prove the existence of *a potential for coverage*, while the insurer must establish *the absence of any such potential*. In other words, the insured need only show that the underlying claim *may* fall within policy coverage; the insurer must prove it *cannot*." *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 300 (1993). The duty to defend is determined by "the facts alleged in the complaint" and "facts known to the insurance company at the time of the coverage decision." *Griffin Dewatering Corp. v. N. Ins. Co. of N.Y.*, 176 Cal. App. 4th 172, 197-98 (2009). "Any doubt as to whether the facts give rise to a duty to defend is resolved in the insured's favor." *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1081 (1993).

At the summary judgment stage, "[o]nce a *prima facie* showing is made [by the insured] that the underlying action fell within coverage provisions, an insurer may defeat a motion for summary judgment on the duty to defend only by producing undisputed extrinsic evidence conclusively eliminating the potential for coverage under the policy." *Anthem Elecs., Inc. v. Pac.*

Emp'r Ins. Co., 302 F.3d 1049, 1060 (9th Cir. 2002) (citation omitted). "Evidence that merely place[s] in dispute whether [the insured's] action would eventually be determined . . . to fall within one or more of the exclusions contained in the polic[y] is insufficient to defeat the insured's right to summary judgment." *Id*. (citations omitted).

Impac argues that the duty to defend standard should be applied to these motions (Opp'n to Houston's MPSJ at 1-4, Doc. 121.) However, while the Policies allow for the advancement of defense costs, they specifically state that "[t]he Insurer does not . . . assume any duty to defend under this Policy." (A10307 at 13, A9823 at 97.) In *Jeff Tracy, Inc. v. U.S. Specialty Ins. Co.*, 636 F. Supp. 2d 995, 1003 (C.D. Cal. 2009), a federal court applying California law found that where a D&O policy "clearly and conspicuously disclaim[ed] the duty to defend," the duty to defend standard did not apply. Another federal court recently cited to *Jeff Tracy* in finding that a clause in a D&O policy providing for the advancement of claims expenses did not trigger the duty to defend. *Petersen v. Columbia Cas. Co.*, 2012 WL 5316352 at *8-10 (C.D. Cal. Aug. 21, 2012.) The *Petersen* court emphasized that the policy in that case "provid[ed] for claims expenses to be advanced subject to several conditions," such as that the insured consult with the insurer before incurring defense costs, and that the insured get the consent of the insurer prior to entering into any settlements. *Id*. at *10. Similarly, the *Jeff Tracy* court noted the fact that the policy in that case barred the insured from "admitting liability, stipulating to any judgment, or incurring any Defense Cost without the [insurer's] prior approval." *Jeff Tracy*, 636 F. Supp. 2d at 1003.

In addition to clearly and conspicuously disclaiming the duty to defend, the Policies state that "[t]he Insureds shall not admit or assume any liability, enter into any settlement agreement, stipulate to any judgment, or incur any Defense Costs without the prior written consent of the Insurer." (A10307 at 13.) Nevertheless, Impac attempts to distinguish *Jeff Tracy* and *Petersen* on the grounds that the policies in those cases contained clauses granting the insurer the right to allocate between covered and uncovered defense costs. (Impac Opp'n to Houston MPSJ at 3; *Jeff Tracy*, 636 F. Supp. at 1004; *Petersen*, 2012 WL 5316352 at *10.) The Policies also contain allocation clauses, but they do not apply to Securities Claims. (A10307 at 13, A9823 at 97.)

Jeff Tracy and *Petersen* cite to the allocation clauses not because the allocation clauses are in and of themselves significant, but because they indicate that the policies at issue in those cases did not contemplate or compel "unconditioned payment of expenses." *Petersen*, 2012 WL 5316352 at *10. There is ample evidence that the Policies do not compel an unconditioned payment of expenses—as noted, they require Impac to obtain prior agreement before entering into any settlement agreement or incurring defense costs. As such, the fact that the Policies do not contain an allocation clause is not enough to distinguish *Jeff Tracy* and *Petersen.*

Because the Policies provide only for the advancement of claim expenses, the duty to defend standard does not apply in this case. In order to prevail on its motions for partial summary judgment, Impac must "establish that the underlying claims are within the basic scope of coverage." *Jeff Tracy*, 636 F. Supp. at 1004.

C. Insurance Policy Interpretation

Under California law, the interpretation of an insurance policy is a question of law. *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 647 (2003); *Waller v. Truck Ins. Exch.*, 11 Cal. 4th 1, 18 (1995). "While insurance contacts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply . . . Thus, the mutual intention of the parties at the time the contract is formed governs interpretation." *Palmer v. Truck Ins. Exch.*, 21 Cal. 4th 1109, 1115 (quoting *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1264 (1992), *AIU Ins. Co. v. Superior Court*, 51 Cal.3d 807, 821 (1990)). In resolving interpretation disputes, the court first "look[s] to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it." *Waller*, 11 Cal. 4th at 18 (citing Cal. Civ. Code § 1638). "In doing so, the court must interpret the language in context, with regard to its intended function in the policy." *Bank of the West*, 2 Cal. 4th at 1264-5. "[A]n abstract ambiguity based on a semantically permissible interpretation of a word or phrase cannot create coverage where none would otherwise exist." *State Farm Gen. Ins. Co. v. JT's Frames, Inc.*, 181 Cal.App.4th 429, 444 (Cal. Ct. App. 2010). If the terms of the policy are in fact ambiguous, the policy must be interpreted "in the sense in which the promisor believed, at the time of making it, that the promisee understood it." *Bank of the West*, 2 Cal. 4th at 1264. If this does not resolve the

ambiguity, the ambiguous language is generally to be construed against the insurer, although "where the policyholder does not suffer from lack of legal sophistication or a relative lack of bargaining power, and where it is clear that an insurance policy was actually negotiated and jointly drafted, [the court] need not go so far in protecting the insured . . . ." *AIU Ins. Co.*, 51 Cal.3d at 822. Finally, coverage may be limited by exclusionary clauses only to the extent that those clauses are "conspicuous, plain and clear." *Haynes v. Farmers Ins. Exch.*, 32 Cal. 4th 1198, 1204 (2004) (quoting *Steven v. Fidelity & Casualty Co*., 58 Cal.2d 862, 878 (1962)).

III. DISCUSSION

A. "Securities Claim" Coverage

The parties do not dispute that the Policies generally cover only Directors and Officers, and cover Impac only with respect to Securities Claims. (Impac's MPSJ re. ML/Citi at 4, Houston's MPSJ at 13-14; *see also* A10307 at 9; A9823 at 92-93 (covering an Organization's Wrongful Acts "solely with respect to Securities Claims").) At issue is whether the underlying claims are in fact Securities Claims. Under the terms of the Policies, a "Securities Claim" is a claim "brought by any person or entity alleging, arising out of, based upon or attributable to . . . the purchase or sale of or offer or solicitation of an offer to purchase or sell any securities *of the Organization*." (A10307 at 7; A9823 at 91) (emphasis added).

Houston argues that the phrase "securities of the Organization" refers to Impac's own securities, (Houston's MPSJ at 2), and Impac does not disagree. However, Impac urges an additional meaning of that phrase—namely, that it also extends to the mortgage-backed securities in dispute in the underlying actions ("Mortage-Backed Securities"). Relying on multiple dictionary definitions of "of," Impac argues that the Mortgage-Backed Securities are also securities "of Impac," both in the sense that that their "derivation, origin or source" was Impac and in the sense that they were "possess[ed], connect[ed] or associate[ed]" with Impac. (Impac's MPSJ re. ML/Citi at 20.)

Impac cites to Maiden Lane's Letter, which describes the disputed certificates as "IMPAC securities offerings" and as "the notes each of you delivered." (ML Letter at 1113, 1115.) Similarly, Citigroup's Complaint arises out of "a mortgage-backed securities trust created by

[Impac]" and generally alleges that Impac "created trusts for the purposes of pooling and holding mortgage loans, collecting payments on those mortgages, and making distributions from those payments to investors." (Citigroup Compl. at 1122, 1123.) Finally, FHLBB's Complaint alleges that Impac "issued, marketed, and/or sold the Certificates" and describes Impac Funding Corp. and Impac Mortgage Holdings, Inc. as the "Sponsor[s] and Controlling Person Defendant[s]." (FHLBB Compl. at 660, ¶810, 370 ¶¶ 83-84.)

The fact that it would be "semantically permissible" to interpret the Policies' language as extending coverage to securities Impac bought, sold, or was involved in the creation of is not sufficient to "create coverage where none would otherwise exist." *State Farm Gen. Ins. Co.*, 181 Cal.App.4th at 444; *Bank of the West*, 2 Cal. 4th at 1265. Rather, the court must interpret the disputed language "in context, with regard to its intended function in the policy." *State Farm*, 181 Cal.App.4th at 444. Here, Impac has provided no admissible evidence that such an interpretation gives effect to the "mutual intention of the parties." *Bank of the West*, 2 Cal. 4th at 1264.

In fact, the language and context of the Policies advocate against Impac's proposed interpretation. First, its proposed interpretation would require the phrase "securities of" to carry multiple meanings within one policy definition. The Policies' definition of "Securities Claim" contains three subsections, one of which permits claims against an insured "brought by a security holder of an **Organization** with respect to such security holder's interest in securities of such **Organization**." (A10307 at 66, A9823 at 130.) In the context of that subsection, the phrase "securities of" makes sense only in reference to the securities of Impac itself. It would be irrational to argue that that same phrase, as it appears in the other two subsections of the definition of "Securities Claim," could refer to all securities Impac issued, marketed, or sold.

Second, the Policies are D&O policies. D&O policies traditionally "cover[] the officers and directors of corporations but not the corporation itself." 3-16 New Appleman on Insurance Law Library Edition § 16.02. By contrast, E&O policies cover entities more broadly for claims arising out of their provision of professional services. *Id.* By ascribing multiple meanings to the phrase "securities of," Impac's construction would result in the provision of vastly broader coverage when the insured happens to engage in the business of securitizing mortgages and would

cause a traditional D&O policy for those particular companies to become a de facto E&O policy, i.e., a professional liability policy for entities.

Significantly, Impac does not address why, given the language or context, the Policies can reasonably be interpreted as extending entity coverage for all claims arising out of its mortgage-backed securities business. Instead, it argues that given the fact that Impac Secured Assets Corp. ("ISA") is considered the "issuer" of the Mortgage-Backed Securities under the Securities Acts of 1933 and 1934, "[a]ny reading of 'securities of an Organization' consistent with the reasonable expectations of an insured must include the 'securities of' the Organization which is the 'issuer of' the securities" under those Acts. (Impac's MPSJ re. ML/Citi at 20-21.)

Contrary to what Impac asserts, it is far from obvious that the language of the regulations supports its interpretation of the Policies. The Prospectus Statement for IMSA 2007-3 identifies ISA as the "depositor" of the securities. The regulations defining "issuer" for the purposes of the Securities Acts of 1933 and 1934 state that "[t]he depositor for the asset-backed securities acting solely in its capacity as depositor to *the issuing entity* is the 'issuer' for purposes of the asset-backed securities *of that issuing entity*." 17 C.F.R. § 230.191(a); 17 C.F.R. § 240.3b-19(a) (emphasis added). In addition, the SEC has clarified that "the person acting as the depositor in its capacity as depositor to the issuing entity is a different 'issuer' from that person in respect of its own securities." 70 FR 1506, 1526 n.155.

Furthermore, the interpretation of insurance policies is a question of state law, and courts are not bound by distinctions and definitions in federal statutes or regulations if they "do not reflect the intent of the parties to the . . . policies at the time of their formation." *AIU Ins. Co. v. Super. Court*, 51 Cal.3d 807, 831 (Cal. 1990). The language of the regulations—which does not even clearly support Impac's interpretation of the phrase "securities of an Organization"—does not require the conclusion that Impac understood and intended that phrase to include its Mortgage-Backed Securities.

Therefore, the Court concludes that the Policies are not ambiguous, and plainly do not cover claims arising out of the Impac's mortgage securitization business.

B. Errors & Omissions Exclusion

Alternatively, Houston argues that coverage for the underlying claims is precluded by the Policies' Errors and Omissions Exclusion ("E&O Exclusion"), which excludes claims "made against an Insured arising out of, based upon or attributable to any Insured's or Organization's performance of (or failure to perform) any professional services, or any act, error or omission relating thereto." (A10307 at 33, A9823 at 117.) As to the Maiden Lane and Citgroup actions, Impac contends that the claims "arise from alleged misrepresentations and omissions in the SEC Filings associated with the Impac Securities but do not allege that [Impac's] conduct constituted the performance of professional services." (Impac's MPSJ re. ML/Citi at 23.) Similarly, Impac contends that the FHLBB Complaint "alleges liability arising from misrepresentations and omissions in the Offering Documents associated with the Certificates but does not allege that [Impac] provided 'professional services.'" (Impac's MPSJ re. FHLBB at 23.)

However, as to Lloyds, the other Defendant in this same action, Impac asserts the exact opposite—that the underlying claims do in fact arise out of its provision of professional services. Impac argues that the underlying claims are covered by E&O policies issued by Lloyds ("Lloyds Policies"), which cover claims arising out of "any actual or alleged negligent act, negligent error or negligent omission committed by the Insured solely in the performance of or failure to perform professional services for others in the Insured's profession [of mortgage banker/mortgage broker]." (Morrison Decl. in Supp. of MPSJ re. ML/Citi Ex. 5 at 229; Ex. 3 at 165, (Docs. 38-5, 38-3.)

In the context of arguing for coverage under the Lloyds Policies, Impac argues that "[t]he plain meaning of 'professional services' of a 'Mortgage Banker' and 'Mortgage Broker' includes [its] conduct giving rise to" all three underlying claims, (Impac's MPSJ re. ML/Citi at 14, Impac's MPSJ re FHLBB at 13), and stating that "[e]ach of the Underlying Lawsuits allege that [it] committed errors and/or omissions in the course of providing the services of mortgage bankers and brokers in securitizing mortgages" (Resp. to Lloyds' Separate Statement of Uncontroverted Facts, Resp. No. 12, 21; Doc. 107; *see also* Resp. to Lloyds' Separate Statement of Uncontroverted Facts, Resp. No. 10, 38, 40).

Impac's argument as to Lloyds is supported by case law, as well as by the undisputed facts in this case. Applying California law, the Ninth Circuit has defined "professional services" broadly, holding that "to be considered a 'professional service' for insurance purposes, a liability 'must arise out of the special risks inherent in the practice of the profession.'" *PMI Mortg. Ins. Co. v. Am. Intern. Spec. Lines Ins. Co.*, 394 F.3d 761, 766 (9th Cir. 2005). *Bank of America, N.A. v. W.H. Opie*, 663 F.3d 997 (9th Cir. 1981), involved a mortgage banking corporation sued for violating a loan agreement as to the proper allocation of funds it had borrowed from a bank.[4] The Ninth Circuit rejected the insurer's argument that that suit did not arise out of a "professional service" because there was no "professional-service relationship" between the mortgage banker and the lending bank. *Id*. Rather, the court held that coverage was "dependent upon the nature of the insured's conduct, not the status of the party harmed" and that "courts must look 'to the act itself' to determine whether the insured's liability was predicated upon the faulty rendition of professional services." *Id*.

The undisputed facts indicate that securitization was a central element in Impac's business, and that that suits arising out of mortgage securitizations arise out of "special risks inherent in" the practice of Impac's profession of mortgage banker. *PMI*, 394 F.3d at 766. As part of its argument in favor of professional services coverage under the Lloyds Policies, Impac cites to a policy paper released by the Mortgage Bankers Association, in which it states that "[m]ortgage bankers . . . realize gains (or losses) on the sale of mortgages when loans are pooled and sold to investors in the secondary mortgage market." (Gorman Decl. in Supp. of MPSJ re. ML/Citi ("First Gorman Decl.") Ex. B at 21, Doc. 36-2.) It also cites to a Mortgage Banking Handbook released by the Comptroller of Currency, which states that "[m]ortgage banking generally involves loan originations, purchases, and sales through the secondary mortgage market." (Gorman Decl. in Supp. of Opp'n to Lloyds' MSJ "Second Gorman Decl." Ex. K at 66, Doc. 116-2) Impac's 2007

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[4] Although *Opie* applies Washington law, the Ninth Circuit cited it with approval in *PMI*, describing the case as containing"[t]he most authoritative construction of the term 'professional services' as used in the malpractice insurance setting." *PMI Mortg. Ins. Co.*, 394 F.3d at 766.

10-K also reflects the intimate connection between the company's mortgage origination business and its mortgage securitizations. Because Impac could not sell its non-conforming mortgages to Fannie Mae and Freddie Mac, it was reliant on the funds it obtained through securitizing mortgages to fund those mortgages. (Impac 2007 10-K at 3, 13.) Mortgage securitization was thus fundamental to Impac's ability to underwrite mortgages, and to its provision of professional services.

Impac provides no coherent explanation for why the underlying claims arise out of "professional services" in the context of Lloyds Policies but not in the context of Houston's E&O Exclusion. In fact, the language of the Lloyds Policies is significantly narrower than the language of the E&O Exclusion, as it limits coverage to acts or omissions committed "solely" in Impac's provision of professional "mortgage banker/mortgage broker" services "for others."

The Court therefore concludes that the underlying claims, which all arise out of Impac's mortgage securitization business, arise out of Impac's "performance of (or failure to perform) . . . professional services." As such, they are excluded from coverage by the E&O Exclusion.

IV. CONCLUSION

For the foregoing reasons, Plaintiffs' motions are DENIED as to Defendant Houston and Houston's motion is GRANTED.

DATED: February 26, 2013

UNITED STATES DISTRICT JUDGE

ATTACHMENT B

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re	:	**Chapter 11**
WASHINGTON MUTUAL, INC., et al.,[1]	:	**Case No. 08-12229 (MFW)**
Debtors.	:	**(Jointly Administered)**
	:	**Re: D.I. 9582**

ORDER DENYING MBS PLAINTIFFS' MOTION TO CLASSIFY ASSERTED CLASS CLAIM AS A CLASS 12 CLAIM, FINDING PROOFS OF CLAIM NOS. 4064 AND 4069 PREMATURELY FILED BY THE MBS PLAINTIFFS, AND GRANTING WMI LIQUIDATING TRUST AUTHORITY TO RELEASE THE RESERVE IN CONNECTION THEREWITH

Upon the *MBS Plaintiff's Motion to Classify Class Claim as a Class 12 Claim*, dated February 7, 2012 [D.I. 9582] (the "Motion"), filed by Policeman's Annuity and Benefit Fund of the City of Chicago ("Chicago PABF"), Boilermakers National Annuity Trust ("Boilermakers") and Doral Bank Puerto Rico (collectively, with Chicago PABF and Boilermakers, the "MBS Plaintiffs"); and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157 and 1334; and consideration of the Motion and the relief requested therein being a core proceeding pursuant to 28 U.S.C. § 157(b); and venue being proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409; and due and proper notice of the Motion having been provided to all parties entitled to receive notice thereof, and no other or further notice being required; and an objection (the "Objection") to the Motion and the relief requested therein having been interposed by WMI Liquidating Trust (the "WMILT"), as successor in interest to Washington Mutual, Inc. ("WMI") and WMI Investment

[1] The Debtors in these chapter 11 cases along with the last four digits of each Debtor's federal tax identification number are: (i) Washington Mutual, Inc. (3725); and (ii) WMI Investment Corp. (5395). The principal offices of WMILT, as defined herein, are located at 1201 Third Avenue, Suite 3000, Seattle, Washington 98101.

Corp. (collectively, the "Debtors"); and a joinder (the "Joinder") to the Objection having been filed by the Statutory Committee of Unsecured Creditors appointed in the Debtors' chapter 11 cases (the "Creditors' Committee"); and a reply (the "Reply") to the Objection and the Joinder having been filed by the MBS Plaintiffs; and, on May 7, 2012, the Court having held a hearing (the "Hearing") with respect to the Motion, the Objection, the Joinder and the Reply and considered the legal arguments presented, including, without limitation, presentations relating to the *Stipulation Resolving Debtors' Amended Thirty-Second Omnibus Objection (Substantive) With Respect to Claim Nos. 3812 and 2689* (the "Stipulation") and the *Order Resolving Debtors' Amended Thirty-Second Omnibus Objection (Substantive) with Respect to Claim Nos. 3812 and 2689* [D.I. # 6068]; and, after due deliberation and sufficient cause appearing therefor; and consistent with the Court's ruling set forth on the record of the Hearing, it is hereby

ORDERED that the Motion and the relief requested therein are denied as set forth below and for the reasons set forth on the record of the Hearing; and it is further

ORDERED that the proofs of claim filed by the MBS Plaintiffs, proofs of claim administratively numbered ~~4064 and~~ 4069, (~~collectively~~ the "Refiled and Amended MBS Claim"), (a) ~~are~~ is disallowed as prematurely filed in contravention of the terms and provisions of the Stipulation and (b) Kurtzman Carson Consultants, LLC, the court-appointed claims and noticing agent, is authorized and directed to update the official claims register in these chapter 11 cases to reflect the provisions of this Order and remove the Refiled and Amended MBS Claim, without prejudice to the rights of the MBS Plaintiffs to re-file a proof of claim in the event that ~~all~~ there is a recovery for holders of Allowed Subordinated Class ~~Allowed Claims and Postpetition Interest Claims in respect of Allowed Claims, each as defined~~ 18 Claims under ~~in~~ the Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United

States Bankruptcy Code, dated December 12, 2011, as amended (the "Plan"), ~~in Classes senior to~~ Class 18 ~~(Subordinated Claims) are paid, in Cash, in full~~; and it is further

ORDERED that, in the event that the MBS Plaintiffs elect to re-file a proof of claim in accordance with the terms and provisions of the Stipulation, such proof of claim may be filed either as a Class 12 General Unsecured Claim or a Class 18 Subordinated Claim, subject to the rights and defenses of WMILT and all other parties in interest as to allowability and classification of such proof of claim, it being determined by the Court that the Stipulation does not require any such re-filed proof of claim to be classified in Class 18 under the Plan; and it is further

ORDERED that the Court's *Order Regarding Tranquility Claim* [D.I. 9225] and the accompanying *Memorandum Opinion Regarding Tranquility Claim* [D.I. 9224] is not dispositive with respect to the classification of the Refiled and Amended MBS Claim ~~or any future proof of claim filed by the MBS Plaintiffs~~ for the reasons set forth ~~in~~ on the Record of the Hearing and the Court need not rule on the classification of any such claim at this time; and it is further

ORDERED that, in accordance with the terms of the Confirmation Order, as defined in the Plan, and based upon the ~~premature filing~~ withdrawal of the Refiled and Amended MBS Claim as set forth above and its removal from the claims register, WMILT is hereby authorized to release and eliminate the reserve previously established for the Amended MBS Claim and distribute such funds and other assets reserved in a manner consistent with the terms of the Confirmation Order and the terms of the Plan; provided, however, that, for purposes of such distribution and, in accordance with the Plan and the Liquidating Trust Agreement, as defined in the Plan, (a) the distribution date of such funds and other assets shall be the fourteenth (14th)

calendar day following entry of his Order (the "Distribution Date") and (b) the distribution thereof shall be deemed timely made if such distribution shall be made within ten (10) days following the Distribution Date; and it is further

ORDERED that the MBS Plaintiffs' *Motion for Order Certifying Class for Purposes of the Class Claim Pursuant to Fed. R. Civ. P. 23 and Fed. R. Bankr. P. 7023 and 9014(c),* dated January 20, 2012 [D.I. 9462], and the accompanying memorandum in support [D.I. 9463] is hereby deemed withdrawn without prejudice to re-filing in the event the MBS Plaintiffs file a new proof of claim consistent with the terms of the Stipulation and the requirements of this Order; and it is further

ORDERED that this Court shall retain jurisdiction to hear and determine all matters arising from or related to the implementation, interpretation, or enforcement of this Order.

Dated: May 16, 2012
Wilmington, Delaware

THE HONORABLE MARY F. WALRATH
UNITED STATES BANKRUPTCY JUDGE

ATTACHMENT C

UNITED STATES BANKRUPTCY COURT

DISTRICT OF DELAWARE

Case No. 08-12229(MFW)

- x

In the Matter of:

WASHINGTON MUTUAL, INC., et al.,

Debtors.

- x

Case No.: 10-53420 (MFW)

WASHINGTON MUTUAL, INC. and

WMI INVESTMENT CORP.,

Plaintiff,

v.

PETER J. AND CANDANCE R. ZAK

LIVING TRUST OF 2001 U/D/O

AUGUST 31, 2001, ET AL.,

Defendant

- x

Adv. Proc. No.: 12-50422 (MFW)

WASHINGTON MUTUAL, INC.

Plaintiff,

v.

XL SPECIALTY INSURANCE COMPANY, et al.,

Defendants

- x

- x

United States Bankruptcy Court

824 North Market Street

Wilmington, Delaware

May 7, 2012

10:31 a.m.

B E F O R E :

HON MARY F. WALRATH

U.S. BANKRUPTCY JUDGE

ECR: BRANDON MCCARTHY

Debtors' Twenty-Third Omnibus (Substantive) Objection to Claims;

Debtors' Objection to Proof of Claim Filed by AT&T Corp.;

Debtors' Sixtieth Omnibus (Substantive) Objection to Claims;

Debtors' Motion to Estimate Maximum Amount of Certain Claims for Purposes of Establishing Reserves Under the Debtors' Confirmed Chapter 11 Plan;

Motion for a Protective Order for Claimants Al Brooks, Todd Baker, Deb Horvath, John McMurray, Tom Casey, and David Schneider Pursuant to Rule 26(c);

Motion of the Official Committee of Unsecured Creditors to Alter or Amend the Court's Opinion and Order Regarding Subordination of the Claim of Tranquility Master Fund, Ltd.;

Motion of Washington Mutual, Inc. for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Rule 9019 of the Federal Rules of Bankruptcy Procedure, Approving Stipulation and Agreement By and Among Washington Mutual, Inc., JPMorgan Chase Bank, National Association and U.S. Bank, National Association, as Successor to Union Bank, N.A. Resolving Adversary Proceeding and Related Proofs of Claim;

Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving the Stipulation and Agreement Between Washington Mutual, Inc. and MSG Media Reducing and Allowing Proof of Claim Number 1841;

Application of (I) Wilmer Cutler Pickering Hale and Dorr, LLP, (II) Pachulski Stang Ziehl & Jones, LLP, and (III) Boies, Schiller & Flexner, LLP for Compensation for Services Rendered and Reimbursement of Expenses as Counsel to the Ad Hoc Group of WMB Senior Noteholders for the Period from the Petition Date Through the Effective Date;

Washington Mutual, Inc. and WMI Investment Corp. v. Peter J. and Candace R. Zak Living Trust of 2001 u/d/o August 31, 2001, et al. (Adversary Proceeding No. 10-53420);

Debtors' Seventy-First Omnibus (Substantive) Objection to Late Filed Claims;

Debtors' Seventy-Second Omnibus (Substantive) Objection to Claims;

Motion of Deutsche Bank Trust Company Americas in its capacities as Indenture Trustee and Guarantee Trustee of Two Series of WMB/CCB Subordinated Notes for Entry of an Order Allowing and Authorizing and Directing Payment of Its Claims for Fees and Expenses;

Motion of Law Debenture Trust Company of New York, in its capacity as Indenture Trustee, for Entry of an Order Partially Allowing and Liquidating Proof of Claim for Fees and Expenses Incurred from January 1, 2012 through and Including March 31, 2012;

Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving Stipulation and Agreement Between WMI Liquidating Trust and SPCP Group, LLC Reducing and Allowing Proof of Claim Number 4048;

Fourth Motion of Wells Fargo Bank, N.A., in its capacity as Successor Indenture Trustee and Successor Guarantee Trustee, for Entry of an Order Further Partially Liquidating and Allowing that Aspect of its Proof of Claim Relating to the Trustee's Fees and Expenses;

Fourth Motion of Wilmington Trust Company, in its capacity as Trust Preferred Trustee, for Entry of an Order Further Partially, Liquidating and Allowing Proofs of Claim for Fees and Expenses;

Fourth Motion of The Bank of New York Mellon Trust Company, N.A. in its capacity as Indenture Trustee, for Entry of an Order Further Partially Liquidating and Allowing Proof of Claim for Fees and Expenses;

Fourth Motion of Wilmington Trust Company, in its capacities as Indenture Trustee and Guarantee Trustee for Five Series of WMB/CCB Subordinated Notes, for Entry of an Order Liquidating and Allowing Proof of Claim for Fees and Expenses;

MBS Plaintiffs' Motion to Classify Claim as a Claim 12 Claim;

Debtors' Seventieth Omnibus (Substantive) Objection to Claims;

Debtors' Seventy-Third Omnibus (Substantive) Objection to Late-Filed Claims;

Debtors' Seventy-Fourth Omnibus (Substantive) Objection to Claims;

Motion of Examiner for Entry of Order (1) Discharging Examiner; (2) Approving Disposition of Documents; and (3) Granting Related Relief;

Motion of Gregory G. Camas to Extend Time to File Proof of Claim, Deeming Proof of Claim Timely Filed, and Classifying Claim as Class 12 Claim Under Seventh Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code;

MBS Plaintiffs' Motion for Order Certifying Class for Purposes of the Class Claim Pursuant to Fed. R. Civ. P. 23 and Fed. R. Bankr. P. 7023 and 9014(c);

Washington Mutual, Inc. v. XL Specialty Insurance Co., et al.;

Tenth Interim Fee Applications.

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P R O C E E D I N G S

THE CLERK: All rise.

THE COURT: Good morning.

MR. ROSEN: Good morning, Your Honor. Brian Rosen, Weil, Gotshal and Manges. With me is my partner, Adam Strochak and Michael Merchant from Richards, Layton and Finger. We're here on behalf of WMI Liquidating Trust, and I'm guess we'll assume the capacity later on for our own respective law firms, Your Honor.

With respect to the agenda, I think we pick up on Page 14, Item Number 11, Your Honor.

THE COURT: All right. Just -- just for the record I have had an opportunity to look at the Items 11-19 which were filed under certification of no objection.

MR. ROSEN: Yes.

THE COURT: And I had no problem with any of them and have entered the orders.

MR. ROSEN: Okay. Thank you, Your Honor. I think that will allow certain people in the courtroom to -- to leave, which would take us then up to, Your Honor, Item Number 20, which Your Honor -- actually, Your Honor, if we could skip to Item 21 just very briefly. There are two other claims on there, if we could get rid of the claims objections first.

THE COURT: That would be fine.

MR. ROSEN: Okay. Items 21 and 22, Your Honor, Item Number 21 is the seventieth omnibus objection. In this objection we sought to disallow sixty-three claims which had been subordinated to the level of preferred or common stock --

THE COURT: Could the operator mute the lines? Thank you.

MR. ROSEN: So pursuant to the confirmed and consummated plan, Your Honor, Classes 19 or 22, and these claims have been subordinated pursuant to orders granted -- granting the thirty-eighth through the forty-second omnibus objections as well as a few others such as the sixty-second omnibus objection.

And, Your Honor, as noted in the objection that we did file here, pursuant to the plan holders of equity interests are now to receive a distribution on account of such equity interests, but the claimants holding the claims on each to this seventieth omnibus have not provided any justification why they should recover any amounts in addition to their equity interests or with respect to the purchases of the equity in the case.

And even the few that have asserted anything beyond the mere value of those losses, Your Honor, from holdings have not provided any support for those assertions. So the debtors' respectfully request that the Court disallow

each of the claims on that Exhibit A, not because we wanted to get rid of their equity interests, Your Honor, but because we were seeking to avoid a duplicate recovery on behalf of those people that have previously filed these claims.

There were six responses, Your Honor, that the debtors' received on or before the deadline, and after that the debtors' submitted under certification of counsel an order which the claim -- excuse me -- the form of which would have removed all of those non-responding ones. And, Your Honor, the Court entered that proposed order on April 2nd. So that left us, then, with these six remaining claims.

And if I could just briefly go through those, Your Honor, for the record.

The first, and I apologize if I mispronounce the name, Mr. Timothy Nguyen and his is Claim Number 3921 for $100,000, and he said in his papers, "I invested on Washington Mutual for $100,000. All my retire savings have lost when WM was transferred to Chase. Could you help me to consider my situation? All my supporting documents were lost when I moved from California to Florida." There is nothing else attached to the pleading, Your Honor.

Additionally, 3922 of the following claim was filed by Nancy Nguyen. Again, almost the same exact

wording. "I invested on Washington Mutual for 22,000 all my retire savings have lost when WM was transferred to Chase. Could you help me to consider my situation? Thank you." She attaches nothing either, Your Honor.

Celia Lucente, Claim 3608, for $545,000 and change says, "I have had taxes withheld on compensation for w-pay" -- I'm assuming work -- "I have performed, but in PD, paid income I was paid in the form of stock. Supporting documentation of brokerage statements for the shares issued and corresponding W2s showing withholdings filed with the proof of claim." There was nothing else filed, Your Honor.

Helen Burleson Kelso, Claim 3236, for 9,750, she said in her response, "I oppose the disallowance of my claim that is subject to the objection. My claim was properly filed previously with the claims agent and all supporting documentation was included therewith. My claim was in order. See attached." There's nothing else to the response, Your Honor. The claim itself has only an account statement showing the November 20th, 2007 market value of her stock to be $9,750.

Ms. Adele Plotkin --

THE COURT: Well, didn't she also attach her stock certificate?

MR. ROSEN: I -- I believe she did. Yes, Your Honor.

THE COURT: Okay.

MR. ROSEN: Ms. Plotkin said in Claim 1431 and in her response, "I am an eighty-nine-year-old senior citizen and did attend a hearing on objection in 201."

THE COURT: Oh, I'm sorry. It's Ms. Plotkin who attached --

MR. ROSEN: I -- I think that's right, Your Honor.

THE COURT: Okay.

MR. ROSEN: She attaches a certificate of 553 shares. "But I'm not physically able to attend the hearing on 4/3/12. I do not understand why the debtors' do not consider any settlement to my proof of claim."

Mr. Armstrong, Claim Number 263 -- excuse me -- 2368 filed in the amount of 41,000 and change. This claim asserted that -- the claim arose out of personal injury and that was sufficient for his claim of damages. He said he is no longer a shareholder. His claim relates only to the personal losses "I suffered up to date of filing of this case and the value of my property which was taken by our government, and makes no mention of any equity interests I may have acquired or disposed of since that time."

Interestingly, Your Honor, when you look at his day trading, which he did attach, he bought a lot of things several days after the seizure, so -- to help pump up his claim. And we also noted that when you do -- he was a day

trader. There's a lot of buying and selling of his claim. We noted that his losses were only in the amount of around $9,000 from what he did buy and sell.

We did actually speak to him and try and get him to be part of the MBL settlement, but we noted that his -- his purchases actually were after the commencement -- or excuse me -- after the closing of the class period. He argues Fifth Amendment; that the FDIC should pay him for taking of the bank. He says the bank -- the FDIC told him, no. He should look here. Your Honor, he argues -- he tries to reargue the subordination issue. We have been unable to come up with any reason as to why this should be paid, Your Honor.

I do have, in the courtroom, Your Honor, Mr. Maciel. Mr. Maciel and others have testified before as to the effects of WMI versus WMB, the claims process, et cetera, and I could tender or proffer Mr. Maciel at this time if the Court thinks it would be helpful.

THE COURT: All right. You may.

MR. ROSEN: And, Your Honor, with you already having granted several of these, I will just try and skip over and go to the ones that are relevant.

THE COURT: Thank you.

MR. ROSEN: Because it would be applicable, I think, to the seven -- perhaps the seventy-three as well.

Your Honor, Mr. Maciel is a senior director with Alvarez and Marsal. He was formally the chief financial officer of Washington Mutual, Inc. and WMI Investment Corp, and he's currently the chief financial officer for the WMI Liquidating Trust. He's present in the courtroom today and I make this proffer on his behalf, Your Honor.

He would testify that as the CFO of the debtors he was one of the persons responsible for overseeing the claims reconciliation and objection process in these Chapter 11 cases. He would testify that in preparation for filing the omnibus claims objections, each of the claims at issue was carefully reviewed and analyzed in good faith using due diligence by the appropriate personnel working under his direction and/or supervision.

He would further testify that he has reviewed the omnibus claims objections and the exhibits and is familiar with the information contained therein.

With respect to the seventieth omnibus one, those were the six responses we were just referring to, Your Honor, Mr. Maciel would testify that each of the sixty-three claims have been previously objected to and been disposed of.

He would testify that pursuant to the seventh amended plan, holders of equity interest have received distributions on account of such equity interests, but the

claimants holding the claims in the seventieth have not provided any justification why they should recover amounts in addition to their equity interests or with respect to their purchases of WMI equity.

And even the few claimants that have asserted anything beyond the mere value of their losses from the holdings of equity have not provided any support for such assertions, including in their responses to the objection.

He would testify that by -- excuse me -- that by this objection the debtors are not seeking to disallow any equity interest held by such claimants, but rather such claimants should not recover additional amounts with respect to the purchases of the equity.

That would be his testimony solely with respect to the seventieth, Your Honor.

Your Honor, if you would like I could then proceed with what he would say with respect to the seventy-third or we could deal with that later.

THE COURT: Well, with respect to those who sold their shares, and I -- I guess it's Mr. Armstrong is the only one --

MR. ROSEN: Right.

THE COURT: -- who sold his shares, he is not getting a distribution as a shareholder.

MR. ROSEN: No, Your Honor.

THE COURT: Why is he not entitled to a distribution -- a distribution as a subordinated creditor for his losses?

MR. ROSEN: Your Honor, we haven't seen any evidence as to why he should be entitled to it. We've asked him to come forward and show us what that evidence would be. Obviously, he has made allegations in his pleadings with respect to directors and officers, but we haven't seen anything beyond that, Your Honor. He is just claiming gross mismanagement on the part of those directors and officers in allowing the bank to be seized by the government. And then he -- as I said, he turned around and said, my Fifth Amendment rights; the government took it; the government should pay me for the taking of my stock, which at this point only the $9,000.

So, Your Honor, we haven't seen anything from Mr. Armstrong that would warrant anything beyond this. If Mr. Armstrong would step forward and provide us with some sort of evidence as to what we perceive to be the nine-thousand-dollar differential between the day trading bought and selling, we would, obviously, take a serious look at it.

THE COURT: All right. Well, I believe Mr. Armstrong is on the line.

Mr. Armstrong?

MR. ARMSTRONG: Yes. Can you hear me?

THE COURT: We can hear you.

MR. ARMSTRONG: Okay. Good.

First, thank you for taking the time today. And I guess I need to get clarification on something that counsel said because they have not contacted me at all or discussed my claim in any form or fashion. So --

THE COURT: Well, just tell me, what is the basis for your claim for damages?

MR. ARMSTRONG: It's in two parts. It's -- the first is actual, out-of-pocket losses from Washington Mutual, which is the $8,305.19.

And I'm -- I'm filing an open claim and not just an equity interest because I believe that the management of the company breached a legal duty and grossly mismanaged my assets, you know, to cause me those losses. I believe they have a legal responsibility for that.

THE COURT: And did you provide a calculation of your actual losses as part --

MR. ARMSTRONG: Yes --

THE COURT: And where --

MR. ARMSTRONG: -- I did.

THE COURT: -- is that?

MR. ARMSTRONG: With my original claim.

MR. ROSEN: Your Honor --

THE COURT: Do you have the --

MR. ROSEN: -- if I could approach, I'll help --

THE COURT: Yeah. Please hand up the original claim.

All right. I'm looking at Exhibit A to your proof of claim and that's the $9,000.

MR. ARMSTRONG: Yeah. That's the summary of it. Correct. And then all the individual trade confirmations follow in Exhibit B.

THE COURT: I have those.

MR. ARMSTRONG: So Exhibits A and B to the claim are the, you know, detailed support for that eight-thousand-three-hundred-dollar number.

THE COURT: All right. And your -- you have another claim you assert you're entitled to?

MR. ARMSTRONG: Yeah. The second part of the claim is the value of the 3,800 shares that I owned as of the petition date.

THE COURT: And --

MR. ARMSTRONG: But, you know, my cost on those is not included in the $8,300.

THE COURT: But you sold those --

MR. ARMSTRONG: The --

THE COURT: -- you sold those shares after the bankruptcy.

MR. ARMSTRONG: After the bankruptcy, yes, ma'am.

MR. ROSEN: Your Honor, it's our understanding, and -- and Mr. Armstrong can correct me if I'm wrong, but he -- he's asserting that he's entitled to an imputed loss of $33,000 because he thinks that the fair value of the stocks should have been $8.75 per share which was the value that TPG paid in April of 2008. So he has grossed up the amount of his claim.

MR. ARMSTRONG: Yes. I -- I used TPG's investment amount.

MR. ROSEN: Even though he didn't buy it at that level.

MR. ARMSTRONG: Correct. But I've since found out that -- and as I stated in my original claim, I've -- I felt that was probably a very conservative estimate of the value of the -- of the shares. And as it turns out, it was a very conservative estimate and I provided additional information in my response to the seventieth objection that shows the FDIC itself --

THE COURT: Well --

MR. ARMSTRONG: -- valuing the shares at $15.50 a piece after -- after the seizure.

THE COURT: All right. Well, as -- as a legal matter, I'm going to disallow any claim for stock you sold after the bankruptcy date. That was a voluntary decision made by you and I don't think that entitles you to anything

from this estate.

MR. ARMSTRONG: Okay. Even if the management of the company caused the value of my asset to basically disappear or vanish --

THE COURT: Well --

MR. ARMSTRONG: -- prior to the petition date or --

THE COURT: Well --

MR. ARMSTRONG: I mean, that's really the basis of my whole claim; that I owned -- that I had property of significant value and because of the management of the company, that value was wiped out.

THE COURT: Well, but -- but had you held your claim, you would have a claim against the estate for your stock, and you did not. I -- I don't think that anything that occurred after the bankruptcy entitles you to a claim for stock that you voluntarily sold.

MR. ARMSTRONG: Oh, I agree with that. But -- but my claim is for the property that I held prior to the bankruptcy.

THE COURT: Well, but I think that's incorporated in your nine-thousand-dollar calculation.

MR. ARMSTRONG: Actually, no. The $9,000 or $8,300, it was actual losses that I had incurred as the value of the stock went down. That does not consider the

value of the 3,800 shares that I still held as of the petition date, if that makes any sense.

THE COURT: No. I understand.

MR. ARMSTRONG: Okay.

THE COURT: Well, but to the extent that the -- well, let me hear the debtors' argument on this. I mean, I'm struggling to see what the --

MR. ROSEN: On the -- on the eighty-three-hundred piece, Your Honor?

THE COURT: -- the issue is. Yeah.

MR. ROSEN: Your Honor, on the eighty-three-hundred piece --

MR. ARMSTRONG: No. She's -- she's talking about the twenty --

THE COURT: The two --

MR. ARMSTRONG: -- the 33,000 and twenty-two --

THE COURT: Yeah. The 2,000 --

MR. ARMSTRONG: -- portion in the claim.

THE COURT: The losses on the 2,000 shares held as of the petition date.

MR. ARMSTRONG: Yeah. The 3,800 shares I held as of the petition date. My claim for the value of those is $33,022.

MR. ROSEN: Your Honor, as I indicated, we tried to break this down into, when we looked at all of the buying

and selling and understanding what he -- what Mr. Armstrong bought the shares of stock, and if you noted he was buying them on the same day he was selling them.

And we -- we added up and he agrees that there was about an $8,305 in losses there. This is for the gross-up, though, that he's referring to, this 8. -- times the TPG value. I honestly -- Your Honor, I'm at a loss to understand why there is a relationship back to what TPG paid and he's focusing on the FDIC's papers in some subsequent filing that the FDIC made somewhere to say, geez, look, there was value in that stock.

We -- I honestly -- Your Honor, I have a hard time understanding it. I don't understand it and I don't see what the relationship is back to the estate. If there is, in fact, a claim that we should be talking about, it should be limited to the $8,300, and at that point, then, if Mr. Armstrong wants to come forward and present evidence as to why the $8,300 qualifies a subordinated claim, then I think that's something, Your Honor, that we can discuss with the Court and, if necessary, litigate and -- and have the Court decide.

But just to make a reference to say there was gross mismanagement on the part of the directors and officers and, therefore, pay me $8,300 or pay me for this impeded value of $33,000 in addition to that, Your Honor,

we're hard-pressed to understand how it's right. He chose to do what he did. He chose to sell the stock. He chose to quantify his loss at the $8,300.

THE COURT: Yeah. Why isn't that correct?

(No verbal response)

THE COURT: Mr. Armstrong.

MR. ARMSTRONG: Oh, I'm sorry. I thought you were asking him.

THE COURT: No. I'm asking you why isn't counsel for the debtor correct?

MR. ARMSTRONG: Well, as far as the eight-thousand-three-hundred-dollar out of pocket losses is concerned, he is correct. And I can see -- the way the question is by alleging that that was a loss caused by a breach of a legal duty by the former management of the company, is it -- is it a legal and reliable claim. If it is, then I would say that it's a -- you know, it's a claim which precedes the petition date and they've got to pay it or treat it, handle it in -- in the estate, just like any other claim. I -- based on what I've learned, I believe that that would be subordinating, the level of co-owned equity.

THE COURT: Yes.

MR. ARMSTRONG: And the fact that I sold the shares afterwards, in my mind, is really irrelevant because

what my claim is for is, you know, pre-petition losses.

THE COURT: Well, I think the debtor is willing to concede $8,300 in out of pocket losses.

MR. ROSEN: Well, Your Honor, I -- I think --

THE COURT: As a calculation.

MR. ROSEN: As a calculation. That's correct. By no means are we conceding liability.

MR. ARMSTRONG: By no means what? Say -- say again, please?

THE COURT: They're not conceding that you lost this money because of any bad acts by the debtors or its --

MR. ARMSTRONG: Oh, okay. Okay. I guess that's for you to decide then. I really don't know what the -- you know, the legal standard is for proving gross mismanagement. If the fact that we're talking today isn't proof enough, then I don't -- you know, I really don't know what else I can provide. I mean, the bank was a hundred-and-something-year-old bank that survived the Great Depression. It was the sixth largest bank in the country and now we're sitting in a bankruptcy court arguing over an eight-thousand-dollar claim.

THE COURT: Well, the problem --

MR. ARMSTRONG: In my mind, that -- that's evidence of mismanagement. But --

THE COURT: Well, I think it's not quite enough

and there are any number of reasons why the stock might have lost value. I mean, I think you have to prove a little bit more than that to prove a loss, even a subordinated loss.

MR. ROSEN: Your Honor, if I could make a suggestion. If we could modify the order to carve Mr. Armstrong's claim out of it and then allow Mr. Armstrong an opportunity to submit some evidence, as the Court did previously with some people who had some of the similar types of assertions that he has now, and then we, perhaps, have a hearing set in the future for the eighty-three-hundred-dollar piece.

THE COURT: All right. I'm willing to allow that. Mr. Armstrong, I suggest that you talk with counsel for the debtor regarding what proof you can come forward with. Okay.

MR. ARMSTRONG: Okay. I'll -- I'll -- I'll gladly do that.

THE COURT: All right. I think the other claims are -- are different from yours and I agree that it appears that all they are asserting is really claims for shares, their share ownership.

MR. ROSEN: Right.

MR. ARMSTRONG: Right.

THE COURT: All right. So we'll carve out Mr. Armstrong.

MR. ARMSTRONG: Okay. My biggest concern, honestly, is -- is the Fifth Amendment issue.

THE COURT: Well, you understand that -- that the taking was by the government, so am I correct that you're asserting a claim against the government for taking of your property, for the seizure of the bank?

MR. ARMSTRONG: I believe -- my own -- my own personal belief is that the government is responsible for compensating the owners of that bank. Yes. Unfortunately, I've had a similar situation on -- with -- on another investment of mine and I filed a claim directly with the FDIC. They called it a third party claim, kicked it back to me and said, go talk to the holding company, which is what I'm doing here. I don't understand the logic behind that, but that is what I was instructed. So --

THE COURT: Well, I'm -- I'm prepared to find that you do not have a Fifth Amendment claim against the debtor.

MR. ARMSTRONG: Okay.

THE COURT: I'll disallow that portion.

MR. ARMSTRONG: Would it be -- would it be out of your venue, if that's the right word, to give me a ruling that we do have a Fifth Amendment claim against the government?

THE COURT: Yeah. I -- that's not -- I don't have jurisdiction or venue to decide that.

MR. ARMSTRONG: That's what I was afraid of. Okay. Very good.

THE COURT: All right.

MR. ARMSTRONG: If the debtors will just contact me on this other, then we'll discuss it.

MR. ROSEN: We will, Your Honor. And thank you, Mr. Armstrong.

MR. ARMSTRONG: Thank you all.

MR. ROSEN: Your Honor, that takes us to the seventy-third omnibus objection, which is Item 22 on the agenda.

In this objection, Your Honor, we objected to nine claims on substantive grounds. And Mr. Maciel would testify that each of the proofs of claims listed in this objection had also been previously objected to and disallowed on the basis that they were late filed. But, Your Honor, if you recall, pursuant to the plan we -- we gave them new life.

THE COURT: Yes.

MR. ROSEN: Mr. Maciel would testify that the debtors have determined that each such claim has been asserted by a party to which the debtors have no legal obligation. He would testify that with respect to certain of these claims, the claimant has attached only an invoice and no case identifying either of the debtors as the recipient of such services, but has not attached a contract

from which the claim arises or any other supporting documentation.

Nonetheless, the debtors searched the records for any contract that might exist between them and the claimants relating to such services without success, and nothing in the debtors' books and records indicated a liability owed to such claimant.

The remainder of the seventy-third omnibus objection claims are miscellaneous claims that improperly seek recovery against the debtors because they arise from mortgages issued by WMB, the bank, and held by the claimants.

Mr. Maciel would testify that the only two responses to this objection came from holders of mortgage claims. With respect to such claims, Mr. Maciel would testify that during the period implicated by these claims WMI was a thrift-holding company that never directly engaged in any of the mortgage operations or related activities implicated by such claims. Specifically, WMI never directly originated or serviced any mortgage loan anywhere in the United States or elsewhere. As such, these claims seek a recovery for conduct that is attributable to WMI.

Mr. Maciel would further testify that neither of the responses provides any justification for why the debtor -- either of the debtors should be liable for the claims

arising from the mortgages issued by WMB.

That -- that would be his testimony today, Your Honor.

THE COURT: All right. Is there anybody here for either the Lloyds or the Soucek family trust?

MR. LLOYD: Mike Lloyd, I'm here.

THE COURT: All right. Do you want to respond to the debtors' testimony that there is no claim against the debtor and, rather, your claim is against the bank?

MR. LLOYD: Well, I'm not agreeing with them as those separate entities and I don't think the Court did either. Already I think Your Honor has ruled that they acted a single control or single person controlled that entity where WMI, WMB were all one in the same. They advertised that on the internet. They even acted in the office of thrift which is responsible for mortgages seized their company. The announcements that were made on the internet certainly -- and the press certainly do not differentiate between WMI, WMB or any other groups that they may have -- have put together.

So it seems like a share game for their convenience to me. But they're objecting and saying that they had no responsibility toward those of us that -- while they owned -- owned controlling interests in WMB and they directed WMB and all their executive team controlled WMB,

that just doesn't seem like there's any -- anything other than a share game. Let's play hide behind the corporate vale.

And so that -- in that regard, in my opinion, the WMI is Washington Mutual and they are related and all connected. They've harbored the same logo. They've had the same billing addresses. When we sent payments in, it was sent -- payments were sent to WaMu. It wasn't sent to WMB. It wasn't sent to anything other than WaMu. So that seems to, I guess, make their -- their claim that WMI is separate from WaMu disappear.

THE COURT: Debtor wish to reply?

MR. ROSEN: Your Honor, we -- we've dealt with this very issue several times over. And contrary to what Mr. Lloyd says, these are the wrong party claims that are exactly the kind that the Court has disallowed pursuant to the nineteenth, the twenty-first, the sixty-third, and sixty-fifth omnibus objections where the Court found the distinction between WMI and Washington Mutual Bank.

WMI observed all corporate formalities, Your Honor, with WMB. They were separate entities. WMI did none of these operations that Mr. Lloyd is referring to. They were either done by Washington Mutual Bank or by Washington Mutual Bank's subsidiary that did the origination of the mortgages.

With respect to where payments are made, I don't know, but I doubt that they went to the corporate offices of Washington Mutual, Inc.

Your Honor, for this reason we would just reassert the same objection that the Court has already upheld several times over, to point out the wrong party nature of this and the separateness of Washington Mutual, Inc. and Washington Mutual Bank. We apologize that there were these issues, but, unfortunately, they are separate entities and there is no claim against the debtors themselves.

THE COURT: Well, I agree --

MR. LLOYD: Can I --

THE COURT: Go ahead, Mr. Lloyd.

MR. LLOYD: I -- I was just going to say that's nice if we could just waive the magic wand and tell everybody that let's make a claim disappear. But there's -- there's way too many egregious things that are going on here that -- that they're objecting to my claim hiding under the Washington Mutual Bank or Washington Mutual -- WMI and -- and saying that WMI is not WMB. Well, the guy who was the president of WMI wanted to be the Wal-Mart of banks. The only parts that they forgot is the whole customer service thing, and when these guys have -- have the banking is their business and they are -- can't seem to get a deposit put in the right account and they cause damage to somebody because

of breach of performance, then this -- this claim cannot be dismissed according -- you know, I'm not a lawyer, but I'm simply reading that, you know, that when there is impropriety that goes on, you just can't get rid of a claim, misconduct alleged. You just can't throw a claim out.

So WMI, WMB are one in the same from the public's eyes, from the operational eyes, and -- of this -- this whole process. And it's nice that they're saving that and I appreciate that they've got someone there that used to work for Washington Mutual that's now being paid for somebody else making testimony. But, quite frankly, I think he's conflicted and not capable of making a decision for everyone else.

This -- they're paying lawyers' fees that -- that are far in excess of what -- what this claim is, not that the amounts matter, but to me it seems that we're letting Washington Mutual who declares bankruptcy escape without having to pay any fines or fees. And obviously there's -- there's no question that -- that they couldn't put a simple deposit into the right account. There's no question of breach of performance. They admit it in a letter which has been submitted to you guys. There's no question that they attempted to foreclose on a mortgage that they did not own and -- and in doing so damaged my personal and professional reputation, not to mention my -- my financial situation.

So, you know, all of that's fine and dandy that -- that they want to separate out and hide behind the corporate veil and play the shell game, but that's neither justice nor fairness nor -- nor in agreement with what the Court's already ruled.

THE COURT: Well --

MR. LLOYD: And Tranquility you -- Your Honor was smart enough to separate out the way that it meant and you were able to judge that these guys were one singly controlled entity. So in my mind that -- that should apply here and that order should stand and this claim should be paid.

THE COURT: Well, the Tranquility decision didn't find as a matter of law or of fact that the corporate veil should be pierced. I simply held that they stated a claim; that if they were able to prove those facts, they stated a claim. However, I have not ruled at any point that anybody has proven what you're suggesting, which is piercing the corporate veil. And -- and the burden of proof is on the creditor who is asserting that.

In this country, corporate entities are separate legal entities, and in the absence of proving why they should be ignored, the corporate entity must be acknowledged. So the burden --

MR. LLOYD: I --

THE COURT: -- the burden of proof is on you to prove it and I'm not hearing any proof. I think it's clear that you --

MR. LLOYD: Okay.

THE COURT: -- dealt with the bank and the actions of which you complain were those of the bank, not its parent, Washington Mutual, Inc.

So I -- I do have to sustain the objection to your claim.

MR. LLOYD: Well, Your Honor, I'm reading just from Wikipedia from news reports from the Wall Street Journal and each of those defines WaMu as one singular entity. They don't separate out that the -- the different entities that are Washington Mutual, et al. They -- they -- they indicate operating under the same WaMu logo, the same executive addresses, the same leadership team, the same executive committee. All of that is identical.

And -- and, of course, in the Tranquility order it says, you know, prior to filing, WMI had directly or indirectly owned all of the outstanding capital stock of Washington Mutual Bank, WMB. WMB's subsidiaries, including Washington Mutual Asset Corp and WaMu Capital Corp. You know, from -- from a layperson's perspective, from somebody who is being serviced by Washington Mutual, you know, it's -- it's one in the same entity. And while legally that

might not be true, this -- this would -- this would allow for illegalities and breach of performance to go on untethered, unchecked --

THE COURT: Now -- now --

MR. LLOYD: -- and --

THE COURT: -- Mr. Lloyd, Mr. Lloyd, you have a claim against the bank.

MR. LLOYD: Okay.

THE COURT: All right. But there's a difference between saying you have a claim against the bank for illegalities and a claim against Washington Mutual, Inc. And I'm hearing no proof. You know, something stated in the press that a one trade name is used to refer to more than one entity is not proof that the entities were not two separate legal corporations that operated as such.

MR. LLOYD: And I'm with you, Your Honor, on that. I mean, I understand how -- how something about the corporations and that's the way to proceed. However, my mortgage, when I took out the application, was with First Trust and the bundling that occurred to allow First Trust Mortgage to sell my mortgage to Washington Mutual, all I got in the mail was a notice that said, pay -- pay to WaMu, We're now -- your payments are now going to Washington Mutual. It didn't say Washington Mutual Bank. It didn't say Washington Mutual, Inc. It just says, WaMu, that's --

you know, it's got their letterhead on it, their logo.

So --

THE COURT: All right.

MR. LLOYD: -- what happened was --

THE COURT: But your transaction was with a bank. It was not with a corporate holding company.

MR. LLOYD: Well, if the corporate holding company controlled the assets and everything else from the bank, it would seem to me that -- that they are still one in the same.

THE COURT: Well, it -- it's -- quite frankly, your argument is not enough for me to find that the corporate veil should be pierced. They were two separate corporations and I think I have to deny your claim. Your claim is against the bank, not against this corporate entity.

MR. ROSEN: Your Honor, may I approach?

MR. LLOYD: When -- Your Honor, when we called to complain with customer service and we escalated the customer service issue, they sent me to what was the executive team at Washington Mutual. It wasn't -- it wasn't Washington Mutual Bank. It was the executive team with Mr. Carney in charge. And now the young lady's name, Ms. Felicia Washington, who communicated with me, she was at the corporate offices in -- out in -- on the west coast.

And so, you know, they then operated at that point as one single control entity.

THE COURT: Well, I -- what -- your argument is not sufficient proof that they did not act as separate entities. And I am going to overrule -- excuse me -- sustain the objection to your claim.

MR. LLOYD: I -- I like overrule better.

(Laughter)

THE COURT: I know, but I'm -- I'm overruling your claim.

MR. ROSEN: Your Honor, may --

MR. LLOYD: Okay. Does that -- and then if you're overruling my claim, does that allow me then to pursue the bank?

THE COURT: You always have --

MR. LLOYD: Because, you know, we -- we were deemed -- we were deemed valid claimants by being on KCC's list and I guess the Court's have had in the past, if that's the case, that we're valid claimants because we're on the KCC list of creditors. So it would seem to me that -- that if you don't separate -- if you -- if you overrule based on -- or sustain the objection based on the separate entities, then we can't hardly be left out because of being left on the creditor list. And as a member of the creditor list, then they're deemed to be valid creditors. I'm just reading

what -- what they say in the different cases that have occurred. Not being a lawyer, of course, that probably puts me at a handicap, but --

THE COURT: All right. Mr. Rosen -- Mr. Rosen.

MR. ROSEN: Yeah. Sir, the KCC list was merely just a registry which sets forth everybody that filed a claim against the estate and what the status is.

To the extent that you have a claim against the estate, your obligation is to file it with the FDIC as receiver for the bank itself.

THE COURT: To the extent you have a claim against the bank.

MR. ROSEN: The bank. Yes.

THE COURT: Not the estate.

MR. ROSEN: I'm sorry. The receivership.

THE COURT: Yeah.

MR. ROSEN: You can still file it against the -- with the FDIC as receiver.

THE COURT: Yeah. Any claim --

MR. LLOYD: Okay.

THE COURT: -- filed in this case is being disallowed because it's only a claim against WMI or the other debtors.

MR. ROSEN: May I approach, Your Honor?

THE COURT: Yes.

All right. I'll disallow the claims, then, and sustain the objection.

MR. LLOYD: Your Honor, I -- I object to the objection and the sustaining of the objection, and -- and I think that it's probably a miscarriage of justice for me to be not allowed this claim simply because there's -- there's way too many avenues to approach this that would suggest that these guys are escaping with breach of performance that rises to payment and that have damaged us, and now they get to walk away from it.

THE COURT: All right. I've -- I've sustained the objection to your claim and I am disallowing your claim.

MR. LLOYD: Okay. And does -- does that mean that I cannot pursue the bank?

THE COURT: To the extent you have a claim against the bank, I am making no ruling on any claim you may have against the bank.

MR. LLOYD: Okay. And so does that also mean that -- that you're -- that we're not hindered by this -- this objection or this disallowance and that we can pursue FDIC and that sort of thing?

MR. ROSEN: In the receivership.

THE COURT: I'm -- I'm not making any ruling as to any claim you have against the FDIC as receiver of the bank.

MR. LLOYD: Okay.

THE COURT: All right.

MR. ROSEN: Thank you, Your Honor.

That -- that takes us to Item Number 23, which is the seventy-fourth omnibus objection. In this one, Your Honor, we objected to a number of claims on substantive grounds. We objected to two claims of vendors that were for services provided to the bank branches pursuant to contracts between the claimants and Washington Mutual Bank. JPMorgan Chase actually paid such claimants in full for these claims.

Additionally, we objected to one municipal claim for fines levied on a Washington Mutual Bank branch just as we had previously filed objections to similar claims.

Additionally, Your Honor, we sought to reduce and allow two claims of former employees. The claimants agreed with us as to the amount of such claims, but were unable to amend their claims prior to the start of the confirmation hearing, and pursuant to the confirmation order filed on February 16th, no claims can be filed, either newly asserted claims or claims amending the previously filed ones.

Finally, there were four claims arising from Washington Mutual Bank subordinated notes. These claims were filed long after the debtors had filed the fifty-fifty omnibus objection in November 2010, so these claims were not included in that objection. And by this objection, we

simply seek the same treatment for those claims; that they would be placed in Class 17(b) pursuant to the plan.

There was one response by the deadline of April 2nd, and that was filed by Marlene Carr on account of her Washington Mutual Bank subordinated note claim. And in that, Your Honor, Ms. Carr stated "I bought this bond with the understanding that Washington Mutual Bank was a thriving financial institution. I feel I am entitled to a financial settlement for the bond now showing nearly valueless on my investment statement. I have limited financial means and having my ten-thousand-dollar bond investment drop in value to zero greatly impacts my financial well-being."

Unfortunately, Your Honor, there was nothing in this response that justifies why this claim should be in anything other than in Class 17(b) with the other Washington Mutual Bank subordinated note claims. So we would ask the Court to deny Ms. Carr's objection and grant the seventy-fourth omnibus objection as we filed it, Your Honor.

THE COURT: Is there anyone here for Ms. Carr?

(No verbal response)

THE COURT: All right. I will sustain the objection.

MR. ROSEN: May I approach, Your Honor?

THE COURT: You may.

MR. ROSEN: Your Honor, next is Item 24 which is

the examiner's motion for an order discharging the examiner, approving disposition of documents, and granting related relief.

Mr. Sewell is here in the courtroom on behalf of the examiner. Your Honor, Mr. Sewell and I did have discussions prior -- last week with respect to this relief being requested. Specifically, we pointed out that the litigation subcommittee is now getting up to speed as the subcommittee of the trust itself, and they may have some questions or at least want to discuss some of these documents or at least get their eyes on some of these documents.

And we have worked out an understanding with Mr. Sewell that there would be a thirty-day lag time; specifically, Your Honor, that I think we were the only party that did raise any points -- no, there were others?

MR. SEWELL: I think there's one objection.

MR. ROSEN: Oh, there's one objection. With respect to our point, Your Honor, we had said that as long as there was a thirty-day period for the litigation subcommittee to raise an issue, that that would come back to the Court. The examiner agreed to that.

I'll now hand it over to Mr. Sewell to address the other objection.

THE COURT: All right.

MR. SEWELL: Good morning, Your Honor. Henry Sewell, McKenna Long Aldridge representing the examiner. I have Kate Stickles from Cole Schotz with me today as well.

Your Honor, we have filed with the Court a motion to formally discharge the examiner from his service in this case. We have requested relief that I believe is consistent with relief granted to examiners. In fact, I think the order that we requested is pretty typical both in this district as well as the Southern District of New York in terms of the relief granted to an examiner at the close of an examination.

Your Honor will recall, we were appointed in the summer of 2010. We were asked to complete a report in a very short time frame. We took one very short extension. We completed our report and filed a three-hundred-and-sixty-page report with exhibits with this Court on November the 1st. That report is posted still on our website as publicly available. The exhibits are publicly available and we'll leave the report up probably for some period of time to come if anyone wants to -- to look at it.

We opted to wait to seek a formal discharge given the significance of the issues raised in our report, the fact the case was still ongoing. We did not seek a formal discharge. We did not believe it would be appropriate to do so until the case was resolved. Now that the case is

essentially resolved we have filed our motion for discharge and we're essentially, Your Honor, seeking three forms of relief.

We are requesting, obviously, that the examiner be formally discharged.

We are requesting that we be permitted and authorized to dispose of, destroy, or return documents that we obtained during the course of our examination subject to the carve out from Mr. Rosen and I have taken our order and made some changes to it that I believe Mr. Rosen is -- is happy with.

We seek relief from this Court to prevent third parties from seeking discovery from the examiner without first coming to Your Honor to determine whether discovery is truly necessary. In prior cases, Your Honor, Mr. -- Mr. Hothberg (ph) has been the examiner in two other cases and in each of those cases the examiner sometimes is viewed as a free source of discovery. So we request as part of the discharge that we be relieved from any obligation to respond to discovery. If there is something that someone truly needs from the examiner, they can come to this Court and ask for this Court to determine whether or not discovery should be had from the examiner.

We request an exculpation of the examiner and his professionals; that is, a release from any claims that might

be made against the examiner in connection with the report that was filed and the conclusions that were reached in the report. We believe, also, that that's necessary and appropriate in the circumstances of -- of this case in particular.

And, finally, Your Honor, we have filed a final application for compensation. And I apologize to Your Honor. I think I might have gotten a little bit ahead of everybody in this case. I did -- we were following the case somewhat, but not in detail, and so at the time I filed that I did not understand there was going to be a final fee process that all the parties were going to participate in. I'm happy if Your Honor wants to defer ruling on that until Your Honor hears the other final applications. That -- that is certainly more than acceptable to us.

But just by way of reports, Your Honor, in our final fee application we are requesting, essentially, final approval of fees and expenses of $6.2 million, approximately 5.9 million of that represented the fees necessary to complete the report. That sum includes $23,907 which has not yet been paid, but we seek allowance of on an interim basis and payment on an interim basis, and as -- as well as the 23,000 includes a ten-thousand-dollar allowance for the clean-up work necessary to have this motion approved and to deal with any -- any objections or issues which come up.

Other than Mr. Rosen's issue which -- which I think we've resolved, there was a formal written objection filed by an individual named Mr. James Berg. Mr. Berg filed a written pleading with this Court objecting to the discharge of the examiner. I believe the objection -- the substance of the objection is that Mr. Berg disagrees with the conclusions and recommendations we made in our report. We obviously stand by those conclusions. We believe they were thoroughly researched, well-founded and -- and I believe they've been largely sustained by this Court during the course of this case.

However, despite that, the fact that he might disagree with our conclusions is not a basis to deny the examiner discharge as we requested in this case. So we would request that that objection be overruled and -- and our order, as we've agreed to the modification with Mr. Rosen, be modified -- be granted as well.

THE COURT: All right. Mr. Berg. Is Mr. Berg on the line?

(No verbal response)

THE COURT: All right. Well, I'm prepared to overrule Mr. Berg's objection. I think not only is it simply that he disagrees with the report, but I think it is rehashing arguments made by Mr. Berg at the confirmation hearing.

And I agree it is not a basis --

MR. BERG: Hello.

THE COURT: Yes. Mr. Berg?

MR. BERG: Oh, there we are. I'm sorry. I do not object to the examiner's discharge. I don't know why I was offline there for a bit. My main -- my main issues are regarding the exculpation and the destruction of documents is the -- is the large one for me. That -- at this point we -- I mean, I've got a list of documents I expected to feature prominently in the examiner's report and they did not. That -- that is in large part why I disagree with the -- I mean, he is -- he has painted it basically as me disagreeing with the conclusions.

What I -- what my argument is more along the lines of not so much disagreeing with the conclusions as there are documents that -- that I know of that are in -- for example, the PF -- PSI report that I believe should have been considered by the examiner, should have been included in his report and that paint an entirely different picture than what he -- what he addressed in his report.

THE COURT: Well, then isn't that simply disagreeing with the report and the conclusions of the report?

MR. BERG: I -- I can -- I guess to an extent that might be true. I -- let me -- let me revise my train of

thought. I've -- you just completely derailed it. All right. Assuming we do that, my argument basically was to hold off on the destruction of documents. We've got -- let's see here, skip way ahead.

Basically, if the documents are destroyed, we have no way of knowing whether the examiner holds other documents which might indicate misconduct on the part of the examiner. That -- that is my primary concern right there. If they're destroyed, obviously, the way -- if he operates in his own self-interest he's going to destroy anything that might essentially be damaging to him and retain anything that -- that could be -- could support his cause if there is any later litigation regarding potential misconduct. And if he -- if he destroys these documents we have no way of knowing whether -- whether any of the other documents he holds justify misconduct.

MR. SEWELL: Your Honor, may I address the issue of the documents for a second? I -- I think I can alleviate whatever concern might be there.

The vast majority of documents that we obtained during the course of our investigation were -- were either from the database maintained by Weil Gotshal or were subsequently deposited into that database as we conducted our investigation. So, essentially, the -- you know, ninety percent of what we have is duplicative of what the debtor

already has.

We did obtain some documents, pretty limited documents from third parties. We entered into confidentiality agreements with those third parties which obligated us to either destroy those or return those to those third parties. So, in essence, we would be complying with our obligations to those third parties.

We filed -- Your Honor, many of our documents that we relied upon were attached to the report and are still available. You can look at the exhibits that are attached to the report online and pull down PDFs of those. So the reality is that the documents that we are getting rid of, basically, are primarily either extra copies of what the debtor already has or they're documents that we have obligations with respect to the third parties to -- to destroy or return them.

THE COURT: Yeah. And, Mr. Berg, I -- I see nothing unusual about the examiner's request. The examiner, other than his report, has no documents that aren't available from other parties and I agree that the examiner is not supposed to act as a free repository for discoverable evidence.

To the extent you --

MR. BERG: But the --

THE COURT: To the extent you're suggesting that

the -- you want the documents because you may want to instigate litigation against the examiner for misconduct, I'm not going to allow that. The examiner was appointed as an officer of the court to provide a report to the Court and the examiner did exactly what the Court asked the examiner to do. Whether you disagree with the conclusions of the report, I don't think that's relevant. I think the fact is the report was issued and that's exactly what the examiner was required to do. And the examiner is entitled to exculpation to the extent his activities were conducted in this case.

MR. BERG: Okay. Well, thank you, Your Honor, for considering my -- my attempt at least.

THE COURT: All right. I will enter the order. You've worked out the thirty-day --

MR. SEWELL: Yes, Your Honor. We'll submit that order under certification of counsel.

How does your -- does Your Honor want me to wait with respect to the final application for compensation so that's heard with the other ones or -- or should we submit an order on that as well?

THE COURT: I -- I don't think there's any reason to wait. Do any of the other administrative professional parties agree?

MR. ROSEN: We have no problem with it going

forward now, Your Honor.

THE COURT: All right.

MR. SEWELL: Okay.

THE COURT: I have no problem with the fee requested by the examiner. I will approve it --

MR. SEWELL: Okay.

THE COURT: -- on a final basis.

MR. SEWELL: Thank you, Your Honor. I appreciate that.

And with that, Your Honor, may I be excused?

THE COURT: You may.

MR. SEWELL: Thank you.

MR. ROSEN: Thanks.

THE COURT: And I thank the examiner for his work.

MR. SEWELL: Thank you.

MR. ROSEN: Thanks, Henry.

Your Honor, that takes us to Item Number 25, and it's reflected on here as being continued. I just want the Court to note that this was the motion of Greg Camas or Camas with respect to extending the time period to file a claim.

THE COURT: Okay.

MR. ROSEN: So we're going to push that to the end of May.

THE COURT: Okay.

MR. ROSEN: Your Honor, what I would like to do now is proceed to Item Number 28, which were all of those fee applications that we had attached there or the index as Exhibit H referenced. I know that speaking from -- I know that speaking from the perspective of Weil, Gotshal and Manges, we have had some discussions with the United States Trustee, Ms. Leamy, and as a result of that, Weil, Gotshal reduced its fee application by $50,245.78. This was a voluntary reduction, but it addressed some of the concerns that Ms. Leamy had.

I know that we have circulated to the parties a chart which sets forth what the numbers are after discussions with Ms. Leamy for the other professionals as well, and I believe that the United Sates Trustee has no objections to the entry of this form of order on an interim basis subject to the final fee hearing which is going to be heard, Your Honor, in the last week of July.

THE COURT: Is that correct, Ms. Leamy?

MS. LEAMY: Good morning, Your Honor. Jane Leamy for the United States Trustee.

Mr. Rosen's correct and I believe there is a summary chart that he will hand up that indicates some other reductions as well.

Thank you.

THE COURT: Okay.

MR. ROSEN: Your Honor, may I approach?

THE COURT: You may.

All right. Well, there were some objections, I think, to some of the interim fee requests.

MR. ROSEN: Yes, Your Honor. I don't know if Mr. Schukfed (ph) is on the phone. Mr. Schukfed files one to the Weil Gotshal and to the Alvarez and Marsal every month as well as I think he -- he may now lodge some to -- objections to a few others as well. And he has been doing this throughout the Chapter 11 case, Your Honor. We've never addressed them, Your Honor. We've always said we would carry it to the final. If the Court would like to address it now, obviously -- Mr. Schukfed may be on the phone. I don't know, though.

THE COURT: I thought I saw -- I guess he is not. I will deal with those at the -- at the final fee application. I had no other concerns and will approve the fees on an interim basis.

MR. ROSEN: Thank you very much, Your Honor.

Your Honor, I think we can get rid of one other status conference on a fairly expedited basis, and this would be Item Number 27 on the agenda. It is a status conference with respect to the adversary proceeding that was commenced, Washington Mutual, Inc. versus XL Specialty Insurance Company, et al.

(Pause)

MR. OLIVERE: Good morning, Your Honor. Mark Olivere, Cousins, Chipman and Brown, counsel to WMI liquidating trust with respect to adversary proceeding 12-50422 against XL Specialty Insurance Company and eleven other insurance carriers.

Your Honor, today was originally scheduled as a Rule 16(b) scheduling conference, but with the consent of chambers and the stipulation among the parties here, we have agreed to go forward today as just a status conference only.

Your Honor, in connection with that the parties filed a join status report last Friday. A copy should have been included in your binder. If you don't, I have another copy I can hand up.

THE COURT: I do have that.

MR. OLIVERE: Okay, Your Honor.

Well, Your Honor, joining me is my co-counsel, Matt Heyn from the law firm of Klee, Tuchin, Bogdanoff and Stern. Mr. Heyn has previously been admitted pro hac in these cases and with the Court's permission I'll just turn it over to Mr. Heyn to go over the status and answer any questions you have.

THE COURT: Thank you.

MR. HEYN: Good morning, Your Honor. As my colleague said, Matt Heyn, from Klee, Tuchin, Bogdanoff and

Stern.

Your Honor, this is a adversary proceeding against twelve insurance carriers seeking damages for breach of contract, damages for breach of the duty of good faith, and declaratory relief.

Pursuant to Your Honor's order, we've continued the response deadline to the complaint until today. At our Rule 26(f) conference with the insurance carriers they indicated that they would be filing a motion -- one or more motions to dismiss today, which we will answer in five weeks, and a reply will be coming shortly thereafter.

We would propose that the Rule 16 scheduling conference be continued until about one month after Your Honor decides these motions to dismiss. Although they might not have made it in the binder, there was filed a joint status report signed off by all parties to this adversary proceeding agreeing to this -- this course.

THE COURT: Yeah. I did see that and that is fine.

MR. HEYN: If Your Honor has any questions, I'm happy to address them now. I -- I don't want to unfairly prejudice the defendants who may not be here.

THE COURT: No. I have no questions.

MR. HEYN: Thank you, Your Honor.

THE COURT: All right. Thank you.

MR. ROSEN: Your Honor, I believe that takes us now to Items 20 and --

THE COURT: 26.

MR. ROSEN: -- 26, that sounds about right, 26 and I will cede the podium to Mr. Etkin or Mr. Sherwood and Ms. Kaswan.

THE COURT: Thank you.

(Pause)

MR. SHERWOOD: Good morning, Your Honor.

THE COURT: Could -- could the operator mute the lines? We're getting some screeching. Thank you.

Go ahead.

MR. SHERWOOD: Your Honor, Jack Sherwood from Lowenstein Sandler. My partner, Mickey Etkin is here. Beth Kaswan, Chris Lometti and Craig Springer for the MBS plaintiffs.

This is our motion to allow the MBS claim as a Class 12 claim. This motion was initially filed before confirmation and was postponed until after confirmation by the Court and then adjourned a few times by the -- by the parties until today. Also, by stipulation with the debtors, we were allowed to file a reply by Friday at noon, which we filed.

THE COURT: I did get that.

MR. SHERWOOD: Your Honor, I think that reply and

our original papers pretty well lay out our position on this motion. But I would like to emphasize a few points.

First, Your Honor, when we talk about the stipulation of November 20th, 2010, which is a focal point of this motion, that stipulation permits the MBS plaintiffs to re-file their claims in the event there is a recovery for holders of allowed subordinated claims as that term is defined in the plan.

Importantly, Your Honor, that stipulation does not limit the form of the recovery under the plan and nowhere in that stipulation is there an agreement by the MBS plaintiffs with respect to classification of the claims once they are re-filed.

One of the interesting or important points is that the amended thirty-second objection to claims which gave rise to the stipulation didn't even raise the issue of subordination under Section 510(b), and neither did the seventh amended plan address subordination. So I think when you talk about the intent and the clear language of the stipulation, it's clear on its face and the Court should apply it as written.

The debtors argue that the term "recovery" has not kicked in yet. I'll call this the trigger argument.

THE COURT: Uh-huh.

MR. SHERWOOD: Has -- has the trigger occurred for

the filing of the proof of claim, and we think it's clear that it did. We cite to Black's Law Dictionary on recovery. It's a -- it's a pretty easy word to figure out. The trigger for re-filing the claim, Your Honor, was simply recovery, not a non-contingent recovery. There is no question, Your Honor, that there was a recovery to Class 18 under the seventh amended plan. We -- we make a number of arguments on that point in our papers, but I think there -- there are two very good ones that I would like to highlight.

The first is if you look at Section 1126(g) of the code, that provision provides that creditors who do not receive any property under the plan are deemed to reject the plan and they're not allowed to vote. Under the plan, the debtors here considered Class 18 to be an impaired and voting class, and if holders of Class 18 claims were not entitled to any recovery under the plan as the debtors now allege in the context of this motion, as a matter of law under Section 1126(g) they would have been deemed to reject the plan and not allowed to vote.

Now, consistent with that, Your Honor, the plan itself provides at Section 30.2 at Page 73, it describes impaired classes entitled to vote on the plan. And it says the claims and equity interests in classes -- and it rattles off a number of classes including Class 18 -- are impaired and are receiving distributions pursuant to the plan and

are, therefore, entitled to vote to accept or reject the plan.

Likewise, Your Honor, in this Court's solicitation order which was filed on January 13th, 2011, it says at Paragraph K on Page 4, that Class 18 is described as subordinated claims and it says "they are impaired and entitled to receive distributions under the plan."

So, Your Honor, the record is clear, by virtue of 1126, that the -- that Class 18 is receiving property under the plan, and by virtue of this language in the plan and the solicitation order that Class 18 is receiving a distribution under the plan. I think it's clear that that also means that they are getting a recovery under the plan and that triggered -- that the trigger has been triggered and the filing of the proof of claim was -- was warranted.

Next, Your Honor, let me turn quickly to the argument by the objectors that somehow, somewhere in a stipulation there is a presumed agreement to be in Class 18. And my first response to that, Your Honor, is that when you have a clear agreement you shouldn't presume anything. The parole evidence rule, the case law on contract interpretation makes it pretty clear that the Court should not read something into a contract that isn't there. And, here, there is nowhere in the stipulation where the MBS plaintiffs agree to Class 18 treatment.

Again, when you highlight, Your Honor, that the motion before the Court that gives right -- rise to the stipulation was a motion not -- that didn't deal with classification. It dealt with the merits of the claim. And what happened back in November of 2010 was that you had a situation where you had massive potential litigation to over claim that may or may not have been subordinated at the time, and simply the parties did what -- what parties do in cases like that is -- is the MBS plaintiffs chose to litigate that issue in the district court, fully reserving all rights here once the trigger occur -- occurred. But there was never ever an agreement to subordinate.

Your Honor, we -- we -- you know, we try to highlight that because this is a big case with a lot of things going on. And in this case the debtor sought and obtained agreements from various parties and we -- we referred to a couple of those agreements where subordination was sought and obtained by the debtors. So, certainly, if the debtors intent was to get us to subordinate back in November of 2010, they knew how to do that, but they didn't.

Your Honor, the -- we also -- we also cite the Court to the comments of debtors' counsel prior to confirmation in the context of the estimate -- the voting motion. We -- we cite to the quote where counsel says that all the debtor had dealt with up to that point in time was

whether the claim would ultimately be allowed or disallowed on the merits. And, Your Honor, I tried -- I've tried to make it clear every time I've gotten up here was that we never ever were seeking a full blown hearing on the merits of our claim, but we just wanted to know what class we were in before confirmation so that we could address that at confirmation.

But -- but what counsel said quite clearly was that the debtor never took the position at all as to whether they -- that's the MBS plaintiffs -- would be treated in Class 12 or Class 18. So when he stood here and said that prior to confirmation, he conceded that the debtors and the estate had not obtained a concession from us with regard to subordination.

Yet, in the context of this motion, Your Honor, the debtor suggests that they had obtained such a concession and that it was clear that those positions, frankly, are -- are very, very inconsistent. The debtor is also -- and the committee before the confirmation hearing suggested to this Court when we were trying to have the issue of the class of our claim heard and determined by the Court before confirmation, that the issue of whether we were in Class 18 or Class 12 was one that would require extensive litigation.

Again, Your Honor, that is a hundred-and-eighty degrees from the position that they now take that this

agreement in November of 2010 in the stipulation is somehow a clear indication that we agreed to be in Class 18.

If that was their position, Your Honor, I respectfully submit that they should have made that clear before confirmation. But for reasons that I think I've gone into before with Your Honor and -- in the papers, that's not something that they wanted to do. They deliberately took the position that we were in Class 12 for voting purposes so that they could turn around after confirmation, like they're -- exactly like they're doing now and -- flip-flop on the issue, which is interesting and creative, perhaps, but it's totally unfair and unjust to my clients.

Your Honor, just a couple more points on -- on -- you know, the fact that we didn't agree to be in Class 18.

First, the seventh amended plan requires entry of a final order determining that a claim is subordinated in accordance with the Bankruptcy Code and -- and that would be in plan Section 1.153, and no such final order was ever entered.

And then, finally, Your Honor, on that issue Paragraph 3 of the stipulation itself states that the parties reserve all rights in all other respects, other than those specifically addressed in the stipulation. The stipulation has a full integration clause, so, again, Your Honor, the stipulation should be read as its written and the

Court should not read anything into that concerning Class 18.

I -- at this point, Your Honor, I would like to turn to the Tranquility issue that -- that's addressed by the debtors' papers and -- and ours.

First of all, Your Honor, Rule 59(e) is -- is ignored largely by the debtors' papers. That is a high standard and it has to be something more than we forgot to argue it the first time. And the objection by the committee and the debtor or -- or the trust does not even try to -- try to address the Rule 59(e) standard. There was no newly discovered evidence. There was no newly discovered legal principle or intervening legal principle. It really is a case that the estate professionals basically said, wow. We should have -- we should have argued this SEC reg, but they didn't.

Now we -- we are -- we are raising the Rule 59(e) argument because we have it, but, frankly, Your Honor, we think Tranquility was right. And whether you did or didn't consider the SEC regulation, we think Your Honor would -- would decide the same way. And that is because the SEC regulation talk about who was a depositor and who was an issuer for SEC purposes. And, essentially, what that does is it sort of spreads liability beyond, you know, in this case the trust to other people who have the responsibility

for reporting and so forth.

But that's not why Your Honor -- Your Honor's decision in Tranquility and in Mobil Tool is based on the principle, which isn't changed in the least by the SEC reg, that here we had some -- some trusts that had pools of mortgages and the investors were not investing in a debtor or an affiliate of the debtor, which is what 510(b) says. They were -- they were investing in these pools of mortgages and they didn't enjoy the benefits of good performance by debtor or an affiliate or the -- or the risks of -- of bad performance by a debtor or affiliate.

There, the successor failure of their investment rose or fell based on the performance of the mortgages. And I think in the -- in the Tranquility opinion Your Honor gave the example of -- of a sale of Apple stock or a broker dealer selling dealer securities and suddenly bringing -- having that -- those types of situation bring 510 into play, and that certainly is not the intention of 510 and it shouldn't be applied, whether or not you consider that -- that SEC reg.

And, Your Honor, just to wrap that up, we also cited from, I think it's Judge Shannon in SemCrude where he made a -- a statement that is very applicable here, and that is that, you know, a word might have one meaning for SEC purposes where the SEC wants accountability and maybe to

spread responsibility for certain things, but another for 510 and -- and we think that Your Honor -- Your Honor's view of Tranquility and the purpose of 510 should continue to carry the day, if the Court has to get there because they haven't satisfied Rule 59(e).

Your Honor, let me just spend one -- one more brief period of time on -- on the reserve issue and the release. Of course, Your Honor, it's our view that that reserve needs to stay in place while we get to the bottom of this. The four-hundred-and-thirty-five-million-dollar reserve was put up by the debtor in a Class 12. It was their decision to do that, and that reserve must stand throughout the pendency of this litigation until it's litigated to a final order.

And I think if Your Honor reads the confirmation order together with the language of the plan, it is beyond dispute that unless and until this Court enters -- or this Court or some other Court enters a final order disposing of this claim, that escrow -- that -- that reserve needs to stay in place.

So, again, Your Honor, obviously we hope that doesn't become relevant for today's purposes, but if it does, we -- we think that the Court cannot order the release of the reserve because that would be a violation of the clear terms of the confirmation and the plan pursuant to

which the reserve was set up.

Your Honor, I -- if the Court has any questions, I -- I can answer otherwise I would maybe reserve some time on rebuttal.

THE COURT: You may.

MR. SHERWOOD: Okay. Thank you.

MR. STROCHAK: Good morning, Your Honor. Morning by just a few minutes till. Adam Strochak, Weil, Gotshal and Manges for the liquidating trust.

Let me start with a little background on our perspective on the stipulation issue and -- and the reasons why we agree to it in the first place and -- and why we think its intent is -- is quite clear from the language of the stipulation as well as the circumstances under which it was entered.

We knew fairly early on in this case that -- that timely distributions were going to be critical and that in order to achieve timely distributions, in order to -- in addition to getting past confirmation, which took longer than anyone hoped or anticipated, that we were going to need to make progress in the claims process because we -- we were fundamentally going to have a limited fund and there were going to have to be certain reserves and those reserves would -- would cause delays in distributions to -- to credit -- to holders of allowed claims.

So we needed a priority throughout the case to move as quickly as we could through the claims process and -- and, obviously, as Your Honor is aware, we -- this is not a case where we sat back and waited until the plan got confirmed to -- to really make significant progress in objecting to -- to claims and -- and moving through the claims resolution process. So -- so that was really a quite critical issue early on.

When we filed the initial objection and then resolved the initial objection to the MBS plaintiffs' claims, we had a plan out there that provided for a contingent distribution to subordinated creditors with a very wide range on it of somewhere between zero and a hundred percent recovery.

So what we agreed to with them was a stipulation that provided for the withdrawal of their claim. We didn't simply stay the claims litigation process. We didn't just agree to a standstill. We -- we worked out a stipulation that provided for the complete withdrawal of their claims with a right to re-file in the event there was a recovery for -- for subordinated claims.

And we think it's quite clear when you look at the stipulation as a whole and when you look at all the circumstances under which it was entered, that implicit in that and that the only reasonable way to interpret the right

to re-file language is that the right to re-file would -- would only apply to a subordinated claim. Otherwise, the language regarding the timing of re-filing; that is, if there is a recovery for subordinated claims, really makes no sense at all.

If the -- if the plaintiffs were taking the position that -- that -- that they were entitled to a general unsecured claim, then it would have made sense to proceed with that litigation and get to the point where there was a judgment resolving their claim one way or the other rather than deferring it until it became clearer what the ultimate recovery for -- for subordinated creditors would be.

The withdrawal has -- has meaning and -- and to interpret the stipulation the way the plaintiffs are suggesting now really -- really guts the meaning of the stipulation from our perspective and what it achieved from our perspective.

So fast-forward to -- to the current -- the plan that was actually confirmed and we have a plan that -- that provides for subordinated creditors much the same way as the plan that was on file at the time of the stipulation. The plan confirmed by the Court provides for a distribution of -- of liquidating trust interests to subordinated creditors if -- it's a contingent distribution -- if we ever get to

the point where there's sufficient value to clear what's ahead of them in the waterfall. So it's a wholly contingent right to receive liquidation trust interest at a time in the future in the event that the waterfall satisfies all -- all claims ahead of them.

So -- so when you compare what was on file at the time of the stipulation and -- and what we actually ended up with in a confirmed plan, there really is no difference from -- from the perspective of the stipulation and what the stipulation achieved for the debtors.

So the interpretation that the -- that the plaintiffs are now offering is one that basically says, well, there really was no bargain for -- for the -- for the debtors; that is, we -- we had the right to re-file at any time.

So while the debtors gave up their right and the creditors' committee and every other party interest -- party in interest in the case, while they -- they gave up their right to proceed in a timely fashion with adjudication of this claim so that it could be resolved and not present any -- any difficulties for distributions to creditors on account of any reserve or -- or any other issue -- that's what the debtors got -- that the -- that the plaintiffs, essentially, had the right to vitiate that bargain at any time. They could come in at any time and say, well, you

know, the plan provides for a contingent right of distribution to subordinated creditors. Therefore, there's been a recovery and we can go ahead and -- and move forward with -- with assertion of our claim.

And --

THE COURT: Mr. Strochak --

MR. STROCHAK: Uh-huh.

THE COURT: -- does the plan provide that liquidating trust certificates are not distributed now, but only after the waterfall is satisfied?

MR. STROCHAK: That's my understanding, Your Honor. Yeah. I'm getting a lot of head nods that I got that one correct.

THE COURT: Yeah.

MR. STROCHAK: So there's no actual distribution of certificates at this time and while the liquidating trustee, the trust advisory board, and -- and everyone else who is involved in the process is obviously working as hard as they can to get distributions as far down the waterfall as -- as is possible, at this point we don't know whether there ultimately will be any trust certificates distributed.

So we -- we made this point in our papers, Your Honor, on the -- on the definition of recovery and in the stipulation, of course. As interpreting that stipulation one question for the Court is, well, what does it mean for

there to be a recovery, and I think, you know, Your Honor's question suggests exactly where -- where we think it is, is that nothing has been distributed at this point in time, so, therefore, there's no recovery.

The plaintiffs' have cited Black's Law Dictionary and they actually cite the second definition in Black's. The first definition that Black's offers for recovery is -- is regaining or restoring something taken away. Well, under our plan and -- and, you know, obviously, everybody wishes it could have been better. But -- but nothing has been regained or restored at this point. The subordinated creditors, to the extent they had claims, be they disputed or -- or fixed, to the extent that they had claims, they have received nothing on those claims until some as yet undefined point in the future hopefully; a bit of a hope certificate on -- on those.

And they cited the Enron decision, which while not directly on point and I don't suggest that it was directly on point, provides a useful analogy. In Enron there was an objection to -- to distributions -- excuse me. There was an objection to the plan on the grounds that it was providing property to -- to a subordinated class or to a shareholder class, when what the plan said was that it would be a contingent right of distribution should -- should distributions clear the rest of the waterfall.

And -- and Judge Gonzalez, I believe, overruled that objection and said, no. This doesn't violate the absolute priority rule. There's no distribution being made. It's simply a contingent right to get something in the future should -- should the waterfall fill the rest of the -- of the recoveries. And it's an analogous situation here.

So you may be asking, Your Honor, what -- what's the harm in being early. We often complain that people are late and the Bankruptcy Code has a -- Bankruptcy Code and the case law, of course, has well defined standards for under what circumstances we'll allow somebody to assert a right if they -- if they're late. But what's the harm in being early?

Well, here the harm is that it would vitiate the bargain that we struck on -- on the stipulation; that we bargained for the withdrawal of that claim so that we would not have to deal with reserves, that we would not have to deal with litigation of these issues unless and until there was actually recovery for subordinated creditors. And it has a very real effect on the other creditors of the estate, on senior creditors of the estate.

There was -- I think -- I think Mr. Sherwood may have misspoken unintentionally. The reserve is not $435 million, you know, cash set aside. That's not the way the reserve works under our plan. The way the reserve works is

-- is that we have to reserve for the claim as if it were an allowed claim in the amount of 435. So all -- all claims, all disputed claims are reserved for as if they were allowed in that amount and then that is calculated in accordance with the holdbacks and everything else.

The effect of reserving as if they are an allowed claim is -- is quite significant due to the accruance -- the accruing of post-petition interest, continuing accrual of post-petition interest on claims -- on allowed claims that have not received their distribution, and has a particularly dramatic effect due to the Court's rulings with respect to the pay-over requirements of the contractually subordinated creditors, in particular the peers.

So we have those in our papers and -- and, you know, the rough calculation is that -- that continuing to reserve for the MBS plaintiffs' claim as if it were an allowed claim of 435 million essentially incurs $700,000 per month in additional post-petition interest expense because -- because that money, what's held back, can't be distributed to holders of allowed claims and the interest continues to accrue on what has not been distributed on their claims.

The effect is much more significant on the peers due to the contractual pay-over requirement. The peers, while they accrue interest at the federal judgment rate in

accordance with the Court's order, they pay-over interest to senior creditors at the contractual rate. So the effect on the peers is to reduce their recovery by -- by about $2 million a month. So it's a quite significant effect on -- on all creditors of the estate and a very dramatic effect on the peers to continue to have to hold the reserve for -- for the MBS claim.

Let me comment briefly on the assertion that we somehow, I guess, sandbagged them and -- and that the comments made in connection with the temporary allowance motion at the time of confirmation are some type of admission that -- that we never expected that -- that the stipulation would limit them only to a subordinated claim.

It's always been our position that the -- that the stipulation limited them to a subordinated claim. We just didn't expect them to agree with it, and, obviously, they haven't. The temporary allowance motion, Your Honor remembers, was -- came before the Court on the MBS plaintiffs' application to -- to temporarily allow their claim into a Class 12 for voting purposes. They asked for it in Class 12 and we looked at the circumstances and said, okay. We can agree to that.

And -- and then they took a step back and said, well, we're not sure we really want what we asked for. We're afraid that you might ultimately try and subordinate

us, so what we really want is by -- by giving us temporary allowance in Class 12, there ought to be a final determination that -- that for distribution purposes we're in Class 12. And we stood up and said, no. That's not what temporary allowance is about.

And Your Honor ultimately agreed with us that -- that there was not going to be a determination of -- of the classification for distribution purposes at the time of confirmation; that that was an issue for later, and that because the plaintiffs had asked for temporary allowance in Class 12, it was appropriate to give them temporary allowance for voting purposes in Class 12, notwithstanding the fact that down the road there was going to be a dispute over whether it was a general unsecured claim or a subordinated claim, both under the stipulation and should we clear the stipulation under -- under 510(b) which would -- which would need to be adjudicated.

And while the MBS plaintiffs contend -- contended that that was unfair, Your Honor ultimately ruled that it was not unfair; that creditors all the time bear the risk that they might later be subordinated due to -- due to the application of 510(b) or other principles of subordination. So that's where we were on that.

Let me pause on the 1126 argument that -- that Mr. Sherwood made in his remarks. He is suggesting that -- that

under 1126 creditors who didn't get property would be deemed to reject and, therefore, if we go back to the question of recovery, has there been any recovery at this point for subordinated creditors that would allow reassertion of the claim, that we should look to 1126(g) for guidance.

We certainly could have, under 1126(g) said that there's no distribution to subordinated creditors. It's only a contingent right in the event we clear the waterfall later. So we'll just deem them to reject the plan and -- and effectively cram down over them. But that wouldn't work under our plan, Your Honor.

Your Honor, we worked for -- for three years to try and get a recovery to -- to shareholders. We had enormous litigation over that and we ended up with a -- with a plan that was the product of really an extraordinarily -- extraordinary compromise and we wanted anyone senior to shareholders to vote in order to -- to confirm that plan without having to deal with Armstrong issues or absolute priority issues or anything else.

And, ultimately, we did get to vote. The plan was confirmed in history. That's obviously very familiar to the Court. So that's the reason why we proceeded that way. I think we probably could have gone either way under 1126 and that's why we opted to go the way we did.

Let -- let me turn if I could to merits of the

subordination argument and -- and start with the reconsideration aspects. We're here on a different claim now, Your Honor.

Tranquility had not filed a lawsuit before asserting its proof of claim. The plaintiffs here obviously had. There certainly are similarities in the claims. There are common issues. There are also very different issues. The bulk of Tranquility's claim was asserted under California State Securities law. They only had a handful of -- of tranches subject to federal law, and as Your Honor is familiar from the opinions and the history of that matter.

Even if we were to look at this through the lens of reconsideration, what the plaintiffs are trying to do here is to -- is to say that the Court's ruling on the Tranquility matter is absolute, final law of the case, never get to look at it again. But that's not what the law of the case doctrine is about, Your Honor.

The law of the case doctrine is about when a matter is -- is kind of firmly settled, that it's going to govern for the rest of the case. There is no conceivable way that the Tranquility matter could be considered resolved or settled as a matter of law. We had a timely motion for reconsideration of the Court's decision pending, which the creditors' committee had filed and which the debtors had joined. That matter was pending when we reached a

compromise to resolve the Tranquility claim.

But the issues that were raised in the reconsideration motion had not been adjudicated. That motion was still pending. The MBS plaintiffs intervened in that motion so that they could be heard on it, on the merits presumably because if all they were going to do is step up and say, too little, too late, Your Honor, that's certainly an argument that Tranquility could have and -- and I'm sure would have made had we -- had we litigated that motion before -- before settling the claim.

So the matter is not settled. The motion for reconsideration remains pending and there is absolutely no reason that the Court should not address that -- that is, should it reach the subordination issues, there is no reason that the Court should not address it in full and address all the substantive issues that -- that are before the Court.

Even if the Court were to look at it through the lens of reconsideration, our argument, Your Honor, is that the Court's decision on -- on subordination is -- falls into the category of a clear error of law that ought to be corrected, and it's obviously with -- with all due respect to the Court that -- that we suggest that.

You know, having read the opinion when it came down and the Court's reasoning, it became apparent to the creditors' committee and to the debtors that -- that

Tranquility had led the Court to an incorrect decision as a matter of law and that it was really incumbent on us, on behalf of the estate, to raise that and -- and make sure that we put before the Court all the information necessary so that -- so that -- in our view it was an error and if the Court concluded it was an error, it would have the benefit of all -- all the reasoning and rationale before it before that decision became final.

The fundamental left turn that we think Tranquility made in its analysis and -- and ended up in the Court's opinion was the distinction between issuer and issuing entity. And this becomes clear in looking at the MBS plaintiffs' amended complaint in the -- in the Western District of Washington action as well as their amended proof of claim asserted here.

In the very beginning of the amended complaint, the plaintiffs talk about their action on -- on securities issued and served by -- by WaMu Capital, the underwriter, in conjunction with the depositors of the -- of the mortgage assets into the trusts: The Washington Mutual -- excuse me -- WaMu Asset Acceptance Corporation and Washington Mutual Mortgage Securities Corporation.

That filters through into the amended proof of claim that they've asserted here where it alleges quite clearly in Paragraph 134 -- it takes a while to get to it.

But in 134 they make it, you know, quite clear the allegation that -- that WaMu Asset Acceptance Corporation served as the issuer of the mortgage-backed securities that -- that the plaintiffs purchased.

It becomes even clearer in looking at the -- at the complaint as a whole; that is, in the Western District of Washington the plaintiffs didn't sue the trusts. They didn't sue the trusts at all. They sued Washington Mutual Asset Acceptance, Washington Mutual Capital Corporation. Their claim; that is, their fundamental allegation that there has been illegality in the issuance of the securities that they purchased, that claim is one that is asserted against, among other entities, the depositor, not the trust.

And the reason for that is -- is because of -- of the principles under the securities law that we have -- that we have laid out -- the creditors' committee laid out in its motion to amend and we have incorporated into our response to the -- to the pending motion for a determination that -- that plaintiffs have filed for a determination that this claim is essentially not subject to subordination. What they're really seeking now in the pending motion is a declaration that -- that their claim is not subject to subordination as a matter of law.

And, you know, we've looked at that and concluded, much for the same reason that we did in -- in conjunction

with Tranquility where we went ahead and Tranquility had objected and -- and said that, no, you shouldn't deal with subordination now, Your Honor. We asked the Court to address subordination and for the same reason that we did in conjunction with Tranquility, we think it's appropriate for the Court to -- to address it here and now should it -- should it reach the issue and not resolve it based on the -- on the stipulation.

So -- so what's the error in the Tranquility analysis and why should -- should the result that the Court reached in the Tranquility opinion not pertain here?

The real issue, obviously, goes back to 510(b) as it must. What we're -- what we're talking about is fundamentally a question of statutory interpretation and Section 510(b) says that -- that we subordinate a claim that arises from the purchase or sale of a security of the debtor or an affiliate of the debtor. It doesn't say a security for which the debtor or the affiliate is the issuing entity. It says, a security of the debtor or an affiliate of the debtor.

And the problem is this distinction, this artificial distinction that says, well, if it's a security for which the affiliate is the issuing entity, then -- then no subordination. If it's a security for -- if it's a security of an entity that's the issuer, then -- then, yes,

subordination. And it's that distinction, that fundamental distinction that we think is the -- is the error.

We have a situation here where the securities laws provide quite unambiguously that -- that the issuer of mortgage-backed securities is the depositor that deposits the mortgages into the trust. The trust is merely a conduit. The trust holds the mortgages, distributes the principal and interest payments, works with the servicer to make sure the mortgages get serviced. But it's really a conduit entity, and it's the -- it's the depositor, for securities law purposes, that's the issuer. It's the depositor who is involved in the issuance of the security and it's the depositor who the plaintiffs have asserted is responsible for illegality in the issuance of the -- of the securities.

Your Honor's opinion discussed the circumstances of, well, let's think of the debtor or the affiliate was just an underwriter or a broker and all it did was sell stock of some third party company. I think Your Honor used Apple --

THE COURT: Uh-huh.

MR. STROCHAK: -- in the decision. So -- so why should this be any different. And the reason why it's different, Your Honor, is because of the securities laws and because we're dealing with mortgage-backed securities here.

This is not a situation where -- where we have truly a -- a completely third party security that has nothing to do with -- with either the debtor or the affiliate. This is -- this is mortgage-backed securities. We live under a different regulatory regime that -- that concludes that it is the depositor that is the issuer of the security.

So while it's undisputed that Apple would be completely unrelated to this estate in the hypothetical, the same conclusion cannot be reached as to -- as to the issuer of the securities for securities laws purposes. And the issuer -- excuse me -- the issuer under securities laws, the depositor, Washington Mutual, WaMu Asset Acceptance Corporation is undisputedly an affiliate of the debtor in this case. I don't think the plaintiffs have disputed that and I think it's -- it's quite clear from the record that -- that that's the case.

So we have a situation where under the securities laws WaMu Asset Acceptance is the issuer. It is the one charged with responsibility for ensuring that the issuance of the securities is legal. The plaintiffs are asserting claims in -- in the Western District of Washington against WaMu Asset Acceptance, and WaMu Asset Acceptance is indisputably an affiliate of the debtor at the time of the issuance of the securities.

So when you add all that up, we end up with a situation that quite clearly demonstrates that the Court's conclusion that -- that neither the debtors nor their affiliates are issuers in -- in reaching its decision on subordination, and that's a quote from Page 20 of the Court's -- of the Court's opinion. But that seems to us to be quite contrary to what the securities laws provide and -- and we think leads inevitably to the result that these claims, the MBS amended claim, must be subject to subordination under Section 510(b) should we -- should we get to the subordination issue on the -- on the merits.

I've struggled, Your Honor, and I can't find any principal basis to come to the conclusion that the purposes of Section 510(b) would be served any differently or there should be any distinction between whether a claim is asserted against an issuing entity or an issuer. I don't see any principal basis to make a distinction why the policies of Section 510(b) would be applied any differently to -- to a claim whether it's -- whether it's against the issuer or whether it's against the issuing entity of the securities. It just doesn't make any sense to me under 510(b), and I've searched and scoured the case law and the commentary for a rationale why they would be treated any different and I -- and I simply can't -- I can't find any, nor have the plaintiffs articulated any.

The real issue is -- is as Slane and Kripke (ph) made clear and all the rest of the commentary and much of the case law makes clear is, you know, are we in a situation where the risk of illegality in the issuance of the security should be shifted in some way. And it -- it seems, you know, patently clear here that -- that where the code very specifically provides that -- that we subordinate not just claims associated with the purchase or sale of equity securities, but also debt securities. That's perfectly clear from the statute. Your Honor has already ruled that way in connection with the WMB bondholders' disputes.

Where the statute makes the distinction between equity securities and debt securities and where the statute clearly provides that subordination is applicable to securities of affiliates as well as securities of the debtor. We are not in a world where we are talking about who bears the risk of illegality of issuance as between -- as between the purchasers of the securities and equity holders of -- of the company as you would be in a traditional, you know, stock subordination argument.

This is not that circumstance. This is the circumstance where we're talking about the risk of illegality in issuance and whether a claim should be treated pari passu with general creditors of the estate or whether it should fall below general creditors of the estate.

And for all the same reasons that -- that subordination is there, we have a situation here where the plaintiffs have a separate set of assets. Their rights are the mortgage-backed securities and the mortgages that provide principal and interest payments for those securities where those assets are separate, where -- where there is no assertion whatsoever that those assets would be available for distribution to general creditors of the -- of the holding company estate. Those assets are gone from the system so to speak. They're in the trust and the general creditors of the estate have no access to those, nor do they have any right of upside in the value that the -- that the plaintiffs acquired when they bought their securities.

If the mortgage-backed securities that they acquired did really well, if they had been underpriced in the market, if they had been purchased for 100 cents on the dollar and the market value increased to 105 cents -- I'm just -- I'm just pulling a hypothetical here -- that increase in value would have been solely for the plaintiffs to -- to enjoy. It would not have gone back to creditors of the estate in any way, shape, or form.

So for all the same reasons that you would subordinate claims relating to the purchase or sale of equity securities, it's equally applicable here because they enjoyed -- the plaintiffs enjoyed all of the upside here.

Just like the acquirer of stock would enjoy all the upside in the value of the company, the acquirer of these securities enjoyed all the upside in the value of the mortgage-backed securities.

And for those reasons there -- there simply is no policy basis to distinguish here between a security of an issuer, which is -- which is what we have here, or a security of an issuing entity. We just don't see the basis. And because -- because we do have securities of an issuer, WaMu Asset Acceptance, and because that issuer for securities law purposes is an affiliate of the debtors, the plain language of 510(b) requires -- requires subordination in this case.

Let me turn to the reserve just briefly, Your Honor. The plaintiffs are kind of standing general appellate principles on their head with respect to the reserve. The -- there was no assertion or no suggestion and no contemplation in the plan that should the Court conclude that a claim is not in a particular class, that we would have to continue to reserve in that class for the claim.

The Court has ample authority to order release of the reserve under the -- under the confirmation order. We have -- we specifically set up the reserve process in a way that we could come back and estimate claims, if we needed to. If we had a claim that was -- that was resulting in

prejudice to the parties on account of the reserve, that we could always come back and estimate the claim in order to -- in order to address that issue.

And the suggestion that we would have to keep the reserve in the wrong class, should the Court rule that the claim is subordinated, until the end of the appeal process, essentially, gives the plaintiffs the right to go off, file appeals. We could go all the way to the Supreme Court and it could take years to get that reserve released. To suggest that the Court is without authority to order the release of the reserve is -- is not consistent with -- with a prompt resolution of the estate or anything else in the plan or the confirmation order.

Now, certainly, if -- if the Court decides to release the reserve, the plaintiffs have the right to come back and say, we're going to appeal, Your Honor, and we would like a stay. We would like to maintain the status quo pending appeal. The rules provide an adequate mechanism for that and there's no reason that they should not be required to bond the costs to the estate of maintaining the reserve. And as I've articulated, it cost $2 million a month to the peers' recovery, $700,000 overall in increased interest payments by the -- by the estate.

And if we get to the point where the reserve is released and the plaintiffs appeal, then this issue can be

adequately dealt with in the context of an application for a stay pending appeal, and the Court's determination of what would be an appropriate bond on that -- on that appeal, given the detriment to the estate and other creditors of continuing to hold the reserve.

I'll stop there, Your Honor. I know Mr. Johnson probably wants to say a few words on behalf of the creditors' committee, unless you have any questions?

THE COURT: No. Thank you.

MR. STROCHAK: Thank you.

MR. JOHNSON: Good afternoon, Your Honor. Robert Johnson from Akin Gump on behalf of the official committee of unsecured creditors.

And before I begin, I would like to disclose that the liquidating trust has engaged Akin Gump for certain limited purposes, including advising the trust advisory board. But I'm here today on behalf of the creditors' committee, the creditors' committee which made the motion to alter, amend the Tranquility decision. We will be filing an amended 2014 statement shortly regarding that other engagement.

Also, before I begin, I'm going to make reference to a diagram which comes from the MBS plaintiffs' proof of claim. It's Page 59, Claim 4069. May I approach and hand up a copy?

THE COURT: You may.

Thank you.

MR. JOHNSON: Your Honor, I'll begin with the stipulation and order point. Much has been said on that already, but I just want to highlight a few points.

As -- as the liquidating trust has argued, there was no recovery of actual property to Class 18 at the time of the sixth amended plan nor now with the seventh amended plan. And so that's why we see that the stipulation and order that was entered into in November 2010 made sense; that if you were to interpret that stipulation and order as saying that there was already at that time a recovery to allowed subordinated claim, the MBS plaintiffs could have immediately re-filed their claim.

It only makes sense in the context of the mandatory subordination of mortgage-backed securities to other bonds that would place them in Class 18 that would then make sense to put off the litigation of the merits of the MBS plaintiffs' claim at that time in November 2010.

So we contend that -- that there was -- because there was no recovery at that time, and there has not yet been a recovery to Class 18 at this time, that it's inappropriate for the claim to be filed at this time.

The plaintiffs have accused us of playing fast and loose with them with regard to the debating, but it simply

isn't so. As the MBS plaintiffs have -- have alleged, as they have argued under Section 1126(g), if they were going to get no recovery, they would have been deemed to reject. They wouldn't have had to vote. They could have stayed in and -- and agreed to be in Class 18, as certain other securities fraud plaintiffs did, and they they could have voted in Class 18. But they choose not to do that.

Then when they came back in after the Tranquility decision and they filed their claim, they then, in my opinion, overreached by saying they wanted to be adjudicated to the Class 12 for all purposes, not merely for voting, but for all purposes. And we said at that time, if you want to vote in 12, we're happy to let you vote in 12, but you can't be adjudicated with a -- a shortcut approach. You have to be in Class 12 for all purposes. And on top of that it's quite clear from the stipulation and order that there had been no recovery to Class 18, still there's no recovery to Class 18, and that they belong in Class 18.

We also very clearly articulated that we, the creditors' committee, disagreed with the Tranquility decision. We had made the motion to alter or amend on January 3rd and we felt that when the time was appropriate, we would be able to make the arguments to Your Honor to explain why we believed that that Tranquility decision did contain an error of law and fact, and that it would cause a

manifest injustice to the creditors who were in Classes 2 through 16.

As to the issue of whether the claim was to be filed as a Class 12 or as a Class 18, there's just no such thing on a proof of claim. A proof of claim form has a box that you can check if you have a secured claim and it's got a box that you can check if you have a priority claim. But there's no place to put on a proof of claim form that this is only going to be filed a subordinated claim. So there's -- that argument is just a red herring, Your Honor.

I would like to move onto the subordination point and to -- to the Tranquility decision.

First, the plaintiffs have argued that we don't have an appropriate basis under Rule 59(e) for the motion to alter or amend. And I would like to highlight, Your Honor, this is not a new argument. The creditors' committee has consistently argued that the mortgage-backed securities at issue were the securities of WaMu Asset Acceptance Corp.

What happened, however, was during the argument, nobody made reference to Section 2(a)(4) of the Securities Act or Section 3(a)(8) of the Exchange Act. But this is a securities fraud case. The plaintiffs are making a claim under Section 15 of the Securities Act and you have to look at the statute under which a cause of action arises to look at the definitions.

And the definitions that are in the Securities Act provide very clearly in Section 204 and in Section 3(a)(8) that the depositor is the issuer. So for purposes of securities fraud, it's the depositor here, WaMu Asset Acceptance Corp., which is the issuer of those certificates, which we then served through the underwriter, WaMu Capital Corp, done through the investors.

And you'll see on the bag, ma'am, that the trust is below. The mortgage lines are transferred into that trust and then the certificates transfer up to the depositor. The depositor then transfers those to the underwriter and the underwriter sells them to the investors. So you can see from this arrangement that here -- and this is in the plaintiffs' own proof of claim -- it's the depositor here that's at issue.

Your Honor, the Max's Seafood case is a case that we put in our pleading to call to the Court's attention that the Third Circuit has said that if an argument -- that the Court must consider, on a motion to alter or amend, an argument, even if the argument had not previously been made. We had argued that the depositor was the issuer. It's just that those citations hadn't been provided at that time.

And I regret that those citations had not been provided to the Court at that time. It certainly would have made things a lot clearer if we had provided citations to

2(a)(4), 3(a)(8), Securities Rule 191, Rule 3(b)(19) and Regulation AB. Believe me, Your Honor, I did a lot of homework between December 20th of 2011 and January 3rd when we filed our motion to alter or amend.

But, unfortunately, Your Honor, in -- in the Court's decision with the sentence that says, "neither the debtors nor their affiliates are the issuers of the certificates," and that is the error that we wanted to call to the Court's attention because under the securities laws, which is at issue for a securities fraud case, it's the depositor that is the issuer, and that is WaMu Asset Acceptance Corp.

Now this is also what distinguishes this case from SemCrude that Judge Shannon decided. In SemCrude what Judge Shannon had before him was a limited partnership and he looked correctly at the Bankruptcy Code and said that the definition of affiliate did not include a limited partnership.

But here, the definition of an affiliate under the Bankruptcy Code clearly does include a corporation that is owned by WaMu Bank and that, in turn, is owned by WaMu, Inc. So here we do fall within the definition of an affiliate and that is what distinguishes us from the SemCrude decision.

It also distinguishes us from the analogy of Apple stock because what we have here in this diagram shows that

what -- what we have are mortgages that were originated by WaMu Bank, transferred down to this depositor, and then there was the securitization process to the investors. That's a far cry from a situation in which WaMu Capital Corp might be buying the stock of a completely unrelated entity. These are related entities as shown in the diagram that the MBS plaintiffs provided. And that shows why it's so different from Apple stock.

I would also like to point to the issue of the equity risk and the policy arguments that were made by the parties and by the Court with respect to 510(b). And what's important here is that it's not a question of acquiring an interest in the affiliate of the debtor when you're talking about a bond as opposed to a stock.

So just as those people who purchased the bonds of WaMu Bank did not acquire an equity interest in WaMu Bank, and yet their bonds were subordinated. The Court properly found that bonds that were issued by this entity, WaMu Bank, which is an affiliate of WaMu, Inc, those are subordinated with respect to WaMu, Inc's creditors. They are subordinated to the creditors of WaMu, Inc. So it's not a question of the equity interest in that entity. It's a question of the bond being subordinated to other bonds.

I would like to speak about the harm to the estate and to the creditors. As the liquidating trust has pointed

out, the clip of 435 million in reserve at the federal judgment rate gets to $700,000 a month, and so that's a true out-of-pocket expense to the liquidating trust. Of course, the peers suffer even more because due to their contractual pay-over requirements, they have to pay up to the more senior creditors, and so with respect to them, the cost is 2 million a month.

Your Honor, there may have been a mistake with respect to the citation or the lack of citation of the particular elements of the law and the prior arguments that were made, but there's no reason why that mistake now should inure to the detriment of these creditors.

I would also like to address the issue of the reserve. It simply makes no sense to require a reserve of cash if the Court determines -- which we respectfully submit the Court will after considering our arguments and our provision of the authority regarding the Securities Act and the regulations. It simply would make no sense to reserve cash for a claim that, as a matter of law, must be a subordinated claim.

We think that what would make sense would be that when we got to the point that liquidating trust interests were being distributed to other allowed subordinated claims, if at that time the MBS plaintiffs' claim is still contingent, if it's still undetermined, if it's still

unliquidated, then there could be a reserve of liquidating trusts' interests in the tranche that corresponds to Class 18 at that time. But there's no reason to hold up $435 million in cash which should be distributed to holders of claims in Classes 2 through 16 if there's no possibility that the MBS plaintiffs will end up with a claim that's in Class 12.

And so, finally, just to sum up, Your Honor, with respect to law of the case, law of the case, of course, is a discretionary doctrine and, Your Honor, we have made it quite clear from as soon as we -- we received the Tranquility decision through our motion to alter or amend that we disagreed with that. We take the position that the Tranquility decision was not a final decision because we had made the motion to alter or amend and it had not been decided.

We also believe that Your Honor should exercise her discretion not to apply law of the case with respect to Tranquility, but to find the law of the case that should be applied here is the law of the case with respect to the bank bondholders. It's that the bonds of an affiliate of the debtor must be subordinated to the other bonds.

Thank you, Your Honor.

THE COURT: Thank you.

Reply.

MR. SHERWOOD: I'll try to keep my remarks limited to reply.

First, Your Honor, let me just reemphasize that the extrinsic facts and circumstances and -- and so forth at the time of entering into the stipulation are irrelevant when the terms of the stipulation are clear; and clearly here they don't address classification; and clearly here they use the word "recovery" as opposed to actual recovery; and clearly here you have the debtor acknowledging that there was a distribution to Class 18 and that Class 18 received property.

But, Your Honor, if you're going to --

THE COURT: Well, I -- I think they said they did not. There was no issuance of litigating trust certificates to Class 18.

MR. SHERWOOD: They said that, but as a matter of law Your Honor can and should find that Class 18 received property under the plan because that's what would have to happen in order for Class 18 to vote and not be deemed to reject under Section 1126.

And, furthermore, Your Honor, it's really in black and white in the debtors' plan. The debtors' plan says that Class 18 is impaired and receiving distributions pursuant to the plan. That's a recovery. A distribution is a recovery and property is a recovery. And for them to start splitting

hairs now on what the meaning of a recovery is in order to keep us from filing our proof of claim --

THE COURT: Well, I'm -- I'm not sure anybody in Class 18 would say that they've gotten a distribution or any recovery as of today.

MR. SHERWOOD: Okay. Your Honor, that raises another good point.

First of all, at the time of the stipulation, the plan that was on file at that point in time was not confirmed. And more importantly, Your Honor, at that time the plan that was on file, and I think the second -- which was not confirmed, and I think the second plan that was not confirmed did not provide for the substantial return to equity that the seventh amended plan provides.

So that is an additional fact and circumstance that the Court should consider. If you think about it, if you want to go back and try to figure out what the facts and circumstances were back in November of 2010, there was no -- there -- there's 100 million-plus of return to equity under the seventh amended plan.

THE COURT: Why is that relevant?

MR. SHERWOOD: Because from the perspective of Class 18, a return to equity is very relevant. A 100 million -- if I'm sitting in Class 18, Your Honor --

THE COURT: Okay.

MR. SHERWOOD: -- and I see no -- a contingent recovery to my -- my constituency, my claim.

THE COURT: Yeah.

MR. SHERWOOD: Yet, I see below me a 100 million-plus recovery to equity, that's -- that's very important from the perspective of a Class 18 holder.

THE COURT: And they voted.

MR. SHERWOOD: Who voted?

THE COURT: Class 18.

MR. SHERWOOD: Class 18 voted and I think, Your Honor, if you look at Class 18, each and every member of Class 18 who voted got some other type of plan consideration under this plan. They got -- you take Tranquility, okay. Tranquility got like a nine-million-dollar Class 18 claim, but they also got a nine-million-dollar Class 12 claim provided they vote in favor of the -- of the plan.

You look at it -- there was another group. They got their counsel fees paid provide -- and, again, provided they vote in favor of the plan. And then there was Mr. Stark's clients who was -- was thrown a Class 18 claim along with substantial other consideration provided they vote in favor of the plan.

So, yeah, they voted and we didn't vote in Class 18 because -- because Your Honor had decided Tranquility. They had indicated that --

THE COURT: Well, you indicated you wanted to vote in Class 12.

MR. SHERWOOD: Correct. But at the same time, Your Honor, we indicated that if we were not going to be in Class 12, it would be nice for us to learn that that was the case before we voted. And, Your Honor, we -- we pressed that issue. We pressed that issue on multiple occasions and -- for the -- for the exact reason that we didn't want to be standing here today saying, Judge, we voted Class 12 and they're trying to put us in Class 18 under this stipulation, and because they want to overrule Tranquility --

THE COURT: But I overruled you on that. I did not decide the classification or amount of your claim for anything other than purposes of voting. And all parties rights were reserved to argue that.

MR. SHERWOOD: That's right. I'm not -- that happened and -- and it happened over my -- over my objection.

But it -- but I think it's something that I would -- would hope that the Court would consider at this point in time because I don't -- I don't think I would have done it any other way, even looking back. Your Honor had decided Tranquility. If -- I mean, what gets me about it, Your Honor, the change of position is what they're saying here is that this -- that this trigger has not occurred, and they

could have said that before confirmation. They could have asked Your Honor --

THE COURT: I think they did say.

MR. SHERWOOD: They could have asked Your Honor to reconsider and rule whether you're going to reconsider Tranquility before confirmation.

THE COURT: but -- but they didn't. They had a lot of other things going on and the whole purpose really of the stipulation was to not decide those issues. Wasn't that the purpose of the stipulation?

MR. SHERWOOD: No. Not from our perspective.

THE COURT: Well --

MR. SHERWOOD: Your Honor, the purpose of the stipulation, the solicitation procedures -- I mean, basically, what we did is we followed the procedures that were set forth by the debtor to a T. And they said if you have filed a proof of claim and you want to allow that claim not just for voting purposes, but also for classification purposes to file a motion, which we did, and we filed a -- we said -- we contend that we have a Class 12 claim for like two-hundred-and-some-million, then we amended it to the 435. And it was incumbent upon the debtor at that point and the estate, if they had a clear view -- I'm just -- I'm just --

THE COURT: I know what your argument was, but I did overrule you on that point.

MR. SHERWOOD: Okay. So let's -- let's get --

THE COURT: Where we are today.

MR. SHERWOOD: Okay. We -- just on that point and -- and we voted in Class 12, but I think the Court should be cognizant of the fact that had we voted in Class 18, the debtor would have -- the debtors' plan would have been in serious jeopardy because of the absolute priority rule. And -- and this was, to some extent -- not to some extent, but clearly gainsmanship on their part to put us in Class 12 at one point and then flip-flop later.

Your Honor, we relied on -- we relied on our Class 12 status in -- in exercising our rights pursuant to the plan and -- and there should be some finality at confirmation with respect to our treatment as a Class 12 creditor.

Let -- let me -- let me turn to the reserve issue. Again, the debtor drafted the plan. The debtor drafted the confirmation order. The terms of the plan are clear. They provide that to the extent that there is any dispute with respect to this or -- or that the order disallowing this claim is not resolved by a final order, the reserve has to stay in place. And the confirmation order and the plan should be enforced as written, again, by the estate. And -- and there's no reason to -- to deviate from that.

THE COURT: I understand.

MR. SHERWOOD: Getting -- getting to Tranquility, the standard for reconsideration is manifest injustice and it has to be -- the error has to be apparent to the -- to the point of being indisputable. And, again, I think if you look at their brief on Page 18 where they cite to SEC Rule 191 and the definition of -- of "issuer" and the bold part at the top of Page 18. It says that the depositor for an asset-backed securities acting solely in its capacity as depositor to the issuing entity is the issuer for purposes of the asset-backed securities of that issuing entity.

And then the same language is at the last part of Paragraph A in Paragraph 34 that's in bold. And I think this -- this really highlights that even the SEC rules recognize a distinction between a depositor in an issue and the issuing entity, just like Your Honor did in Tranquility. And I think that that philosophy, that rationale, is still good.

And, you know, in terms of the basis for that, I think, Your Honor, that there was that Slane and Kripke article that you cite in Tranquility and I think it's clear that the purpose of Section 510(b) is to guard against having someone who is an equity holder in the debtor or in an affiliate of the debtor being elevated to -- to the position of a creditor, and that's not what's happening here.

And then finally on Tranquility, Your Honor, the reported entity, the issuer, the depositor and -- and, you know, all of the entities in -- in the chart that was handed up by counsel to the committee, they are all included within these SEC definitions really to expand liability and reporting. And just because the SEC -- just because some -- there is a claim under SEC law, that doesn't mean that that law that governs that claim is suddenly going to govern a bankruptcy court's analysis under Section 510. And 510 purposes -- 510 has a completely different purpose and -- and Your Honor is -- and there's nothing manifestly long or grossly unjust about what -- what Your Honor's rationale was in Tranquility.

So, Your Honor, you know, based on all that we -- we think that -- that the language of the stipulation is clear and there has been a recovery under the plan to Class 18, which is a class that's receiving property and distributions for sure. And a contingent right of recovery is no less a recovery than an actual right. And it wouldn't make sense, also, Your Honor, to read the stipulation to wait for actual cash to come in -- into hand because that would be -- you know, at that point in time we don't know what the facts and circumstances would be. And, moreover, we're in Class 12 anyway so it just doesn't make sense.

So for those reasons, Your Honor, and really just

before I sit down I think it -- it would be unjust for Your Honor to allow the debtor and the committee to sort of play the game that they did by putting us in Class 12 and sort of laying down for voting purposes when they knew full well all alone -- all along that they were going to change their tune. I think that's playing fast and loose with the Court, certainly with me and our clients who, you know, deserve to have a day on the merits of their claim. And -- and that's all we're seeking here. We're not seeking a four-hundred-and-thirty-five-million-dollar allowed claim. We just want to know that we're in Class 12.

Thank you.

MS. KASWAN: Your Honor, could I just speak to some issues --

THE COURT: Okay.

MS. KASWAN: Counsel did address back to what hard work we did in --

THE COURT: All right.

MS. KASWAN: Your Honor, I'm not a bankruptcy lawyer. I'm a securities lawyers. And -- and that's why I wasn't speaking, certainly, in the first part of this argument. But the securities laws, both Section 11 and Section 10(b)(5) are disclosure statutes. They -- they don't turn on who owns the securities. They turn on who is the speaker. And in connection with Section 11, ordinarily,

the issuing entity and the issuer are the same. They are the ones who file the statements with the Court. They are the speakers.

And so Section 11 imposes liability if the disclosures are false or misleading. And that would be ordinarily on the entity that files the disclosure statements, the officers who sign the disclosure statements, and the underwriters who sell the securities. That's a very different concept than Section 510(b) which looks to the entity that owns the securities or in connection with the bond, the entity whose collectability and resources the debtors are looking to for repayment of the bond.

So that's why, you know, I believe that the regulation is irrelevant to the issue of a 510(b) question and, also, the securities law for interpretation of Section 11 and the issue of who is liable under the disclosure statutes is irrelevant to subordination under 510(b). Both of those statutes are directed to different concepts.

And certainly, you wouldn't say, for example, that WMI and the officers are affiliates even though the affiliates are speakers and, therefore, liable under Section 11, and WMI could be liable as a control person under Section 15 for the false statements by the officers. That's what's happening here is that because the depositor is the manager and the speaker, they are liable under Section 11;

that is wholly unrelated to the question of whether or not they are the owner of either the stock or the bonds that are being issued that -- the owner of the bonds or the issuing entity. And so that's why that's the appropriate entity to look to under 510(b).

THE COURT: Thank you.

MR. JOHNSON: Your Honor, very briefly on the point that Ms. Kaswan just made. I think she hit the nail right on the head. The question of the securities laws is who is the speaker and the question under the Bankruptcy Code is what is the definition of an affiliate.

Now where that intersects is right here on this chart. I just drew a circle around all the entities that are corporations and the ones that are affiliates. Washington Mutual Bank is an affiliate of WMI because it's one-hundred percent owned by WMI. WaMu Asset Acceptance Corp. is one-hundred percent owned by Washington Mutual Bank, and under Section 101 of the Bankruptcy Code, that means that WaMu Asset Acceptance Corp. is an affiliate.

And as Ms. Kaswan correctly pointed out, the securities laws do look to who is the speaker in order to determine where there is liability. And the basis of their lawsuit in Washington and their claim here is securities fraud against WaMu Asset Acceptance Corp. It's not against the trust, which merely held those mortgages.

So here we now have the intersection of the securities law providing the definition of what is the issuer and the Bankruptcy Code providing that if the issuer is an affiliate, then it -- it then matches the definition of what is an affiliate and, therefore, it needs to be subordinated under Section 510(b).

Thank you.

THE COURT: Thank you.

MR. STROCHAK: Thank you, Your Honor. Adam Strochak. Just -- just two very brief points.

Mr. Sherwood, I think, quoted from Section 22.1 of the plan, the treatment of subordinated claims, and he left out the key language. The plan says that "Commencing on the effective date and in the event that all allowed claims and post-petition interest claims in respect of allowed claims are paid in full, then each holder of an allowed subordinated claim will get liquidating trust interests."

That's the key language. The way the plan works is that until the waterfall fills up, there is no distribution of liquidating trust interests to -- to the holders of allowed subordinated claims.

The latter point I'll just echo what -- what Mr. Johnson said and perhaps put a little different slant on it.

You know, we -- we agree that the SEC rules do make a distinction between issuer and issuing entity. And

the key point, the whole -- the whole argument that we've made is that -- is that Section 510(b) doesn't make that distinction. There is no principal basis to make a distinction between issuer and issuing entity in connection with mortgage-backed securities.

And as Ms. Kaswan stated, you know, we're a little bit out of the ordinary here. This is not the ordinary situation where the issuer is both the entity and the speaker, as she -- as she put it. We're in a situation where -- where those were separated.

But what rational basis is there under 510(b) to say that, well, a claim against one would be subject to subordination, but a claim against another would not. If -- if the -- if the allegation is that there was illegality in the issuance of the securities, then -- then there's no reason to say that a claim against the issuer would not be subject to -- that is, a claim relating to securities of the issuer would not be subject to subordination as long as the issuer is an affiliate, and plainly in this case it was.

Thank you, Your Honor.

MR. ETKIN: This has been very difficult for me to just sit through --

THE COURT: All right. So --

MR. ETKIN: So with the Court's indulgence just two minutes.

THE COURT: Two minutes.

MR. ETKIN: First of all, I think we have a basic disagreement as to what provisions of the plan to -- to look to to determine --

THE COURT: You have to identify yourself for the record.

MR. ETKIN: I'm sorry, Your Honor. Michael Etkin, Lowenstein Sandler, bankruptcy counsel to the MBS plaintiffs. My apologies.

We're -- we're looking at different plan provisions. Your Honor, I think that Section 30.2 of the plan which Mr. Sherwood pointed out earlier, and which has not been the subject of comment by either the post-confirmation trust or the committee, says clearly and unequivocally that -- that Class 18, along with other classes, are receiving distributions pursuant to the plan. You can't -- you can't talk your way around that, Your Honor.

THE COURT: Well, you can if you look at the actual language of whether they're getting distributions.

MR. ETKIN: But, Your Honor, the debtors -- the debtors admit in the context of the plan that they're getting distributions. That's an admission. That's clear and unequivocal. They can't now say, well, we didn't mean it. They can't now say, well, you know, we -- we really

meant that it was non-contingent distributions. It says what it says and it's clear. So from our perspective, Your Honor, that really resolves the issue.

And then one point on this Tranquility argument, which -- which Mr. Strochak just talked about. The fact that there's no reason or no basis under 510(b) to distinguish between the issuer and -- and the issuing entity. Well, the SEC makes that distinction. They don't make that distinction. 510(b) doesn't talk about securities, doesn't talk about an issuer. 510(b) talks about securities, whether equity or debt, of the -- of the debtor or an affiliate of the debtor.

Now we're arguing as to who they think an affiliate of the debtor is. The fact is that the -- that the securities, the asset-backed securities are securities of the issuing entity. Now why do I say that? Because that's what the SEC rule says. It says that -- that the depositor is considered the issuer for all of those issues relating to reporting because they're the ones who have the information and they're the ones who would stand liable for misstatements with respect to that information.

But the rule goes further and it says, as -- as the debtors quoted in their -- in their objection, it says that the depositor to the issuing entity is the issuer for purposes of the asset-backed securities of that issuing

entity. That parrots the language of 510(b). The securities are of the issuing entity. They're not securities of the issuer. The assets of the issuer, performance of the issuer have nothing to do with the investment that was made.

This all makes perfect sense, especially when you look at the background of 510(b) which has been appended to tell the investor that you can't jump the line simply by asserting a litigation claim if you bought securities of the debtor or of an affiliate of the debtor. By virtue of the SEC's own language, these were asset-backed securities of that issuing entity. That issuing entity was not an affiliate. 510(b) does not apply.

Thank you, Your Honor.

THE COURT: All right. No more. I'll tell you what I am going to decide today.

First of all, the trigger has not occurred for purposes of the stipulation. There has been no recovery on Class 18 simply by confirmation of the plan or by the fact that the debtor allowed that class to vote. The reality is there has been no distribution of any property, cash, liquidating trust certificates, or anything to Class 18. The stipulation provided that no claim would be filed until that time and, therefore, the claim is premature.

With respect to the reserve, therefore, since

there is no pending claim, no reserve need be provided by the debtor in cash or in liquidating certificates.

With respect to the issue of whether there was an agreement that they would only file a Class 18 claim, there is nothing in the stipulation that says that. So at the time of the trigger, they are free to file a Class 12 claim.

With respect to the applicability of the Tranquility decision, I don't think the MBS plaintiffs can rely on that. It was not a decision with respect to their claim. The claims are different. In addition, it was not a final decision at all because of the pendency of the motion for reconsideration. I did not get the chance to address that motion or make any ruling on those arguments. So, quite frankly, it is not law of the case. If it were, I would exercise my discretion not to apply it to this claim.

But I think it's not necessary for me to decide the merits of that argument at this time because I think that the MBSA -- MBS plaintiffs do not have the right to file or prosecute a claim now and won't have that right until the -- any recovery is had on the Class 18 claims, and that means a -- an actual distribution.

Okay.

MR. STROCHAK: Your Honor, I think it quite makes sense for us to reduce your ruling to an order, circulate it to plaintiffs and then submit it under certification.

THE COURT: Okay.

MR. ROSEN: Thank you very much, Your Honor.

THE COURT: We're done with the agenda, then?

MR. ROSEN: That is the agenda, Your Honor.

MR. SHERWOOD: Thank you, Your Honor.

MR. ETKIN: Your Honor, I think there's one more thing on the agenda, which was the least -- and it could be handled quickly, I guess, but it -- there was a status conference in connection with the certification motion. I don't know that there's much to be said right now. I'm -- given the length of the argument on the certification, I'm not going to get into arguments on the objection filed. We can do that in reply papers prior to a scheduled hearing on the merits.

With respect to timing, and I think one of the issues that the debtors -- that the debtors raise is that issue. I guess we can talk to the debtor about that and see whether we can reach some agreement, or we can advise the Court and put it on for substantive hearing at -- at some omnibus hearing date in the future.

THE COURT: I think you should talk about whether or not we -- and when we have it.

MR. STROCHAK: We'll do that, Your Honor.

MR. ETKIN: We will discuss that, Your Honor.

THE COURT: All right.

All right. We'll stand adjourned, then.

MR. STROCHAK: Thank you, Your Honor.

MR. ROSEN: Thank you.

MR. SHERWOOD: Thank you.

(Whereupon, the proceedings concluded at 1:16 p.m.)

I N D E X

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Debtors' Objection to Proof of Claim Filed by AT&T Corp.	--	--
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Debtors' Motion to Estimate Maximum Amount of Certain Claims for Purposes of Establishing Reserves Under the Debtors' Confirmed Chapter 11 Plan	--	--
Motion for a Protective Order for Claimants Al Brooks, Todd Baker, Deb Horvath, John McMurray, Tom Casey, and David Schneider Pursuant to Rule 26(c)	--	--

I N D E X (CONT.)

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RULINGS

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Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving the Stipulation and Agreement Between Washington Mutual, Inc. and MSG Media Reducing and Allowing Proof of Claim Number 1841	--	--
Application of (I) Wilmer Cutler Pickering Hale and Dorr, LLP, (II) Pachulski Stang Ziehl & Jones, LLP, and (III) Boies, Schiller & Flexner, LLP for Compensation for Services Rendered and Reimbursement of Expenses as Counsel to the Ad Hoc Group of WMB Senior Noteholders for the Period from the Petition Date Through the Effective Date	--	--

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Motion for an Order, Pursuant to Section 105(a) of the Bankruptcy Code and Bankruptcy Rule 9019, Approving Stipulation and Agreement Between WMI Liquidating Trust and SPCP Group, LLC Reducing and Allowing Proof of Claim Number 4048	--	--

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Fourth Motion of Wilmington Trust Company, in its capacity as Trust Preferred Trustee, for Entry of an Order Further Partially, Liquidating and Allowing Proofs of Claim for Fees and Expenses	--	--
Fourth Motion of The Bank of New York Mellon Trust Company, N.A. in its capacity as Indenture Trustee, for Entry of an Order Further Partially Liquidating and Allowing Proof of Claim for Fees and Expenses	--	--

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C E R T I F I C A T I O N

I, Sherri L. Breach, CERT*D-397, certified that the foregoing transcript is a true and accurate record of the proceedings.

SHERRI L. BREACH

AAERT Certified Electronic Reporter & Transcriber

CERT*D -397

Veritext

200 Old Country Road

Suite 580

Mineola, NY 11501

Date: May 8, 2012

ATTACHMENT D

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FILED

JUL 11 2003

MICHAEL L. WILLIAMS, CLERK
U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OKLAHOMA

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OKLAHOMA

IN RE:	)	
	)	
COMMERCIAL FINANCIAL SERVICES, INC.,	)	**Case No. 98-05162-R**
	)	**Chapter 11**
and	)	
CF/SPC NGU, INC.,	)	**Case No. 98-05166-R**
	)	**Chapter 11 Jointly Administered with**
Debtors.	)	**Case No. 98-05162-R**
NATIONSBANK, N.A.	)	
	)	
Plaintiff,	)	
	)	
v.	)	**Adv. Case No. 98-0356-R**
	)	
COMMERCIAL FINANCIAL SERVICES, INC.,	)	
	)	
Defendant,	)	
and	)	
	)	
THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS, and THE OFFICIAL COMMITTEE OF ASSET-BACKED SECURITYHOLDERS	)	
	)	
Intervenors.	)	

ORDER GRANTING COMMERCIAL FINANCIAL SERVICES, INC.'S MOTION FOR SUMMARY JUDGMENT

Before the Court are the following pleadings:

- Commercial Financial Services, Inc.'s Motion for Summary Judgment (Adv. Doc. 122) ("CFS Motion") and Memorandum of Law in Support of Motion of Commercial Financial Services, Inc. for Summary Judgment (Adv. Doc. 123) ("CFS Opening Brief"), both filed on February 7, 2002;

- Commercial Financial Services, Inc.'s Supplement in Support of Motion for Summary Judgment (Adv. Doc. 128) ("CFS Supplement"), filed on March 15, 2002;

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Clerk, U.S. Bankruptcy Court
Northern District of Oklahoma

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- Bank of America, N.A.'s Combined (1) Objection to Commercial Financial Services, Inc.'s February 7, 2002 Motion for Summary Judgment, and (2) Supporting Brief (Adv. Doc. 133) ("BOA Objection"), filed on May 15, 2002;

- Commercial Financial Services, Inc.'s Reply in Support of its Motion for Summary Judgment (Adv. Doc. 143) ("CFS Reply"), filed on June 14, 2002;

- Joint Statement of Intervenors in Support of Commercial Financial Services, Inc.'s Reply in Support of its Motion for Summary Judgment (Adv. Doc. 145) ("Intervenors' Statement"), filed on June 14, 2002; and

- Bank of America, N.A.'s Surreply Regarding Commercial Financial Services, Inc.'s Motion for Summary Judgment (Adv. Doc. 151) ("BOA Surreply"), filed July 19, 2002.

I. Jurisdiction

The Court has jurisdiction of this "core" proceeding by virtue of 28 U.S.C. §§ 1334, 157(a), and 157(b)(2)(A), (B) and (O); and Miscellaneous Order No. 128 of the United States District Court for the Northern District of Oklahoma: Order of Referral of Bankruptcy Cases effective July 10, 1984, as amended. Further, the Court retained post-confirmation jurisdiction to determine adversary proceedings pending on or initiated after the effective date of the Second Amended Plan of Orderly Liquidation entered in the main bankruptcy case on September 14, 2001. See Order Confirming Second Amended Plan of Orderly Liquidation (Bankr. Doc. 3306) at 18, ¶ P(5).

II. Summary Judgment Standard

Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c) (made applicable herein by Bankruptcy Rule 7056). "One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses [and]

. . . it should be interpreted in a way that allows it to accomplish this purpose." Celotex Corp. v. Catrett, 477 U.S. 317, 323-24 (1986).

Substantive law determines which facts are material; "[o]nly disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). "[S]ummary judgment will not lie if the dispute about a material fact is 'genuine,' that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Id. It is incumbent upon the non-movant to demonstrate that there are genuine issues of fact for trial. See Vitkus v. Beatrice Co., 11 F.3d 1535, 1539 (10th Cir. 1993). Or as the Seventh Circuit more pointedly articulated in Albiero v. Kankakee, 246 F.3d 927, 933 (7th Cir. 2001), *quoting* Schacht v. Wisconsin Dep't of Corr., 175 F.3d 497, 504 (7th Cir.1999), "summary judgment 'is the "put up or shut up" moment in a lawsuit, when a party must show what evidence it has that would convince a trier of fact to accept its version of events.'"

"[A]t the summary judgment stage the judge's function is not . . . to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." Liberty Lobby, 477 U.S. at 249. Reasonable inferences that may be made from the proffered evidentiary record should be drawn in favor of the non-moving party. See Adams v. American Guarantee and Liability Ins. Co., 233 F.3d 1242, 1246 (10th Cir. 2000). However, "[i]f the [non-moving party's] evidence is merely colorable or is not significantly probative, summary judgment may be granted." Liberty Lobby, 477 U.S. at 249-50 (citations omitted). "Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.'" Matsushita Electric Industrial Co., v. Zenith Radio Corp., 475 U.S. 574, 587 (1986).

III. Procedural History

Plaintiff Bank of America, N.A., formerly known as NationsBank, N.A. ("BOA"), filed its Amended Complaint to rescind the purchase of a note (the "Series Note") that it purchased pursuant to a Note Purchase Agreement between BOA and Defendant Commercial Financial Services, Inc. ("CFS"), and to seek a declaration of a constructive trust upon proceeds of the sale of the Series Note (the "Constructive Trust Claim") that BOA claims is traceable into a CFS bank account (the "Fund").[1]

On October 15, 2001, this Court entered an Order Granting in Part and Denying in Part Motions to Dismiss First Amended Adversary Complaint ("Order Resolving Motions to Dismiss") (Adv. Doc. 101) (published as NationsBank, N.A. v. Commercial Financial Services, Inc. (In re Commercial Financial Services, Inc., 268 B.R. 579 (Bankr. N.D. Okla. 2001)), in which the Court had an opportunity to scrutinize the purposes and policies of two provisions of the Bankruptcy Code— Section 541(d), under which BOA claims the Fund is excluded from the estate because, it contends, BOA is the equitable owner of the Fund (under a constructive trust theory) while CFS has only the bare legal title (11 U.S.C. § 541(d), hereinafter "Section 541(d)"), and Section 510(b), upon which CFS relies in arguing that BOA's claim for rescission of its purchase of the Series Note and declaration of constructive trust must be subordinated to prevent BOA from obtaining a greater *pro rata* share of the estate than other similarly situated creditors (11 U.S.C. § 510(b), hereinafter "Section 510(b)"). In its Order Resolving Motions to Dismiss, the Court concluded that BOA's Constructive Trust Claim could not be dismissed as contrary to the policy of Section 510(b)— *i.e.*,

[1]Currently, the Fund is held in a reserve account (the "BOA Reserve") which was established to secure payment to BOA in the event that BOA prevails on its Constructive Trust Claim.

that rescission of security purchases must be subordinated to claims of equal or higher priority—while there existed the possibility that BOA might be able to present evidence that Section 510(b) was not even applicable to BOA's rescission claim, inasmuch as BOA asserted that the Series Note did not even implicate Section 510(b) because it was not a security of CFS or one of its affiliates. Order Resolving Motions to Dismiss at 29-30. The Court found that the Amended Complaint and the documents attached thereto did not definitively establish that the Series Trust was a "person" that could qualify as an "affiliate" under the definitions given to those terms by the Bankruptcy Code. Id. at 30 n.31. Thus, dismissal on the pleadings was not appropriate.

Failing to obtain dismissal of the Amended Complaint, CFS filed its Amended Answer, Affirmative Defenses and Counterclaim of Commercial Financial Services, Inc. to First Amended Adversary Complaint on November 8, 2001 (the "Amended Answer") (Adv. Doc. 103). CFS's affirmative defenses include the contention that BOA is not entitled to a constructive trust "because such a remedy would violate the federal bankruptcy priority scheme and policies established under Chapter 5, subchapter I of the Bankruptcy Code in general, and 11 U.S.C. § 507 in particular" and "pursuant to 11 U.S.C. § 510(b)." Id. at 20. CFS also asserted the following as a counterclaim—

> The claims asserted in the First, Second and Third Causes of Action in BOA's Complaint, and BOA's request for equitable relief, are claims "arising from rescission of a purchase or sale of a security of the debtor [CFS] or of an affiliate of the debtor," or are claims "for damages arising from the purchase or sale of such a security," as those terms are used in 11 U.S.C. § 510(b).
>
> WHEREFORE, CFS requests that the Court enter judgment pursuant to Section 510(b) of the Bankruptcy Code subordinating BOA's claims, and BOA's request for equitable relief, to all claims or interests that are senior or equal to such claims.

Id. at 21-22.

On December 10, 2001, BOA filed its Reply of Bank of America, N.A. to Counterclaim of Commercial Financial Services, Inc. (Adv. Doc. 106). As affirmative defenses to the counterclaim, BOA asserted that (1) pursuant to Section 541(d), the Fund is not property of the estate and is not subject to distribution under title 11, which makes Section 510(b) inapplicable; (2) the Series Note was not issued by CFS or its affiliate; (3) "the types of claims and/or interests held by the Bank are not of the type that are either required or permitted to be subordinated under § 510(b)"; (4) the Section 510(b) issue has already been adjudicated in the Plan and Confirmation Order; and (5) all other arguments made in BOA's briefs filed in connection with CFS's Motion to Dismiss are incorporated therein. Id. at 1-3.

IV. Summary of the Arguments of the Parties

In an effort to resolve as a matter of law the outstanding question regarding whether BOA purchased a security from CFS or an "affiliate," as the term "affiliate" is defined in the Bankruptcy Code, CFS filed the CFS Motion, the CFS Opening Brief, and appendices containing the securitization documents and other documentary evidence. CFS again contends that BOA's Constructive Trust Claim against the Fund must be denied as a matter of law because it is a "claim arising from rescission of a purchase . . . of a security of the debtor or of an affiliate of the debtor," and that Section 510(b) of the Bankruptcy Code requires that such a claim be subordinated to other claims of equal priority.

First, CFS argues that the Note Purchase Agreement between and among CFS as administrator, CF/SPC GREAT, Inc. as transferor, Kitty Hawk Funding Corporation and Enterprise Funding Corporation, as note purchasers, and BOA, as agent and alternative note purchaser, is itself

a "security of the debtor" and that under the securitization documents, the Series Note can be determined to be a "security" issued directly by CFS.

CFS also claims that the undisputed facts derived from the securitization documents show that CFS managed and operated the Series Trust and/or the property of the Series Trust. Management and/or operation of the Series Trust, or its assets, would qualify the Series Trust as an "affiliate" of CFS under Bankruptcy Code's definition of affiliate and would render the Series Note a security of an "affiliate of the debtor." Because the imposition of a constructive trust presupposes rescission of BOA's purchase of the Series Note, CFS argues that BOA's Constructive Trust Claim is a claim for rescission of the purchase of a security of the debtor or its affiliate which must be subordinated pursuant to Section 510(b).

BOA argues that CFS's Section 510(b) subordination argument is irrelevant because the funds BOA seeks to recover are not property of the estate inasmuch as CFS obtained legal title of the funds by engaging in fraud, which in equity confers *equitable* title to the defrauded purchaser of the security, BOA. Section 541(d) exempts from the estate property in which a debtor holds, as of the commencement of the case, bare legal title and no equitable interest. See 11 U.S.C. § 541(d).

BOA also contends that CFS is precluded from asserting Section 510(b) subordination as a defense to the Constructive Trust Claim because "[t]he Plan and Confirmation Order are *res judicata* as to any claim for subordination under Section 510(b) of claims against the estate asserted by Asset-backed Securityholders." BOA Objection at 13 (initial capitals omitted). It is undisputed that as part of the overall compromise that was embodied in the Plan and Confirmation Order, the adversary proceeding that CFS had initiated to subordinate all ABS claims (the "Section 510(b) Adversary") was "deemed dismissed with prejudice" as of the effective date of the Plan. BOA contends that the

dismissal of the 510(b) Adversary, coupled with CFS's alleged failure to explicitly reserve the right to seek subordination of the Constructive Trust Claim, resulted in a final adjudication in favor of BOA on the Section 510(b) issue which, BOA contends, may not now be revived by CFS as a defense or counterclaim to the Constructive Trust Claim.

BOA also disputes that the Note Purchase Agreement is a security of CFS as the term "security" is used in Section 510(b) and denies that the Constructive Trust Claim arises from the "purchase" or "sale" of the Note Purchase Agreement.

Finally, BOA contends that disputed issues of material fact regarding the business of the Series Trust preclude a determination that the Series Note is a security of an "affiliate" of CFS. BOA takes the position that notwithstanding its registration as a "business trust," the Series Trust merely holds assets rather than operating them, and therefore it is not a "business trust" as contemplated by federal law. Since business trusts are the only type of trusts that can qualify as "persons" and only "persons" may be "affiliates," BOA argues that the Series Trust can never be an "affiliate of the debtor" and the Series Note cannot be a security of an "affiliate of the debtor."

In its Reply, CFS claims that BOA has not raised any new issue of fact or law to justify a reconsideration of the analysis of the underlying policies and legislative histories amplifying Sections 541(d) and 510(b) of the Bankruptcy Code that this Court announced in the Order Resolving Motions to Dismiss. In exasperated tones, CFS also denies that the Plan and Confirmation Order bar its continuing campaign to subordinate the Constructive Trust Claim.

In the Intervenors' Statement, the Intervenors, comprised of Lloyd Whitaker as Liquidating Trustee of the ABS Liquidating Trust and Stephen A. Jay as Liquidating Trustee of the Unsecured Creditors Liquidating Trust, join in CFS's Reply and, as representatives of the two voting classes

of creditors (see Plan at § 6.1), argue that the agreed dismissal of the Section 510(b) Adversary pursuant to the Plan did not adjudicate the subordination issue *on the merits* in favor of either CFS and the unsecured creditors on one hand or in favor of the ABS Trustees or Individual Claimants on the other– rather, only the issue of subordination of ABS Claims was compromised. The Intervenors also argue that the Constructive Trust Claim was a defined term in the Plan and that the Constructive Trust Claim was distinct from the ABS Claims that were compromised and distinct from the other Individual ABS Claims; that the Constructive Trust Claim was defined as a Disputed Claim, not a settled claim, and that it was not, and was not intended to be, settled or compromised in the Plan; and that CFS's subordination defense against the Constructive Trust Claim was expressly preserved in the Plan.

V. Material Facts as to Which No Genuine Issue Exists

A. Evidentiary issues

1. The Declaration of Caroline B. Benediktson.

In support of the CFS Motion, CFS submitted, among other evidence, the Declaration of Caroline B. Benediktson to which fifteen documents are attached (the "CBB Affidavit," CFS App. A and Exhibits A-1 to A-15). In her affidavit, Ms. Benediktson states: "I have personal knowledge of the matters asserted herein." CBB Affidavit at ¶ 1. In support of that statement, she indicates that from August 1994 to December 1998, she served as general counsel of CFS, and from December 1998 to the present, she served as its in-house counsel. CBB Affidavit at ¶ 2. She further states that in the course of her duties, she reviewed the securitization documents attached to the CBB Affidavit, and she testifies that the documents "report or record acts, events, conditions, opinions, or diagnosis, made at or near the time by, or from information transmitted by, a person with knowledge. Each of

these documents was kept in the course of a regularly conducted business activity,[and] [i]t was the regular practice of that business activity to make these documents." CBB Affidavit at ¶ 3. The CBB Affidavit thus provides a *prima facie* foundation for the admission of the documents and their contents pursuant to Fed. R. Evid. 803(6) and 902(11). The Court concludes that the documents have been properly authenticated and their contents are not hearsay; thus the documents are admissible.

BOA objects to the admission of the affidavit testimony of Ms. Benediktson because the affidavit "omits to indicate if the statements contained therein are made by Ms. Benediktson as a witness or participant in the acts, events and conduct described therein, or if she is stating her interpretation of portions of the documents attached thereto." BOA Objection at 5. To the extent that Ms. Benediktson's testimony reflects her personal interpretation of the documents attached to the affidavit, BOA objects to the admission of her testimony.

It is difficult to determine the precise grounds for BOA's objection to Ms. Benediktson's testimony or which particular statements are objectionable. The case cited by BOA in support of its objection, Harris v. Beneficial Oklahoma, Inc. (In re Harris), 209 B.R. 990 (B.A.P. 10th Cir. 1997), holds that unauthenticated documents attached to a summary judgment motion or brief are not admissible, and that authentication is achieved by attaching a document to an affidavit of a "competent witness through whom the document may be received into evidence." Id. at 996, *quoting* 11 James Wm. Moore, et al., MOORE'S FEDERAL PRACTICE §§ 56.10[4][c][i] & 56.14[2][c] (3d ed. 1997). As stated above, the CBB Affidavit provides testimony of a "competent witness through whom the document[s] may be received into evidence." Authentication is not a problem here.

BOA also refers to Weeks v. Latter-Day Saints Hospital, 418 F.2d 1035 (10th Cir. 1969), for the proposition that "if Ms. Benediktson is testifying as to the contents of the documents attached to her Affidavit, her testimony is inadmissible under Fed. R. Evid. 1002." BOA Objection at 5.[2] In Weeks, the trial court excluded from evidence two documents that the court concluded were misleading because they were taken out of their context. Weeks, 418 F.2d at 1039. When the defendant attempted to introduce the contents of the excluded documents into evidence through oral testimony, the trial court refused to allow the testimony, and appropriately so, said the Tenth Circuit, because the documents themselves were the best evidence of their contents. Id. at 1040. In this case, however, the Court has found that the documents attached to the CBB Affidavit are admissible; thus, Ms. Benediktson's testimony about the documents may be evaluated in light of what the documents themselves provide. This is not a situation in which a party is attempting to place into evidence the contents of an inadmissible document or an absent document.

In the CBB Affidavit, Ms. Benedikton does two things: she authenticates the attached documents, and she provides testimony of events that occurred and actions taken by CFS and others in relation to those documents. Ms. Benediktson stated under oath that she has personal knowledge of these events and actions. BOA has not controverted any factual statements made by Ms. Benediktson with admissible evidence. Thus, the CBB Affidavit and its accompanying documents will be admitted into the record for the purpose of evaluating CFS's Motion.[3]

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[2]Rule 1002 states: "To prove the content of a writing, recording, or photograph, the original writing, recording, or photograph is required, except as otherwise provided in these rules or by Act of Congress." Fed. R. Evid. 1002.

[3]To the extent that the CBB Affidavit contains any conclusory statements, however, such statements will not be considered undisputed "facts." In addition, to the extent that statements made by Ms. Benediktson characterize or summarize the content of any document, such statements were

2. Discovery

BOA complains that it has not been given adequate opportunity for discovery prior to responding to the CFS Motion. BOA Objection at 2-3. This is nonsense. BOA filed its lawsuit on December 23, 1998, and its Amended Complaint on June 23, 1999. While it is true that various Rule 12 motions dominated the early days of this action and briefing on such motions was not closed until June 28, 2001, all preliminary motions were resolved on October 15, 2001. CFS filed its detailed Amended Answer on November 8, 2001, which clearly narrowed the issues in dispute.

CFS's sole basis for summary judgment is its assertion that BOA's Constructive Trust Claim must be subordinated pursuant to Section 510(b) of the Bankruptcy Code. BOA cannot be heard to claim surprise that CFS would file summary judgment based on this defense and counterclaim. BOA has known that CFS would rely upon Section 510(b) as its principal defense since CFS filed its Motion to Dismiss on August 3, 1999. After the Motion to Dismiss was denied in part in October 2001, CFS renewed its Section 510(b) subordination claim as an affirmative defense and a counterclaim in its Amended Answer. In the Joint Status Report filed with the Court on January 17, 2002, CFS disclosed that it intended to file a motion for summary judgment on its Section 510(b) defense. On February 7, 2002, CFS filed its summary judgment motion based on its Section 510(b) defense. BOA was granted additional time, until May 15, 2002, to file its response to the CFS Motion. Thus, to the extent that BOA believed that it required discovery concerning any facts relevant to CFS's Section 510(b) defense before filing the BOA Objection to CFS's Motion, it had ample opportunity to obtain such discovery.

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verified by the Court by reading the document to which she refers.

On May 30, 2002, CFS filed a motion requesting that discovery be stayed while the CFS Motion was pending because in BOA's Objection, BOA denied only four of CFS's statements of fact and full-blown discovery would be wasteful if summary judgment was eventually granted in CFS's favor. As for the four "disputed" facts, BOA disagrees with CFS's characterization of certain provisions of a document that is an exhibit to the CFS Motion and points to other provisions of the same document to controvert CFS's characterization. Bank of America, N.A.'s Combined (1) Objection to [CFS's] Motion to Stay Discovery and (2) Supporting Brief (Adv. Doc. 144) at 4. BOA suggested that it would have liked to obtain testimony from Ms. Benediktson or the Trustee of the Series Trust to counter CFS's assertion that it managed or operated the property of the Series Trust. Id. at 5. However, nothing prevented BOA from attempting to obtain that testimony prior to filing its Objection. BOA has not shown that any additional discovery would assist in disputing CFS's statements of fact.

As of May 30, 2002, BOA had done no discovery in this adversary proceeding, although it had participated in and obtained the benefit of the extensive Rule 2004 discovery production made by CFS in the main bankruptcy case. Soon thereafter, BOA propounded discovery requests. Attachments to [CFS's] Supplemental Memorandum in Support of Motion to Stay Discovery Pending Ruling on Its Motion for Summary Judgment (Adv. Doc. 141). The Court reviewed those discovery requests and concluded that they were not specifically designed to elicit facts needed to controvert the statement of material facts asserted by CFS in its Opening Brief. On June 19, 2002, the Court stayed discovery for 120 days. That period expired on October 17, 2002. BOA has had since October 17, 2002, to conduct additional discovery and supplement its objection, if it desired.

Rule 56(f) of the Federal Rules of Civil Procedure, which is applicable in this proceeding by virtue of Bankruptcy Rule 7056, permits a party opposing a motion for summary judgment to file an affidavit stating reasons why it cannot present facts essential to justify that party's opposition and to request a continuation to permit discovery. Fed. R. Civ. P. 56(f). BOA has not complied with Rule 56(f) or requested that consideration of the CFS Motion be deferred while BOA obtained discovery. Instead, BOA filed its Objection and disputed four facts by referring to other provisions in documents supplied by CFS. In any event, to the extent that BOA desired to obtain discovery after receiving the CFS Motion, it has had since February 7, 2002 (except for the 120 day stay from June 19 to October 17, 2002) to obtain whatever testimony it believed it needed to controvert CFS's statement of facts.

BOA has not been denied time for discovery, and thus, the Court will proceed to decide the CFS Motion on its merits.

B. Undisputed material facts

CFS, which was incorporated in Oklahoma in 1986, was founded for the purpose of collecting loans that it purchased from the FDIC, and later, from the RTC and other financial institutions. CFS Opening Brief at 7, Statement of Uncontested Facts ("CFS Facts") ¶¶ 1, 2.[4] In 1995, CFS and/or its affiliates began purchasing delinquent credit card receivables from credit card issuers after the issuers had ceased their own collection efforts and "charged off" the receivables.

[4] In connection with each citation to a "CFS Fact," the Court has verified the fact by reviewing the supporting evidentiary material cited and supplied by CFS. As previously noted, BOA objected to four "facts" and in those instances, the Court reviewed the evidentiary material provided by both CFS and BOA to determine whether there was a material factual dispute. The Court has concluded that there are no disputed material facts.

CFS Facts, ¶ 3. Thereafter, CFS's primary line of business became the acquisition and collection of charged-off credit card receivables. CFS Facts, ¶ 4.

In 1995, CFS began to "securitize" the loans and charged-off credit card receivables ("Loans") through a series of transactions in which CFS packaged the Loans and transferred such packages to an affiliate of CFS, which in turn sold the Loan packages to a trust. CFS Facts, ¶ 5. CFS and its affiliate agreed to sell securities backed by the Loan packages to specific investors or to a placement agent Id. CFS simultaneously contracted to service the Loans in all respects and to manage the operations of the securitizations that it had established and sponsored. CFS Facts, ¶ 6. CFS, or one of its affiliates, received the net proceeds from the sale of the securities, a fee for servicing the Loans, and a right to any residual value of the Loans when and if the securities were paid in full. CFS Facts, ¶ 7.

From 1995 to 1998, CFS promoted fifteen such securitizations. CFS Facts, ¶ 8. Each new securitization increased the number of Loans that CFS was required to service; thus, from 1995 to 1998, the number of CFS employees increased from 267 to approximately 3,900. CFS Facts, ¶¶ 9, 21.

The first thirteen securitizations were accomplished from 1995 to 1998 through what CFS named Securitized Multiple Asset Rated Trusts, which were known as the SMART series of securitizations. CFS Facts, ¶ 10. The SMART securitizations raised over $1.5 billion from investors. CFS Facts, ¶ 11. The final two securizations were called Global Rated Eligible Asset Trust ("GREAT") securitizations. CFS Facts, ¶ 10. Although BOA's claim arises from the GREAT 1998-B securitization, the SMART securitizations are relevant because some of the SMART securitizations were later consolidated into the GREAT securitizations. In addition, BOA claims to

have relied on CFS's representations concerning the performance of the SMART securitizations in choosing to invest in the GREAT 1998-B securitization.

Each of the SMART securitizations was structured in the same general way. CFS Facts, ¶ 12. Each was documented through an integrated package of agreements called the "Basic Documents."[5] CFS Facts, ¶ 13. The SMART securitizations were effectuated as follows: Pursuant to a Contribution and Sale Agreement, CFS or one of its affiliates[6] transferred a package of Loans to a special purpose vehicle ("SPV") that was also an affiliate or wholly-owned subsidiary of CFS and was specifically structured to be "bankruptcy remote." CFS Facts, ¶ 14. The SPV then transferred the Loans to a "bankruptcy remote" trust and the trust issued securities that were secured by the Loans. CFS Facts, ¶¶ 15-16. The SPV caused the securities to be sold to investors or to a placement agent. CFS Facts, ¶ 17. CFS or its affiliates received the proceeds of the sales of the securities, net of various transactional costs and fees. CFS Facts, ¶ 18.

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[5]CFS provides documents effecting the SMART 97-5 securitization as an example of the structure of the SMART securitizations. CFS App. Exh. A-1, A-2, A-12, A-14 and A-15. Ms. Benediktson testifies that this securitization is representative of the other SMART securitizations.

[6]In the Basic Documents, "affiliate" is a defined term meaning—

> With respect to any specified Person, any other Person controlling, controlled by or under common control with such specified Person. For the purposes of this definition, "control" when used with respect to any specified Person means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

CFS App. Exh. A-2, Sale and Servicing Agreement, at its Appendix A [Definitions] at 1. In the undisputed facts section of this order, the Court uses the term "affiliate" consistent with the above-stated definition. Whether entities are affiliates of CFS under the definition of "affiliate" in the Bankruptcy Code is a disputed legal issue in this case, and the Court's use of the term affiliate in this section is not an indication that the entity referred to is an affiliate under the Bankruptcy Code definition.

CFS was obligated under a servicing agreement to service the Loans– that is, to collect the Loans from the account debtors and make the collection revenues available for payment to the security holders. CFS Facts, ¶ 19. In the servicing agreement, CFS agreed not to resign as servicer unless the performance of its duties under the servicing agreement was no longer permissible under applicable law. CFS Facts, ¶ 20. To discharge its servicing obligations under the servicing agreement, CFS employed thousands of employees and implemented new computer systems to keep up with the rate of growth. CFS Facts, ¶ 21. The servicing agreement also required CFS to perform all of the duties of the trust, including keeping the books of the trust. CFS Facts, ¶ 22.

Securities holders were paid as follows: CFS instructed Loan account debtors to send their payments to a designated lock-box account that CFS established for each securitization. CFS Facts, ¶ 23. On a daily basis, collections were swept from the lock-box account into a designated collection account that CFS established for the benefit of the securities holders. CFS Facts, ¶ 24. Funds in the collection account were paid by a paying agent first to CFS for its servicing fees, then to other entities owed transaction fees, and the remainder to a distribution account, from which the securities holders were paid. CFS Facts, ¶ 25, 26. The paying agent made such payments pursuant to information obtained from CFS by virtue of monthly statements which contained calculations made by CFS as to the total amount available, the amounts of fees payable and "all other amounts required to determine the amounts to be deposited in or paid from each of the Collection Account, the Reserve Account and the Distribution Account." CFS Facts, ¶ 27; CFS App. A-2, § 6.6. CFS also created the monthly statements providing collection and financial information to securities holders and annual statements that securities holders required for tax purposes. CFS App. A-2, § 6.7 and Exh. C.

Beginning in June 1998, CFS, with others, structured the GREAT securitizations, which were to be a series of securitizations based on one "Master Trust." CFS Facts, ¶ 28. The primary difference in structure between the SMART and GREAT securitizations was that the GREAT securitizations employed a second tier of related trusts, known as "series trusts." CFS Facts, ¶ 29. In the GREAT securitizations, the trustee of the series trust was called the Series Owner Trustee. The series trusts issued notes to investors that were backed by a Trust Certificate. CFS Facts, ¶ 30. The Trust Certificate, which was issued to the series trust by the Master Trust, transferred to the series trust an undivided beneficial ownership interest in the Master Trust which held legal title to all of the Loans, including each new package of Loans securitized in each new series. CFS Facts, ¶ 31. With each new addition of a package of Loans to the Master Trust, a new series trust would be formed and notes would be issued to investors (the "Securities Holders"). CFS Facts, ¶ 33.

As with the SMART securitizations, CFS serviced the Loans and performed all the administrative functions of the GREAT securitizations through a master servicing agreement, which was supplemented to take into account each new series. CFS Facts, ¶ 34. On June 30, 1998, CFS entered into the Pooling and Servicing Agreement with CF/SPC GREAT, Inc. ("SPC," as the "Transferor" of the Loans), the Global Rated Eligible Asset Trust (as the "Master Trust" and "Certificate Issuer"), and Bankers Trust Company (acting in two capacities, as Master Trustee of the Master Trust, and as backup servicer in the event CFS became unable to perform servicing under the servicing agreement) (the "GREAT Servicing Agreement"). CFS App. Exh. A-7. The execution of the GREAT Servicing Agreement itself accomplished a number of steps in the securitization process. First, the GREAT Servicing Agreement acted as an instrument of conveyance whereby SPC transferred assets to the Master Trust. CFS App. Exh. A-7, § 2.1. In consideration for the transfer

of assets, the Master Trust was to issue securities to be delivered "upon the written order of the Transferor [SPC] pursuant to the Master Trust Agreement and other applicable Series Basic Documents" and a deferred consideration consisting of the right to remove Loans from the Master Trust and receive the residual after all securities were fully paid. Id., §§ 2.3, 4.9. Second, the GREAT Servicing Agreement provided the framework for the administration and servicing of the Loans and "management of the Assets." Id., § 3.1. The Certificate Issuer, that is the Master Trust, appointed CFS to perform these duties. Id.; CFS Facts, ¶ 35.

> With respect to these duties, the GREAT Servicing Agreement provides—
>
> (b) The Servicer's [CFS's] duties shall be to service the Loans and manage the Assets in accordance with the provisions of this Agreement and the Servicing Standards, including, without limitation, to collect and post all payments on the Loans, to respond to inquiries of Obligors on the Loans, to investigate delinquencies, to send payment statements to Obligors, to report tax information to Obligors to the extent required by applicable law, to account for collections, and to furnish monthly and annual statements to the applicable Trustees [defined as the Series Owner Trustee, the Series Indenture Trustee and the Master Trustee][7] with respect to distributions.

GREAT Servicing Agreement, CFS App. Exh. A-7, at 10, § 3.1(b). CFS was empowered to "do or cause to be done all things" necessary to collect the Loans owned by the Master Trust, including executing documents and commencing lawsuits in the name and on behalf of the Master Trust, without the need to obtain approval from the Master Trust. Id., § 3.1(c)-(e). CFS was required to "cause all Collections received in respect of any Related Assets to be allocated ratably among the Loans." Id., § 3.1(g).

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[7]See GREAT Servicing Agreement, CFS App. Exh. A-7, its Appendix A [Definitions] at 28.

In addition to servicing, the GREAT Servicing Agreement obligated CFS to perform all administrative duties for the Master Trust and the Series Trust. Section 11.1 of the agreement provides—

> (a) Servicer [CFS] shall perform all its duties and the duties of Certificate Issuer [the Master Trust] under the Master Trust Agreement and each Series Note Issuer [the Series Trust] under each Series Trust Agreement and shall consult with the Master Trustee and each Series Owner Trustee as Servicer deems appropriate regarding the duties of Certificate Issuer under the Master Trust Agreement and the duties of each Series Note Issuer under each Series Trust Agreement. Servicer [CFS] shall monitor the performance of Certificate Issuer and each Series Note Issuer and shall advise the Master Trustee and each Series Owner Trustee when action is necessary to comply with Certificate Issuer's duties under the Master Trust Agreement or each Series Note Issuer's duties under the applicable Series Trust Agreement. Servicer [CFS] shall prepare for execution by Certificate Issuer and each Series Note Issuer or shall cause the preparation by other appropriate Persons of all such documents, reports, filings, instruments, certificates and opinions as it shall be the duty of Certificate Issuer or such Series Note Issuer to prepare, file, or deliver pursuant to the Master Trust Agreement or Series Trust Agreement. In furtherance of the foregoing, Servicer [CFS] shall take all appropriate action that is the duty of Certificate Issuer to take pursuant to the Master Trust Agreement or any Series Note Issuer to take pursuant to the applicable Series Trust Agreement.

GREAT Servicing Agreement, CFS App. Exh. A-7 at 45, § 11.1(a). The agreement also restricted CFS from taking certain non-ministerial actions without notifying the Master Trustee and Series Owner Trustee and giving them an opportunity to withhold consent. These actions included amending or supplementing any of the Basic Documents and appointing successor agents or trustees. Id., § 11.1(b). CFS was also obligated to "maintain appropriate books of account and records relating to services performed under this Agreement, which books of account and records shall be accessible for inspection by Certificate Issuer and each Series Note Issuer at any time during normal business hours." Id., § 11.2. Additionally, CFS was required to

> (a) maintain (or cause to be maintained) the books of the Certificate Issuer [Master Trust] on a calendar year basis on the accrual method of accounting and (b) deliver

> to each Holder [defined as any Certificateholder or Noteholder], as may be required by the Code and applicable Treasury Regulations or otherwise, such information as may be required to enable each Holder to prepare its federal income tax return.

Id. at 18, § 4.5; CFS Facts, ¶ 36.

With respect to payments to Securities Holders, CFS determined the amount to be paid each month from the collection and distribution accounts and provided a report to the Master Trustee and the paying agent for each series. CFS Facts, ¶ 38. Section 6.6 of the GREAT Servicing Agreement provided—

> On or before each Delivery Date,[8] the Servicer [CFS] shall calculate the Total Available Amount,[9] the Servicing Fee, the Master Backup Servicing Fee for each Series, the Series Owner Trustee Fee for each Series, the Series Indenture Trustee Fee for each Series and all other amounts required to determine the amounts to be deposited in or paid from each Collection Account, information concerning Converted Loans, the Series Reserve Account for each Series and the Series Distribution Account for each Series, each as of the related Determination Date and shall provide a summary of the results of such calculations to the Master Trustee and each Series Paying Agent.

Id. at 30, § 6.6. CFS was responsible for "accounting for collections, and to furnish monthly and annual statements to the applicable Trustees with respect to distributions." Id. at 10, § 3.1(b). CFS was also to deliver to a monthly statement to the Depository Trust Company, the backup servicer

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[8]Delivery Date is defined at page 7 of Appendix A to the agreement as "the seventh Business Day (but in no event later than the eleventh calendar day) after the related Determination Date for such Monthly Period." The Determination Date is "the last calendar day in [each] such Monthly Period." Id. at 8.

[9]The Total Available Amount for each Monthly Period was (i) all Collections on the Loans received during such Monthly Period, (ii) the Warranty Payment or Administrative Purchase Payment for each Loan that was assigned to the Transferor or purchased by the Servicer during such Monthly Period, (iii) all Investment Earnings on amounts on deposit in the Collection Account during such Monthly Period and (iv) all other immediately available funds on deposit in the Collection Account . . . immediately prior to such Distribution Date." GREAT Servicing Agreement, Appendix A [Definitions] at 27.

[Bankers Trust] and each Security Holder. Id. at 30, § 6.7(a)-(b), and Exhibit C to the agreement.

On each Distribution Date, based upon the information contained in the monthly statements delivered by CFS, the Master Trustee [Bankers Trust] was to distribute funds from the Collection Account in the following order: first to pay the Master Trustee's fee, then to pay CFS's current servicing fees and prior unpaid servicing fees and then to reimburse CFS for certain accounting fees. Id. at 18-19, § 4.7. From the remaining funds collected by CFS, and using the calculations and reports provided by CFS, a paying agent was to make payments to the Security Holders. GREAT Series Trust 1998-B Trust Agreement ("Series Trust Agreement"), CFS App. Exh. A-8 at 8, § 5.1.

Section 5.10 of the GREAT Servicing Agreement, entitled "Non-consolidation with CFS," provided that –

> CFS shall be operated in such a way that none of the Certificate Issuer [Master Trust], the Transferor [SPC], nor any Series Note Issuer [Series Trust] would be substantively consolidated in the bankruptcy estate of CFS, and the separate existence of each of the Certificate Issuer, the Transferor and each Series Note Issuer would not be disregarded in the event of CFS's bankruptcy. . . .

Id. at 22, § 5.10. This paragraph is followed by fifteen subparagraphs describing actions the entities shall or shall not take to preserve the separate nature of each entity, such as observing entity formalities, appointing independent directors, maintaining separate bank accounts, requiring consideration for services, separating assets, debts, and financial statements, maintaining arm's length relationships, and conducting business in their own names. Id. at 23-25. In that context, the agreement provides—

> None of the Certificate Issuer [Master Trust], any Series Note Issuer [Series Trust] or the Transferor [SPC], on one hand, nor CFS or any of its Affiliates (other than the Transferor, as applicable), on the other hand, will be or will hold itself out to be responsible for the debts of the other or the decisions or actions respecting the daily business and affairs of the other.

Id. at 25, § 5.10(xiii).

The GREAT Servicing Agreement was executed by Ms. Benediktson as vice president of the SPC that transferred the Loans, and by Ms. Benediktson as vice president of CFS as servicer. Id. at S-1. The First GREAT securitization, GREAT 1998-A, closed on June 30, 1998. CFS Facts, ¶ 41.

The Master Trust Agreement and GREAT Servicing Agreement also served as the basis of the "Series Basic Documents" for the GREAT 1998-B securitization. CFS Facts, ¶ 42. The GREAT 1998-B Servicing Supplement (CFS App. Exh. A-3, the "1998-B Supplement") defined the GREAT 1998-B "Series Basic Documents" as the "Contribution and Sale Agreement, the Master Trust Agreement, the Pooling and Servicing Agreement, the Lock-Box Agreement, the Series Trust Agreement, the Series Indenture, the Series Interest Rate Cap, the Securities, this Series Supplement, the Series Purchase Agreements, the Custodian Agreement and such other documents and certificates delivered in connection therewith." 1998-B Supplement at 8.

BOA invested in the GREAT 1998-B securitization by purchasing the Series Note, and thereby became a Security Holder. In early 1998, BOA and Nationsbanc Montgomery Securities LLC ("NMS") entered into discussions with CFS regarding, among other things, a commitment by BOA to invest up to $600 million in securities through a conduit facility. CFS Facts, ¶ 43. On April 1, 1998, NMS prepared an Initial Credit Approval Recommendation ("Recommendation") relating to the creditworthiness of CFS. CFS Facts, ¶ 44. The author recommended initial credit approval for a $600 million facility in which BOA and its affiliates would purchase securities backed by a pool of loans consisting of charged-off credit card receivables that would be serviced by CFS. The

Recommendation is submitted by CFS as Appendix C.[10] In arriving at its recommendation that BOA and its affiliates enter into a transaction with CFS, the author discussed and evaluated CFS's history, operational capacity, financial strength, sources of revenue, and ratings of its prior securitizations. In supporting its recommendation for a $600 million facility, the author stated–

> Based on [CFS's] existing relationships with Goldman [Sachs], Chase, and [Bankers Trust], this transaction provides a unique opportunity for NationsBank to step into a dominant position as a financial advisor to the [sic] CFS. Other considerations include (i) the Company's dominant position in the industry, (ii) the strength of the credit rating of CFS's previous securitizations (A ratings by the four major agencies), and (iii) the potential of NMS to step into a strong position for [CFS's] initial public offering (anticipated in late 1998); NationsBanc Montgomery Securities LLC recommends the initial credit approval of NationsBank, N.A. for the transaction described herein.

Recommendation, CFS App. C at 13; CFS Facts, ¶ 49.

The discussions between CFS, BOA and NMS culminated in the execution of the Note Purchase Agreement dated July 1, 1998, which committed BOA to purchase up to $430 million in one or more series notes in the future. CFS Facts, ¶ 50; Note Purchase Agreement, CFS App. D at 11, §§ 2.1 and 2.2, and at 6 (see "Facility Limit"). The Note Purchase Agreement is a contract between and among CFS as Administrator; CF/SPC GREAT, Inc., a special purpose vehicle wholly owned by CFS, as Transferor of Loans ("SPC GREAT"); two commercial paper conduits administered by BOA: Kitty Hawk Funding Corporation ("Kitty Hawk") and Enterprise Funding Corporation ("Enterprise"), as Purchasers; and NationsBank (BOA) as Agent for the Purchasers/conduits (and other participating financial institutions) and as Alternate Purchaser. CFS

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[10]Although not authenticated by affidavit, BOA has not objected to the admission of CFS Appendices B-E, and therefore the documents are admitted for the purpose of considering summary judgment. Appendix B is a copy of a petition filed by BOA in Tulsa County District Court; Appendices C and E appear to be documents created by BOA or its affiliates; and Appendix D is a copy of the Note Purchase Agreement that was attached to BOA's Amended Complaint.

Facts, ¶ 52. Neither the Master Trust nor the Series Trust was a party to the Note Purchase Agreement.

The Note Purchase Agreement provided that CFS's subsidiary, SPC GREAT, would sell (or cause to be sold) a series note to the purchasers/conduits and BOA. Section 2.1 provided–

> Upon the terms and subject to the conditions set forth herein, (x) the Transferor [SPC GREAT], or the Administrator [CFS] on its behalf, may, at its option, sell or cause to be sold to the Agent [BOA], on behalf of the Purchasers or the Alternative Purchasers, as applicable, and (y) the Agent [BOA], on behalf of the Purchasers, may, provided that the Termination Date shall not have occurred, at each Purchaser's respective option, or the Agent [BOA], on behalf of the Alternative Purchasers, provided that the Termination Date shall not have occurred, shall, if so requested, purchase, without recourse except as provided herein, the Series Note, identified on the related Additional Note Purchase Supplement hereto for the Purchase Price set forth therein, not to exceed the Principal Facility Limit.

CFS App. D, Note Purchase Agreement at 11, § 2.1.[11] Section 2.2 provided for the sale of additional series notes to Purchasers.

In conjunction with offering the series note identified above to prospective purchasers, CFS prepared a Private Placement Memorandum (the "98-B PPM"). CFS App. Exh. A-6 at v; CFS Facts, ¶ 54. The 98-B PPM sets forth in detail CFS's role in the securitization. The 98-B PPM identified the Master Trust as the Certificate Issuer, the Series Trust as the Series Note Issuer, CFS as the Initial Seller and Servicer, SPC GREAT as the Transferor, and NMS as the Placement Agent and Initial Purchaser for the 1998-B securitization. The 98-B PPM describes a proposed transaction in which the Master Trust issues a certificate to the Series Trust, which certificate "represents[s] the right to receive . . . on each Distribution Date, accrued and unpaid Administrative Distributions . . . for such Series and all principal and interest on the Securities of such Series due to the holders thereof on

[11]The series note identified in § 2.1 is the Series Note at issue in this case.

such Distribution Date." CFS App. Exh. A-6 at ii. "The only source of funds available to the Certificate Issuer to pay interest and principal on the Trust Certificate will be the payments in respect of principal and interest collections and other proceeds of the Transferred Assets [the Loans]." Id. These Loans are the receivables purchased initially by CFS or its affiliate and sold or contributed by CFS to another affiliate, the Transferor, who transfers the Loans to the Master Trust, which has a contract with CFS for servicing. Id. at iv.

The 98-B PPM further provides that the Series Trust would hold the Trust Certificate and issue notes in an aggregate principal amount of up to $198,699,650. The notes were to be issued pursuant to a 1998-B Series Indenture with Bankers Trust as Indenture Trustee. Under the Indenture, the notes would be secured by the Trust Certificate and other assets. The 98-B PPM further stated that the "only source of funds available to the Series Note Issuer [Series Trust] to pay interest and principal on the Notes . . . will be the payments in respect of principal and interest that the Series Note Issuer receives from the Certificate Issuer [Master Trust] with respect to the Trust Certificate." Id. at iii. Again, these are CFS's collections on the Loans.

The 98-B PPM warned that CFS's servicing performance was fundamental to the performance of the Securities and that in the event CFS is no longer able or available to service the Loans, "[t]here may . . . be few or no successor Servicers capable of achieving comparable collection performance." Id. at 30; CFS Facts, ¶ 58. The PPM further explained that CFS had experienced significant growth since 1996 and that the success of the servicing the loan pools depended upon CFS being able to hire and train sufficient personnel. "No assurance can be given as to the ability of the Servicer to meet its future personnel requirements." CFS App. Exh. A-6 at 29.

The 98-B PPM directed prospective investors to contact CFS (rather than the Master Trust or Series Trust) for information regarding the transaction. CFS Facts, ¶ 56.

> Investors interested in purchasing the Securities should conduct an independent investigation of the Securities, CFS, the Transferor, the Certificate Issuer, the Series Note Issuer and the Loans. Officers of CFS are available to answer questions concerning the Securities, CFS, the Transferor, the Certificate Issuer, the Series Note Issuer and the Loans and will, upon request, make available such other information as investors may reasonably request.

CFS App. Exh. A-6 at v. BOA conducted its due diligence directly with CFS personnel. CFS Facts, ¶ 57.

In early September 1998, CFS notified BOA that a new series note, the GREAT 1998-B Series Note (the "Series Note"), would be issued on September 30, 1998. CFS Facts, ¶ 60. On or about September 30, 1998, pursuant to the commitment made in the Note Purchase Agreement, BOA, on behalf the conduits, Kitty Hawk and Enterprise, purchased the Series Note issued by the 1998-B Series Trust (the "Series Trust") for $189 million. CFS Facts, ¶ 61. This transaction occurred as follows:

CFS transferred a package of Loans to SPC GREAT pursuant to the GREAT Contribution and Sale Agreement (CFS App. Exh. A-11). CFS Facts, ¶ 62. SPC GREAT transferred the Loans to the Master Trust pursuant to the GREAT Servicing Agreement (CFS App. Exh. A-7). CFS Facts, ¶ 63. The Master Trust, a Delaware business trust, entered into the Series Trust Agreement with Wilmington Trust Company ("Wilmington"), as Series Owner Trustee, to form the Series Trust, which was also a Delaware business trust (CFS App. Exh. A-8). CFS Facts, ¶ 64. Pursuant to Sections 4.2(b) and 5.1 of the Master Trust Agreement and Section 2.3 of the GREAT Servicing Agreement, and at the direction of SPC GREAT, the Master Trust issued a Trust Certificate to the

Series Trust, giving the Series Trust an undivided beneficial ownership interest in the Master Trust, which held legal title to the Loans.[12] CFS Facts, ¶ 65. This beneficial interest related to newly acquired Loans transferred pursuant to the 1998-B securitization, to the Loans transferred to the trust in the 1998-A securitization, and to any future Loans from future securitizations. CFS Facts, ¶ 66.

The parties to the Series Trust Agreement, which created the Series Trust, declared that it was their intention that the Series Trust be a business trust under the Delaware Business Trust Statute. CFS App. Exh. A-8, § 2.6; CFS Facts, ¶ 67. Section 2.6 of the Series Trust Agreement states, in part–

> It is the intention of the parties hereto that the Series Note Issuer [the Series Trust] constitute a business trust under the Business Trust Statute and that this Agreement constitute the governing instrument of such business trust. . . . Effective as of the date hereof, the Series Owner Trustee [Wilmington] shall have all rights, powers and duties set forth herein and, to the extent not inconsistent herewith, in the Business Trust Statute with respect to accomplishing the purposes of the Series Note Issuer [Series Trust]. The Series Owner Trustee shall file the Certificate of Trust substantially in the form of Exhibit B hereto with the Secretary of State of Delaware.

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[12]Section 2.3 of the GREAT Servicing Agreement provides–

> In consideration of the transfer of the Transferred Assets to the Certificate Issuer [the Master Trust], upon request of the Transferor [SPC GREAT], the Certificate Issuer [the Master Trust] will cause Securities in authorized denominations to be duly authenticated and delivered to or upon the written order of the Transferor pursuant to the Master Trust Agreement and other applicable Series Basic Documents.

CFS App. Exh. A-7 at 2, § 2.3. Section 4.2 of the Master Trust Agreement provides–

> Each Trust Certificate of each Series will represent a fractional undivided beneficial interest in the Certificate Issuer [the Master Trust]. The Series Note Issuer [the Series Trust] for each Series will be entitled to receive, on each Distribution Date, the Series Available Amount for such Series in accordance with the terms of the Pooling and Servicing Agreement.

CFS App. Exh. A-4, at 12, § 4.2(b).

CFS App. Exh. A-8 at 5, § 2.6. The Certificate of Trust of GREAT Series Trust 1998-B was filed with the Delaware Secretary of State. CFS Facts, ¶ 68. The State of Delaware thus recognizes that the Series Trust was "duly formed under the laws of the State of Delaware and is in good standing and has a legal existence so far as the records of this office show, as of the thirtieth day of September, A.D. 1998." Certificate of Good Standing, CFS App. Exh. A-10.

As previously noted, for the GREAT 1998-B transaction, the GREAT Servicing Agreement and the Master Trust Agreement were supplemented by the 1998-B Supplement (CFS App. Exh. A-3). CFS Facts, ¶ 77. The 1998-B Supplement, by and among SPC GREAT as Transferor, CFS as Servicer, the Master Trust as Certificate Issuer, and Bankers Trust as Master Trustee and Backup Servicer, provides in its recitals–

> Pursuant to the Master Trust Agreement, dated as of June 30, 1998 (. . . as supplemented hereby . . .), between the Transferor and the Master Trustee, in connection with the issuance of a Series, the Transferor may from time to time issue, and direct the Master Trustee to authenticate, on behalf of the Master Trust, one or more Series of Certificates representing interests in the Transferred Assets.
>
> Pursuant to the Pooling and Servicing Agreement, dated as of June 30, 1998 (. . . as supplemented hereby . . .), among Transferor, Servicer, Master Backup Servicer and Master Trustee, the Series Supplement for any Series shall set forth certain terms and conditions with respect to such Series as shall be permitted by the Pooling and Servicing Agreement and otherwise required in connection with the issuance of such Series. Each of the Master Trust Agreement and the Pooling and Servicing Agreement provide that certain terms applicable to a Series are to be set forth in a Series Supplement. This Series Supplement is a "Series Supplement" as that term is defined in Appendix A to the Pooling and Servicing Agreement.
>
> Pursuant to this Series Supplement, the Transferor and the Certificate Issuer shall create a Series of Securities (the "Series 1998-B Securities") and specify certain of their terms.

1998-B Supplement at 1. This document further provides that "[c]apitalized terms used and not otherwise defined herein are used as defined in Appendix A to the Pooling and Servicing Agreement.

If a term is defined here and in Appendix A, the definition herein shall control." Id. at § 1.1.[13] The Series Owner Trustee, Wilmington, signed the 1998-B Supplement on behalf of the Series Trust. CFS Facts, ¶ 78.

As previously noted, the GREAT Servicing Agreement and the other documents listed as Basic Documents gave CFS broad powers and imposed obligations on CFS not only to service the Loans, but also to perform all functions allocated to the trustees of the Master Trust and the Series Trust, *i.e.*, CFS employees executed all banking transactions required under the documents, performed all necessary calculations and actions required for collection, allocation, payment and distribution of the proceeds of the Loans, generated reports to trustees and Securities Holders, issued tax statements, and generally performed all steps in the securitization process save actually making payments to the Security Holders, which was performed by a Paying Agent using information provided by CFS. CFS App. Exh. A-7, §§ 3.1 and 11.1.

VI. Conclusions of Law

A. Does the treatment of the ABS claims in the Plan bar CFS's Section 510(b) defense and counterclaim in this adversary proceeding under the doctrine of *res judicata*?

BOA suggests that the Court should refrain from considering the merits of CFS's Section 510(b) defense and counterclaim because, BOA contends, the provision in the Plan and Confirmation Order that dismisses with prejudice the adversary proceeding styled Commercial Financial Services, Inc. v. Norwest Bank Minnesota, N.A., et al., Adv. Case No. 00-0002-R (the "Section 510(b)

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[13]The Court spells out these sections of the Supplement because BOA disputes CFS's characterization that the 1998-B Supplement "incorporated" the GREAT Servicing Agreement. BOA Objection at 6. Based on the quoted recitals, the Court concludes that technically the GREAT Servicing Agreement is *supplemented* by the 1998-B Supplement, but this distinction does not appear to be material.

Adversary") constitutes *res judicata* of all Section 510(b) claims, including CFS's defense and counterclaim. BOA further contends that its *res judicata* defense to the counterclaim presents factual issues that preclude summary judgment. BOA Objection at 13. BOA has not presented evidence to frame any particular factual dispute requiring a trial on the *res judicata* issue, however. Thus, the inquiry is whether the undisputed facts that are before the Court are sufficient to preclude summary judgment in favor of CFS on BOA's *res judicata* defense.

As the proponent of an affirmative defense upon which BOA would have the burden of proof at trial, BOA has the burden, in defending against summary judgment, of coming forward with sufficient facts to establish the elements of its defense. F.D.I.C. v. Giammettei, 34 F.3d 51, 54-55 (2d Cir. 1994). In connection with its *res judicata* defense, BOA fails to comply with the Local Rule of this Court governing summary judgment which requires the non-movant to supply the Court with a statement of additional material facts in separately numbered paragraphs and supported by evidentiary materials. See Local Rule 7056(b). Instead, BOA incorporates into its argument various references to pleadings, orders and transcripts. These documents are attached as exhibits to BOA's Objection. CFS and the Intervenors have not objected to the procedure or the exhibits. The Court recognizes these exhibits as pleadings, orders and transcripts filed in either CFS's main bankruptcy case, Case No. 98-05162-R, or in the Section 510(b) Adversary. Although the Court would be justified in striking BOA's *res judicata* argument for non-compliance with the Local Rule, in the service of expediency and in recognition of the bias toward adjudicating issues on their merits, the Court will take judicial notice that BOA's exhibits are copies of documents that were filed with this Court and will consider the content of the exhibits for what they are: pleadings, orders and transcripts of hearings. Resolution of the *res judicata* issue at this juncture will advance the merits of the case

and will not prejudice any party, and in any case, no one has objected to BOA's defective procedure.[14]

Thus, the record on summary judgment for BOA's *res judicata* defense consists of the Second Amended Plan of Orderly Liquidation (Bankr. Doc. 3304) (the "Plan");[15] the Order Confirming Second Amended Plan of Orderly Liquidation (Bankr. Doc. 3306) ("Order Confirming Plan") attached to BOA Objection as Exhibit A; the First Amended Complaint to Disallow, Subordinate and/or Liquidate Asset-Backed Securities Claims ("Section 510(b) Complaint") in the case of Commercial Financial Services, Inc. v. Norwest Bank Minnesota, National Association, Adv. Case No. 00-0002-R (Adv. Doc. 15);[16] the First Amended Disclosure Statement Pursuant to Section 1125 of the Bankruptcy Code (Bankr. Doc. 3069) ("Disclosure Statement");[17] and the Transcript of the Proceedings, August 29, 2001 (Bankr. Doc. 3358) (the "Transcript").[18]

In the Section 510(b) Adversary, CFS sued Norwest Bank Minnesota, N.A. ("Norwest") and Bankers Trust Company ("Bankers Trust") in their respective capacities as Trustee and Back-up Servicer of the SMART and GREAT securitization trusts. Bankers Trust was the Trustee and Back-

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[14]The Court has the power and discretion to waive its own rules. See Local Rule 1001(c).

[15]The copy of the Plan attached as BOA's Exhibit B is incomplete; the complete Plan that was filed in the case will be considered by the Court.

[16]The copy of the Section 510(b) Complaint attached as BOA's Exhibit C is incomplete; the full complaint that was filed in the Section 510(b) Adversary will be considered by the Court.

[17]The copy of the Disclosure Statement attached as BOA's Exhibit D is incomplete; the complete Disclosure Statement that was filed in the bankruptcy case will be considered by the Court. The Court notes that CFS attached a complete copy of the Disclosure Statement to the CFS Reply as Exhibit A.

[18]The copy of the Transcript attached as BOA's Exhibit E is incomplete; the complete transcript that was filed in the bankruptcy case will be considered by the Court.

up Servicer of the GREAT 1998-B Series Trust, which is the Series Trust that issued the Series Note to BOA. Section 510(b) Complaint at 2. In the Section 510(b) Complaint, CFS sought to subordinate the claims that Bankers Trust had filed on behalf of itself and on behalf of beneficiaries of the securitization trusts, including BOA. In paragraph 75 of the Section 510(b) Complaint, CFS alleged–

> On or about June 11, 1999, BT [Bankers Trust] filed Proof of Claim No. 104 (the "GREAT 1998-B Claim") in the amount of $186,814,900.58, a copy of which (without exhibits) is included in the Appendix as Exhibit 61 and is incorporated herein by reference. The GREAT 1998-B Claim states that "[t]his Proof of Claim is asserted by Bankers Trust on behalf of Bankers Trust, the Noteholders and the Certificateholders . . ." [citation omitted]. In the GREAT 1998-B Claim, BT asserts claims against CFS's estate arising from CFS's purported breaches of the Servicing Agreement (as supplemented by the GREAT 1998-B Servicing Agreement Supplement) and the GREAT Contribution Agreement. . . . BT also seeks to have CFS repurchase the GREAT 1998-B Assets under Section 3.7(c) of the GREAT Servicing Agreement and Section 3.3 of the GREAT Contribution Agreement.

Section 510(b) Complaint at 36, ¶ 75. In a footnote, CFS stated: "The GREAT 1998-B Claim filed by BT covers the same claims asserted by BOA in its adversary complaint against CFS (Adv. No. 98-0356-R) in which BOA seeks imposition of a constructive trust." Id. at 36 n.7. In Count XIV of the Section 510(b) Complaint, CFS requested subordination of the GREAT 1998-B Claim pursuant to Section 510(b). Id. at 96, ¶¶ 359-68. After alleging that the GREAT 1998-B is a Delaware business trust and therefore a "corporation" that can be an "affiliate" of CFS, and that the GREAT 1998-B Basic Documents are "securities" of CFS, CFS stated—

> Notwithstanding BT's attempt to characterize the GREAT 1998-B Claim as a breach of contract claim, the GREAT 1998-B Claim is a claim "arising from rescission of a purchase or sale of a security of the debtor [CFS] or of an affiliate of the debtor," or a claim "for damages arising from the purchase or sale of such a security," as those terms are used in 11 U.S.C. § 510(b).

> Section 510(b) of the Bankruptcy Code mandates that the GREAT 1998-B Claim be subordinated to all claims or interests that are senior or equal to such claim, including, without limitation, the claims of CFS's general unsecured creditors.

Section 510(b) Complaint at 96, ¶¶ 367-68. The predecessor of the UCLT was permitted to intervene in the Section 510(b) Adversary in order to protect the interests of its constituents, whose claims would be diluted by approximately $1.4 billion in additional claims if the ABS Trustees' breach of contract claims were not subordinated. The Section 510(b) Complaint also served as an objection to the priority of the Trustees' claims. Thus, resolution of the Section 510(b) Adversary was crucial not only to the unsecured creditors, who were in danger of having their claims diluted, but also to the Securities Holders, who would receive nothing under a liquidating plan if CFS succeeded in subordinating the Trustees' claims.

BOA's *res judicata* defense is premised upon the language contained in Section VI (I) of the Disclosure Statement, Section 5.47 of the Plan, and paragraph 23 of the Order Confirming Plan. BOA claims that because these provisions dismiss the Section 510(b) Adversary with prejudice and therefore bar CFS from asserting subordination against the ABS Trustees' Claims, which included the Bankers Trust's claim arising from the GREAT 1998-B securitization, CFS is barred from seeking subordination of the Constructive Trust Claim.

Section VI (I) of the Disclosure Statement states–

> The Plan shall constitute a compromise and settlement pursuant to Section 1123(b)(3)(A) of the Bankruptcy Code as set forth in the terms of the Plan with respect to all rights, claims, causes of action, controversies and disputes arising under or relating to the Section 510(b) Adversary and/or the Interim Agreement Dispute. CFS, the OCUC, the ABS Committee, the ABS Trustees, all holders of Claims and Interests, and all other parties in interest, and their respective successors and assigns, shall be bound by such compromise and settlement and the terms of the Plan. As of the Effective Date, the Section 510(b) Adversary shall be deemed dismissed with

> prejudice, and the ABS Claims filed by the ABS Trustees shall be Allowed and treated as set forth in the Plan. . . .

Disclosure Statement at 52. Section 5.47 of the Plan similarly provides—

> The Plan shall constitute a compromise and settlement pursuant to Section 1123(b)(3)(A) of the Bankruptcy Code as set forth in the terms of this Plan with respect to all rights, claims, causes of action, controversies and disputes arising under or relating to the Section 510(b) Adversary and/or the Interim Agreement Dispute. CFS, the OCUC, the ABS Committee, the ABS Trustees, all holders of Claims and Interests, and all other parties in interest, and their respective successors and assigns, shall be bound by such compromise and settlement and the terms of the Plan. As of the Effective Date, the Section 510(b) Adversary shall be deemed dismissed with prejudice, and the ABS Claims filed by the ABS Trustees shall be Allowed and treated as set forth in this Plan. . . .

Plan at 32, § 5.47. And the Order Confirming Plan provides—

> Section 1123(b)(3)(a) of the Bankruptcy Code permits the Plan to provide for the settlement or adjustment of any claim or interest belonging to CFS. Section 5.47 of the Plan provides for the compromise and settlement of all rights, claims, causes of action, controversies and disputes arising under or relating to the Section 510(b) Adversary and/or the Interim Agreement Dispute. The Court finds that the compromise and settlement of the Section 510(b) Adversary and the Interim Agreement Dispute brokered by CFS was negotiated in good faith and at arms length by the OCUC and the ABS Committee. . . . The Court finds that CFS is receiving adequate consideration for the compromises and settlements contemplated in these sections and other provisions of the Plan. The Court further finds that all compromises and agreements embodied in the Plan which have not been approved previously by Final Order of the Bankruptcy Court are, pursuant to Section 363 of the Bankruptcy Code and Bankruptcy Rule 9019, fair, reasonable, in the best interests of CFS and its creditors, and a reasonable exercise of CFS's business judgment; constitute substantial, integral and material elements of the Plan, essential to the consummation of the transactions contemplated by the Plan and upon which creditors relied in connection with their voting on the Plan; and are authorized under Section 1123(b)(3)(a) of the Bankruptcy Code.

Order Confirming Plan at 8-9, ¶ 23.

The Plan and Confirmation Order are binding on CFS, the Intervenors and BOA. "It is well-settled that a confirmed chapter 11 plan has a binding effect on both debtors and claimants under the

plan, and functions as a judgment with regard to the parties bound by the plan." Tor Husjord Shipping v. Port Isabel/San Benito Navigation District (In re Burton Securities, S.A.), 202 B.R. 411, 418 (S.D. Tex. 1996), *aff'd* 129 F.3d 607 (5th Cir. 1997) (Table), *citing* Laing v. Johnson (In re Laing), 31 F.3d 1050, 1051 (10th Cir. 1994). Further, Section 1141(a) of the Bankruptcy Code, entitled "Effect of confirmation," provides—

> Except as provided in subsections (d)(2) [concerning debts excepted from discharge under section 523] and (d)(3) [concerning exceptions to discharge] of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a). Thus, the provisions of the Plan and Confirmation Order replace and supersede the pre-confirmation relationships between CFS and the ABS Trustees and between CFS and BOA. The Plan and Confirmation Order also represent the terms of the settlement of the Section 510(b) Adversary. One term of the settlement was that the Section 510(b) Adversary would be dismissed with prejudice. But nothing in the Plan or Confirmation Order indicates any intention by CFS to settle or otherwise compromise the Constructive Trust Claim or this litigation. As set forth herein *infra*, other provisions in the Plan clearly contemplate the continuation of CFS's opposition to the Constructive Trust Claim.

The Tenth Circuit Court of Appeals recently outlined the elements of *res judicata*, or claim preclusion (the term the Tenth Circuit prefers), as follows–

> Res judicata requires the satisfaction of four elements: (1) the prior suit must have ended with a judgment on the merits; (2) the parties must be identical or in privity; (3) the suit must be based on the same cause of action; and (4) the plaintiff must have had a full and fair opportunity to litigate the claim in the prior suit.

Plotner v. AT&T Corp., 224 F.3d 1161, 1168 (10th Cir. 2000). With respect to the first element, the appellate panel cited Clark v. Haas Group, Inc., 953 F.2d 1235, 1238 (10th Cir.), *cert. denied* 506 U.S. 832 (1992), for the proposition that a "'stipulated, voluntary dismissal of [the plaintiff's] first suit, approved by the court with prejudice, was a judgment on the merits' for res judicata purposes." Plotner, 224 F.3d at 1169. Thus, BOA correctly asserts that the agreed dismissal of the Section 510(b) Adversary with prejudice was a judgment on the merits. However, BOA further argues that the dismissal is also a judgment on the merits on the issue of subordination of the Constructive Trust Claim because (1) the Section 510(b) Adversary included a claim arising from GREAT 1998-B transaction; (2) BOA, as the beneficiary of the Series Trust, is in privity with the Trustee, Bankers Trust, one of the defendants in the Section 510(b) Adversary; and (3) CFS sought subordination of claims in both the Section 510(b) Adversary and in this proceeding.[19]

BOA further relies upon Restatement (Second) of Judgments § 24 in arguing that the scope of claims that are barred by the dismissal of the Section 510(b) Adversary includes any claim that arose out of the GREAT 1998-B securitization. Section 24 provides—

> (1) When a valid and final judgment rendered in an action extinguishes the plaintiff's claim pursuant to the rules of merger or bar (see §§ 18, 19), the claim extinguished includes all rights of the plaintiff to remedies against the defendant with respect to all or any part of the transaction, or series of connected transactions, out of which the action arose.
>
> (2) What factual grouping constitutes a "transaction," and what groupings constitute a "series," are to be determined pragmatically, giving weight to such considerations as whether the facts are related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understanding or usage.
>
> The general rule of this Section [24] . . . is subject to the exceptions stated in § 26.

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[19]BOA does not address the full and fair opportunity to litigate element.

RESTATEMENT (SECOND) OF JUDGMENTS § 24 (1982). Indeed, CFS's pursuit of subordination of Norwest's and Bankers Trust's claims against the estate in the Section 510(b) Adversary included the subordination of Bankers Trust's claim that arose from the GREAT 1998-B securitization, which is the same transaction that BOA claims resulted in a constructive trust in its favor. However, the broad transactional scope of *res judicata* set out in Section 24 of the Restatement is limited by the exceptions contained in Section 26 of the same Restatement. Section 26(1)(a) and (b) of the Restatement are directly applicable here. These provisions state—

> (1) When any of the following circumstances exists, the general rule of § 24 does not apply to extinguish the claim, and part or all of the claim subsists as a possible basis for a second action by the plaintiff against the defendant:
>
> > (a) The parties have agreed in terms or in effect that the plaintiff may split his claim, or the defendant has acquiesced therein; or
> >
> > (b) The court in the first action has expressly reserved the plaintiff's right to maintain the second action[.]

RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(a) and (b).

> With respect to the first exception, the Restatement commentators explain—
>
> Where the plaintiff is simultaneously maintaining separate actions based upon parts of the same claim, and in neither action does the defendant make the objection that another action is pending based on the same claim, judgment in one of the actions does not preclude the plaintiff from proceeding and obtaining judgment in the other action. The failure of the defendant to object to the splitting of the plaintiff's claim is effective as an acquiescence in the splitting of the claim.

Id., comment a. Here, the Section 510(b) Adversary and CFS's motion to dismiss the Constructive Trust Claim on the grounds of Section 510(b) subordination were simultaneously pending from January 5, 2000 (the date CFS filed its original Section 510(b) Complaint to commence the Section 510(b) Adversary) to September 17, 2001 (the Effective Date of the Plan which is when the Section

510(b) Adversary was deemed dismissed). Plan at 6, ¶ 44 and 32, § 5.47. BOA was on notice that CFS sought to dismiss or defeat the Constructive Trust Claim pursuant to Section 510(b) since at least August 3, 1999, when CFS filed its Motion to Dismiss in this proceeding (Adv. Doc. 35, 36). The subordination defense in this case remained pending up to and through confirmation of the Plan and was reasserted as a defense and a counterclaim after the motions to dismiss were resolved. Throughout the pendency of the twin litigations, BOA never argued that it was improper for CFS to assert its subordination argument in both proceedings nor did it request consolidation of the proceedings. The Court concludes that BOA acquiesced to CFS's "claim splitting" as a matter of law, and therefore the dismissal of the Section 510(b) Adversary does not preclude CFS from continuing to assert in this proceeding that the Constructive Trust Claim should be subordinated.

Section 26(1)(b) of the Restatement, the exception to the relitigation bar based upon the express reservation of a party's right to maintain the second action by court order, is also applicable. Because this exception requires interpretation of the Plan, the Court will recite the Plan provisions that in the aggregate can only be interpreted as preserving CFS's ability to seek subordination of the Constructive Trust Claim.[20]

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[20]BOA contends that the Court cannot establish the scope of the claims barred by the dismissal of the Section 510(b) Adversary without examining the intent of the parties and that intent is a contested factual issue precluding summary judgment. BOA Objection at 21. When a contract is not ambiguous, however, intent must be gleaned from the document itself and extrinsic evidence is not admissible. "[W]hether a contract is ambiguous to require extrinsic evidence to clarify the ambiguity is purely one of law for the court." First Nat'l Bank and Trust Co. v. Kissee, 1993 OK 96, 859 P.2d 502, 507.

> Oklahoma law states "[a] contract is ambiguous if reasonably susceptible of more than one interpretation." Williams v. Shearson Lehman Bros., Inc., 917 P.2d 998, 1004 (Okla.Ct.App.1996), or "through vagueness of expression it has a double meaning." See Cinocca v. Baxter Labs., Inc., 400 F. Supp. 527, 532 (E.D.Okla.1975). In other words, a contract is ambiguous if reasonably intelligent persons, on reading

The Plan definitions provide that the "BoA Constructive Trust Claim" is —

> the Claim asserted by BoA in the BoA Adversary [defined in ¶ 23 as "NationsBank, N.A. v. Commercial Fin. Servs. Inc., Adv. No. 98-0356-R pending before the Court"] seeking imposition of a constructive and/or resulting trust against certain funds now held by CFS in a segregated account by agreement of the parties and/or by an order entered by the Court on May 25, 1999. The BoA Constructive Trust Claim is a Disputed Claim.

Plan at 4, ¶ 23, 24. A "Disputed" claim is defined as —

> with respect to a Claim . . . (i) any Claim . . . as to which CFS or any other party in interest has interposed a *timely objection or request for estimation or subordination*, whether by *contested motion* or adversary proceeding, in accordance with the Bankruptcy Code, the Bankruptcy Rules and/or this Plan, which objection or request for estimation or subordination has not been withdrawn or determined by a Final Order in favor of the holder of the Claim . . . as of the Effective Date.

Plan at 5, ¶ 42 (emphasis added). The BoA Constructive Trust Claim was still a Disputed Claim as of the Effective Date because CFS and the Intervenors had interposed a timely objection to the claim *and* a timely request for subordination in their Motions to Dismiss, which was contested by BOA and which had not been determined by a Final Order, nor had the request for subordination been withdrawn.

> the contract, would honestly differ as to its proper meaning. See United States Fidelity & Guar. Co. v. Guenther, 281 U.S. 34, 37, 50 S.Ct. 165, 74 L.Ed. 683 (1930).

Gamble, Simmons & Co. v. Kerr-McGee Corp., 175 F.3d 762, 767 (10th Cir. 1999); cf., Bartmann v. Maverick Tube Corp., 853 F.2d 1540, 1545 (10th Cir.1988) ("[a] term is unambiguous where it is reasonably and fairly susceptible of only one meaning").

The Court concludes that the Plan and Confirmation Order unambiguously preserve CFS's right to defend the Constructive Trust Claim by seeking its subordination and therefore extrinsic evidence of intent is inadmissible. Because parol evidence cannot be presented as to intent, BOA's contention that an issue of material fact exists regarding intent is overruled and BOA's further complaint that it has not been afforded an opportunity for discovery on the issue of intent is moot. BOA Objection at 21.

In the Plan, the BoA Constructive Trust Claim is classified as a Class 3 Claim. Plan at 11, § 2.4. BOA asserted its Constructive Trust Claim separately from BOA's other claim against CFS, Claim No. 1901 in which BOA seeks damages for CFS's rejection its obligations under the $189 million Series Note to the extent that it is not compensated by the Constructive Trust Claim (the "Rejection Damages Claim").[21] BOA's unliquidated Rejection Damages Claim is an "Individual ABS Claim" that the Plan treats as a beneficial interest in Bankers Trust's Class 5 claim.

Section 4.5 of the Plan describes the treatment of the Class 5 ABS Claims. Claims of the ABS Trustees (Norwest and Bankers Trust) were considered impaired, and therefore the Trustees were entitled to vote on behalf of Class 5 to accept or reject the Plan. Plan at 15, § 4.5(a). Holders of Individual ABS Claims, including BOA with respect to its Rejection Damages Claim, were not entitled to vote directly– the ABS Trustees were required by their contracts to comply with the instructions of their beneficiaries, however. In general, the Plan provides that the ABS Liquidating

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[21]Exhibit D of Plan is a list of "Individual ABS Claims." BOA's Claim No. 1901 appears on page 6 of Exhibit D. A footnote to that claim states—

> Claim No. 1901 filed by Bank of America, N.A., f/k/a NationsBank, N.A. ("BoA"), is an Individual ABS Claim to the extent that it asserts a claim for rejection damages arising under Sections 2.3 and 2.4 of the Note Purchase Agreement. BoA asserts that its rejection damage claim has a liquidated component ($4,728,554.36) and an unliquidated component. See Claim No. 1901, at ¶¶ 3-4.

BOA's Constructive Trust Claim and its Rejection Damages Claim overlap because BOA seeks different remedies for the same loss. In effect, BOA has protected itself by pursuing not only the constructive trust remedy to compensate for a portion of its claim (approximately $50 million), but a claim for rejection damages (*i.e.*, the unpaid portion of the Note) which includes recovery of damages for the same $50 million loss in the event that BOA is not successful in obtaining a constructive trust remedy.

Trust, of which the two ABS Trustees are beneficiaries, will receive 55% of the net proceeds[22] of the liquidation of CFS's assets, and distributions of those proceeds are to be made by the ABS Liquidating Trust to the ABS Trustees in a *pro rata* fashion. The ABS Trustees will in turn make distributions to their beneficiaries, including BOA to the extent of its unliquidated Rejection Damages Claim. Plan at 15, § 4.5(b).

In order to prevent a double recovery to Individual ABS Claimants who are the beneficiaries of the ABS Trusts, all Individual ABS Claims, including BOA's Rejection Damages Claim, were disallowed as duplicative of the Trustees' ABS Claims. The Individual ABS Claimants will recover their share of the liquidation proceeds not from the estate, but from their respective ABS Trustees. Section 4.5(e), entitled "No Direct Distribution to Holders of Individual ABS Claims," provides–

> As provided in Section 4.5(f) below, ABS Claims [asserted by the ABS Trustees] shall be Allowed in the full amount of the total outstanding indebtedness owed under and relating to the ABS Trusts. The Allowed ABS Claims represent the aggregate of all outstanding claims of holders of notes and certificates under the ABS Trusts and, hence, subsume recoveries by holders of Individual ABS Claims. The Individual ABS Claims shall receive compensation with respect to their Claims through the allowance of the ABS Claims and distributions from the ABS Trustees. Individual ABS Claims shall receive no direct distributions under the Plan, and shall have no further right to assert Claims against CFS or the Estate.

Plan, at 16-17, § 4.5(e). The Plan provides further—

> Allowance of ABS Claims. Pursuant to and by operation of this Plan, the respective proofs of claim filed by each of the ABS Trustees [Norwest and Bankers Trust] are hereby deemed amended to withdraw claims of federal, state or common law fraud, if any, and are combined, modified and Allowed as an Allowed ABS Claim as set

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[22]For the purpose of this dispute, it is sufficient to address in general terms how the liquidated estate will be divided between the ABS constituency on one side and the unsecured creditors on the other. The Court acknowledges that some of the estate's recoveries of cash, such as from D&O insurance policies, and the payment of certain unadjudicated claims, such as indemnification claims, are allocated between the two constituencies in a different manner.

forth immediately below. The percentage distribution of the ABS Fund to be paid to each ABS Trust is also set forth below:

ABS Trust	Claim Nos.	Amount of Allowed ABS Claim	Percentage (%) Distribution from ABS Fund
*****	*****	*****	*****
GREAT 1998-B	104, 1993	$185,198,043.12 [fn 2]	11.50% [fn 3]

Plan at 17, § 4.5(f). The footnotes beside the amounts in the table state: "2/ The $185,198.043.12 is comprised of $179,435,229.13 for GREAT 1998-B noteholders [BOA] and $5,762,813.99 for GREAT 1998-B certificateholders [also BOA]" and "3/ The approximate percentage distribution from the ABS Fund to be paid to GREAT 1998-B shall decrease if and to the extent that the BoA Constructive Trust Claim is Allowed as set forth more fully in Section 4.3(c) of the Plan." Plan at 17, § 4.5(f).

Section 4.3 of the Plan, explaining the treatment of the BoA Constructive Trust Claim, provides—

> (a) Impairment and Voting. Class 3 is not impaired by the Plan. BoA, as holder of any Allowed BoA Constructive Trust Claim in Class 3, is deemed to have accepted the Plan.
>
> (b) Payment of Claim. The CFS Liquidating Trustee shall pay BoA in full from the BoA Reserve the amount of the BoA Constructive Trust Claim (to the extent that such Claim is Allowed by a Final Order) on the day on which such Claim becomes an Allowed Claim, or as soon thereafter as practicable. To the extent that the BoA Constructive Trust Claim is disallowed, the corresponding amount of the BoA Reserve shall be distributed by the CFS Liquidating Trustee, fifty five percent (55%) to the ABS Liquidating Trust and forty five percent (45%) to the Unsecured Creditors Liquidating Trust, pursuant to 4.4 and 4.5 of this Plan.
>
> (c) Effect of Payment on the Allowed ABS Claim in favor of GREAT 1998-B. The amount of BoA's beneficial interest in the Allowed ABS Claim in favor of the ABS Trustee of GREAT 1998-B shall be reduced by the amount of any Allowed BoA

> Constructive Trust Claim, and BoA shall be entitled to its Pro Rata distribution on account of such beneficial interest pursuant to Section 4.5 hereof only to the extent of such reduced amount. Unless and until the BoA Constructive Trust Claim is either Allowed or disallowed by a Final Order, BoA shall not be entitled to a distribution on account of its beneficial interest in the Allowed ABS Claim for GREAT 1998-B to the extent of the amount of the BoA Constructive Trust Claim; and the ABS Liquidating Trustee shall not establish or hold a Reserve on account of that portion of BoA's beneficial interest in the Allowed ABS Trust Claim for GREAT 1998-B.

Plan at 13-14, § 4.3.

BOA argues that because Section 4.5(f) of the Plan provides for the payment of a percentage of approximately $180 million to Bankers Trust on account of the GREAT 1998-B claim, which is the full amount of BOA's unliquidated Rejection Damages Claim, that BOA's claim is *unsubordinated* in the Plan, and because the Plan is binding, no part of BOA's claim can be subordinated at this point. BOA Objection at 22-25. Thus, BOA argues that CFS's subordination defense and counterclaim are inconsistent with BOA's treatment in the Plan. BOA ignores the difference between its Rejection Damages Claim, on which Bankers Trust will recover on an unsubordinated basis, and its Constructive Trust Claim, the subordination of which has not yet been adjudicated.

The Court finds that the Plan's treatment of the BoA Constructive Trust Claim and BOA's unliquidated Rejection Damages Claim recognizes the pendency of the subordination defense in the BOA Constructive Trust Adversary and fully anticipates and addresses all possible resolutions of the adversary, including CFS's subordination defense and counterclaim. Accordingly, if BOA is successful in establishing a constructive trust *and* in defeating CFS's subordination claim, the following will occur–

- BOA will recover the full amount of the BoA Reserve (Plan, § 4.3(b));

- Bankers Trust's Allowed ABS Claim related to the GREAT1998-B securitization will be reduced by the amount BOA recovers on the Constructive Trust Claim and therefore its percentage of the ABS Liquidating Trust proceeds will be correspondingly reduced (Plan, §§ 4.3(c) and 4.5(f) n.3); and

- BOA's recovery from Bankers Trust (*i.e.*, BOA's Rejection Damages Claim) will be reduced to the amount that Bankers Trust obtains on account its GREAT 1998-B Allowed Claim (Plan, §§ 4.3(c) and 4.5(e)).

The Plan anticipates that some claims may be subordinated after confirmation, as a separate class, Class 6, was created for such subordinated claims. Section 4.6 of the Plan provides that a member of Class 6 "shall receive no distribution on its Class 6 Claim." Plan at 17-18, § 4.6(b). Thus, if CFS's subordination defense and counterclaim are successful, the following will occur–

- The Constructive Trust Claim will be subordinated in priority to claims "senior to or equal the claim represented by such security" (11 U.S.C. § 510(b)). Claims equal to the Series Note are the other Individual ABS Claims who will recover through their Trustees under Class 5. Thus, the Constructive Trust Claim will be reclassified as a Class 6 Claim (Plan, §§ 4.5, 4.6).

- The BoA Reserve will be distributed by the CFS Liquidating Trustee, fifty-five percent (55%) to the ABS Liquidating Trust and forty-five percent (45%) to the Unsecured Creditors Liquidating Trust (Plan, §§ 4.3(b));

- Bankers Trust will receive a percentage of liquidation proceeds based on the full amount of its Allowed ABS Claim on account of the GREAT 1998-B securitization (Plan, § 4.5(f)); and

- BOA will recover on its Rejection Damages Claim from Bankers Trust (Plan, § 4.5(e) and (f)).

The same result flows from the situation in which BOA simply fails to establish the elements of a constructive trust–it may recover its full *pro rata* share of its Rejection Damages Claim through its ABS Trustee.

Thus, BOA's treatment in the Plan is fully consistent with allowing CFS and the Intervenors to pursue their subordination argument.

Finally, Section 8.3 of the Plan, entitled "Preservation of Claims, Causes of Action and Objections to Claims," provides in pertinent part—

> (a) In accordance with Section 1123(b)(3) of the Bankruptcy Code, the CFS Liquidating Trustee (as representative and attorney in fact of CFS and/or the Estate) will receive from CFS the right to prosecute any claims and causes of action against third parties, . . . including, without limitation, . . . *claims and causes of action against or involving . . . BoA, and the right to object to Claims and to file complaints or motions to subordinate and/or estimate Claims*. Except as otherwise expressly set forth in this Plan, the CFS Liquidating Trustee shall have the right and power to object to Claims or Interests *on any ground*, including the grounds set forth in Section 502 of the Bankruptcy Code.
>
> (b) CFS's Schedules identify Creditors whose claims are Disputed . . . . Further, CFS has already filed numerous objections to Claims and adversary complaints to disallow, *subordinate* and/or estimate Claims, many of which remain pending. . . . **THIS PLAN DOES NOT AND IS NOT INTENDED TO RELEASE ANY SUCH OBJECTIONS TO CLAIMS (EXCEPT ANY OBJECTIONS TO THE ABS CLAIMS; *ABS CLAIMS* ARE EXPRESSLY ALLOWED PURSUANT TO THIS PLAN), OR CLAIMS AND CAUSES OF ACTION AGAINST THIRD PARTIES. ALL SUCH RIGHTS, CLAIMS AND CAUSES OF ACTION ARE SPECIFICALLY RESERVED AND RETAINED BY CFS AND/OR THE ESTATE.**

Plan at 37-38, § 8.3(a) and (b) (italics added).

The Court concludes that Section 8.3(a) and (b) constitute a clear and explicit reservation by CFS of the right to object to and seek subordination of the Constructive Trust Claim. In subsection (a), CFS preserved its right to object to the Constructive Trust Claim on any ground, including subordination. Subsection (b) expressly provides that confirmation of the Plan will not release any pending subordination claims or objections to claims. CFS's and Intervenors' Motions to Dismiss the Constructive Trust Claim, which asserted that BOA's claim was subject to mandatory subordination, were pending at the time the Plan was confirmed. Therefore, the subordination objections were preserved.

BOA argues that the language set out in bold capital letters excepts its Constructive Trust Claim from CFS's reservation of rights. The exception, however, only releases objections to the ABS Claims, which are defined in the Plan as claims asserted by any ABS Trustee. Plan at 1, ¶ 2. The Constructive Trust Claim is not a claim asserted by any ABS Trustee.

The Court concludes, as a matter of law, that the Plan and Confirmation Order *expressly preserve* CFS's and the Intervenors' right to maintain their subordination claims and objections to the Constructive Trust Claim, and as such, the dismissal of the Section 510(b) Adversary does not bar such action. See RESTATEMENT (SECOND) OF JUDGMENTS § 26(1)(b).

B. Must the Court decide the merits of the Constructive Trust Claim before the merits of CFS's Section 510(b) defense and counterclaim?

As stated above, the CFS Motion picks up where the Order Resolving Motions to Dismiss left off insofar as the Section 510(b) verses Section 541(d) debate is concerned. In the Order Resolving Motions to Dismiss, the Court concluded generally that a claim seeking the remedy of a constructive trust over proceeds that can be traced to the purchase and sale of a security is a claim for rescission of such purchase and sale which directly implicates the application of Section 510(b) to subordinate such a claim. See Order Resolving Motions to Dismiss at 16-27 (268 B.R. at 592-98). BOA reasserts the proposition that the Court must *first* decide the merits of its Constructive Trust Claim under Oklahoma law before considering whether Section 510(b) imposes any limitations on the claim. See BOA Objection at 7-13. BOA argues that if it can prove the elements entitling it to a constructive trust remedy under state law, the Fund, now in the BoA Reserve, will be excluded from the estate pursuant to Section 541(d), and therefore would not be property subject to

distribution to CFS's creditors.[23] Because Section 510(b) states that "[f]or the purpose of distribution," a claim for rescission of a securities transaction "shall be subordinated" to claims

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[23]BOA now argues that the Court lacks jurisdiction to subordinate BOA's claim because the Court's jurisdiction "is limited to matters affecting the estate and the parties' conflicting claims to estate property." BOA Objection at 7, *citing* U.S. v. Challenge Air Int'l, Inc. (In re Challenge Air Int'l, Inc.), 952 F.2d 384 (11th Cir. 1992). Therefore, BOA argues, if the Fund is ultimately found to be subject to a constructive trust, the Fund will no longer be property of the estate.

BOA neglects to mention that the Court has core jurisdiction to adjudicate "counterclaims by the estate against persons filing claims against the estate" (28 U.S.C. § 157(b)(C)), which includes a counterclaim to subordinate a claim for rescission of a securities transaction (11 U.S.C. § 510(b)). At this point, BOA only has a claim for rescission of a securities transaction and seeks the remedy of a constructive trust. In any event, BOA's claim and CFS's subordination defense is clearly a "matter affecting the estate" since the disposition of over $50 million of deposits in CFS bank accounts is at stake.

BOA also offers Fiscint, Inc. v. First Wisconsin Financial Corp. (In re Xonics, Inc.), 813 F.2d 127 (7th Cir. 1987) for the proposition that "[o]nly after identifying the 'property of the estate' may the bankruptcy court apportion that property among creditors." BOA Objection at 7. Xonics, however, concerned the bankruptcy court's jurisdiction of a dispute between two creditors over property that the estate had *abandoned*. The court correctly held that "[t]he resolution of that dispute would not affect the creditors of the bankrupt, and there would be no source of jurisdiction." Id., 813 F.2d at 131. In this case, CFS has not abandoned the Fund, but in fact claims ownership of the Fund and seeks to subordinate BOA's rescission claim, which, if met with success, would increase the pool of liquidation proceeds to be distributed to unsecured creditors and to the ABS Claimants. The rule of Xonics is not relevant to this Court's jurisdiction.

Continental Nat'l Bank v. Sanchez (In re Toledo), 170 F.3d 1340 (11th Cir. 1999), also cited by BOA, is not applicable for the same reason. There, the debtor, who owned 50% of a partnership, did not even arguably have an interest in the partnership's real property; thus the bankruptcy court did not have core jurisdiction to determine the validity or priority of liens on this non-estate property. See also Torkelsen v. Maggio (In re The Guild and Gallery Plus, Inc.), 72 F.3d 1171 (3d Cir. 1996) (cited by BOA and also not relevant; there, it was "uncontroverted that the property [at issue] . . . was never 'property of the estate'. . . ." Id. at 1173).

BOA cites Pearlman v. Reliance Ins. Co., 371 U.S. 132 (1962), as authority for the premise that "bankruptcy law does not authorize distribution of other people's property among creditors of the debtor." BOA Objection at 7. This statement is true as a general principle. However, it is also true that in many instances, the Bankruptcy Code authorizes the reversal of otherwise effective property transfers to maximize the estate's distribution to creditors. See 11 U.S.C. §§ 544-550. Exercising rights under one of these statutes might appear to be "distributing other people's property among creditors of the debtor" in absence of the authorization to do so under the Bankruptcy Code. Similarly, Section 510(b) authorizes the subordination of certain rescission claims, even if subordination might defeat a claim to equitable ownership of funds.

represented by the security, BOA argues that it does not seek priority in "distribution" of property of the estate, but rather seeks a declaration of equitable ownership of such property under state law, and thus Section 510(b) does not apply.

The Constructive Trust Claim is based upon BOA's allegation that fraud infected the disclosures upon which it based its decision to purchase securities. In bankruptcy, claims arising from allegations of fraud in the purchase of securities are subject to subordination because claims for rescission or damages result in the elevation of the claim to a higher distribution priority than the security itself would yield in bankruptcy. One of the underlying policies of bankruptcy law is the equitable distribution of assets of the debtor. By enacting Section 510(b), Congress consciously closed potential loopholes that might allow claimants to unfairly elevate their priority in distribution over similarly situated claimants. The purpose and policy of Section 510(b) resolve the philosophical inquiry as to whether a defrauded securities purchaser who can trace some proceeds of its transaction to some asset of the estate should be entitled to recover in full prior to any recovery by other defrauded securities purchasers who cannot trace proceeds to assets of the estate. In this case Congress would have asked: Should a defrauded security purchaser be paid in full before any unsecured trade creditor receives any distribution? Who *should* shoulder the risk that these complex structured multi-million dollar securities transactions might be tainted with fraud: Unsecured trade creditors who never had any opportunity to avoid the fraud, or the party purchasing the securities who had direct access to due diligence materials and to the principals and professionals promoting the transaction?

The Court believes that the federal interest expressed by Congress when enacting Section 510(b)— that claimants who voluntarily assume the risk of fraud and insolvency by purchasing a

security in order to obtain potential benefits beyond those of an unsecured creditor should be subordinated – overrides the state's interest in creating an equitable ownership interest in property through a fictitious trust to compensate victims of fraud *when those victims are defrauded securityholders*. See Butner v. United States, 440 U.S. 48, 55 (1979) (property interests created by state law will be respected in bankruptcy unless "some federal interest requires a different result;" in footnote 10 of the opinion, the Supreme Court notes, for example, that bankruptcy laws requiring the avoidance of preferential or fraudulent transfers disturb state law property rights, including outright ownership of property, "in order to protect general creditors").

The most persuasive evidence that Congress intended that claims for rescission of securities transactions be subordinated, even claims that seek the remedy of a constructive trust, is its express adoption of the views espoused by John J. Slain & Homer Kripke in THE INTERFACE BETWEEN SECURITIES REGULATION AND BANKRUPTCY – ALLOCATING THE RISK OF ILLEGAL SECURITIES ISSUANCE BETWEEN SECURITYHOLDERS AND THE ISSUER'S CREDITORS, 48 N.Y.U. Law Rev. 261 (1973) (hereinafter "Slain & Kripke"). Slain and Kripke's article advocated that the results of two cases, Oppenheimer and Rhine, should be legislatively overruled because they resulted in a rash of securityholders attempting to elevate their claims from last priority to the priority of unsecured claims. Rhine permitted "reclamation" by defrauded investors of funds traceable from their purchase of oil and gas working interests (which Congress likened to "investment contracts," thus securities) to the seller/debtor's bank accounts. See In re Rhine, 241 F. Supp. 86, 91, *rehearing denied*, 242 F. Supp. 127 (D. Colo. 1965). Slain and Kripke sharply criticized the outcome of Rhine, stating—

> It is important to focus on the practical effects of the Rhine decision. In addition to the rescinding purchasers of working interests, the bankrupt had other creditors whose claims arose from the operation of the venture: open-account vendors, laborers

> and other suppliers of goods and services. The result of a successful reclamation would have been the payment of all traceable assets of the estate to the former owners of the equity interest in the business, with general creditors sustaining a total loss. Thus, in any situation where tracing is possible, Rhine suggests that rescinding equity investors have a real possibility of bootstrapping their way to secured creditor status. Yet, the same rescinding investors would have received the entire benefit of the venture had it prospered. This is an enviable posture clearly contrary to the usual rule that leveraged opportunity for gain also entails leveraged, rather than sheltered, risk of loss.

Slain & Kripke, at 279. They continued–

> The time has come for a reconsideration of the preference given to restitutionary interests, at least in the context of rescinding securityholder claims. There are compelling reasons why the general premise of American law that the victims of the wrongdoer should prevail over his general creditors should not apply here. . . .
>
> The Oppenheimer-Rhine view . . . is tunnel vision. It fails to see that in any case of issuer insolvency the claims of rescinding stockholders can be satisfied only out of assets which otherwise would be allocated to making innocent parties whole. The parties did nothing to create the rescinder's problems and in the overwhelming majority of cases advanced money, labor or credit in reliance on the existence of the equity or junior debt cushion which the rescinder purported to provide. The Oppenheimer-Rhine approach can be justified only if it is assumed that the policies underlying federal and state securities law are of such transcendental importance that they necessarily displace all other doctrines of law and all considerations of simple fairness. It is our thesis that no rational basis exists for such an assumption.

Id. at 285-86. Congress concurred with Slain and Kripke's critique of the then-current law and adopted as federal bankruptcy policy the Slain/Kripke view that once bankruptcy has been filed, claims of rescinding security holders who might otherwise be entitled to recover traceable assets ahead of or untraceable assets in *para passu* with general creditors should *not* be permitted to recover any assets until general unsecured creditors have been made whole. See H.R.Rep No. 95-595, 95th Cong. 1st Sess. at 195-96 (1977), reprinted in COLLIER ON BANKRUPTCY (hereinafter "COLLIER"), App. C, Pt. 4(d)(i) at 1308-09 (Lawrence King ed.,15th ed. rev.)(1979). The policy is justified by the fact that in exchange for the upside benefits not shared with general creditors, security holders should

be allocated the risk that the security transaction was tainted by fraud, a risk that general creditors had no opportunity to avoid.

BOA's Constructive Trust Claim parallels the Rhine plaintiffs' "reclamation" claim. Congress expressly overruled the result of Rhine and iterated a policy that *all* claims for rescission by defrauded investors, even rescission claims that seek a remedy through the fiction of a constructive trust, should stand behind innocent general unsecured creditors. See id. at 195, COLLIER, App.C, Pt. 4(d)(i) at 1307, *citing* In re Rhine, 241 F.Supp. (D. Colo 1965) [sic].

Nothing in the BOA Objection persuades the Court that its earlier analysis of the language, purpose and legislative history of Section 510(b) and its application to a claim seeking rescission of a securities transaction in order to obtain the remedy of a constructive trust, or that its construction and harmonization of the two competing statutes, Sections 510(b) and 541(d), is in error. See Order Resolving Motions to Dismiss at 17-27 (268 B.R. at 592-99).[24] Since the Order Resolving Motions

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[24]BOA sets up a false dichotomy in the BOA Objection, arguing—

> A. If the debtor has legal *but not* equitable title to property, Section 541(d) bars the equitable interest from entering the estate via Section 541(a), thus precluding distribution of the equitable interest under Title 11, and Section 510(b) is not implicated;
>
> ***or***
>
> B. if the debtor holds legal *and* equitable title to property, Section 541(d) is not implicated; the property enters the estate via Section 541(a) fully subject to distribution under Title 11, in which event Section 510(b) subordination issues become meaningful.

BOA Objection at 11 (emphasis in original). The premise of each statement assumes that the kind of title to the Fund CFS possesses – legal, equitable or both – can be determined without first assessing the nature of BOA's claim to the Fund. The status of CFS's title depends upon the resolution of the merits of the Constructive Trust Claim and in fully adjudicating the merits, the Court must first determine CFS's complete or dispositive defenses, one of which is subordination of the *claim itself*.

Section 510(b) subordinates "claims for rescission." BOA's request for the *remedy* of

to Dismiss was entered, the Tenth Circuit Court of Appeals has decided Allen v. Geneva Steel Co. (In re Geneva Steel Co.), 281 F.3d 1173 (10th Cir. 2002). In Geneva, the Tenth Circuit construed Section 510(b) broadly in order to implement the intent of Section 510(b), allowing that the "unfortunate reality behind Section 510(b) . . . is a strong congressional disapproval of investor fraud claims in bankruptcy." Id. at 1179. Encouraged by Geneva's expansive interpretation of Section 510(b), this Court reiterates and incorporates herein the legal conclusions announced in the Order Resolving Motions to Dismiss as if set out in full.

The Court finds further that resolution of the Section 510(b) issue could be dispositive because if the Constructive Trust Claim is subordinated, it will be reassigned to Class 6 which provides for no distribution, rendering the amount or allowance of the Constructive Trust Claim moot.

C. Is the Series Trust is an "affiliate of the debtor?"[25]

In the preliminary stages of this litigation, the Court was not able to assess whether Section 510(b) applied to the Constructive Trust Claim because BOA's Complaint and its attachments did not contain evidence upon which the Court could conclude as a matter of law that the Series Note was a security of CFS or of an "affiliate" of CFS.

Section 510(b) provides–

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constructive trust presupposes rescission, and therefore this proceeding is one on a "claim for rescission." Section 510(b) subordinates claims for rescission of "a purchase or sale of a security of the debtor or of an affiliate of the debtor." Whether the Series Note or Note Purchase Agreement are securities of CFS or of a CFS affiliate is the primary issue presented by CFS in CFS's Motion.

[25]The resolution of this issue eliminates the need to decide whether the Note Purchase Agreement is a security of CFS, an alternate argument urged by CFS.

> For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

11 U.S.C. § 510(b). Section 101(2)(C) states—

> [A]ffiliate means —
>
> *****
>
> (C) person whose business is operated under a lease or operating agreement by a debtor, or person substantially all of whose property is operated under an operating agreement with the debtor.

11 U.S.C. § 101(2)(C). CFS contends that the Series Trust, which issued the Series Note, was CFS's "affiliate" because CFS operated the business and property of the Series Trust under an operating agreement.

In order for the Series Trust to be an "affiliate" of CFS, it must first conform to the definition of "person" under the Bankruptcy Code. "'[P]erson' includes individual, partnership, and corporation, but does not include governmental unit . . . ." 11 U.S.C. § 101(41). Although the Bankruptcy Code does not specifically include trusts in the realm of "persons," the definition of "corporation," which is a "person," includes "(i) association having a power or privilege that a private corporation, but not an individual or a partnership, possesses; . . . or (v) business trust." 11 U.S.C. § 101(9)(A).

If the Series Trust is a "business trust," then it qualifies as a "person" that may be an "affiliate of the debtor." CFS contends that the Series Trust is a "business trust." BOA contends that the Series Trust merely holds and protects assets and does not operate a business, and therefore it is a trust in the generic sense rather than a "business trust." What constitutes a "business trust" is

therefore a pivotal issue that requires an examination of the nature, purpose, function and form of the entity alleged to be a business trust. See In re Sung Soo Rim Irrevocable Trust, 177 B.R. 673, 676-79 (Bankr. C.D. Cal. 1995).[26]

Courts that have been called on to interpret the term "business trust," as it appears in the Bankruptcy Code, have had an opportunity to address the gamut of possible trust forms and functions, from the traditional "business trust" wherein trustees operate an active business for the benefit of unrelated investors, on one hand, to the testamentary or family trust in which business property constitutes a part of the *res* of the trust, but the trustee manages the property for the benefit of non-investors chosen by, and perhaps related to, the grantor, which is clearly not a "business trust." A perfectly serviceable, generic and uncomplicated definition of "business trust" is found in In re Armstead and Margaret Wayson Trust, 29 B.R. 58, 59 (Bankr. D. Md. 1982), and provides as follows–

> A business trust has been defined as "an unincorporated business organization created by an instrument by which properties to be held and managed by trustees for the benefit and profit of such persons as may be or may become the holders of transferrable certificates evidencing the beneficial interests in the trust estate." Ann. 88 A.L.R.3d 704, 717. The business trust is a voluntary pooling of capital by a number of people who are the holders of freely transferable certificates evidencing the beneficial interests in the trust estate. The holders are entitled to the same limitation of personal liability extended to stockholders of private corporations. Because of the similarity, Congress has afforded the business trust the same privileges in bankruptcy as a private corporation.

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[26]Trusts that are not "business trusts" are not considered "persons" because "trust" is specifically named as a member of a group defined as "entities," the most comprehensive of groups identified in the Bankruptcy Code, while "business trust" is specifically named as a member of a select species of organizations called "corporations," which is itself a member of the society of "persons." See 11 U.S.C. § 101(9), (15) and (41). Section 101(15) states that "'entity' includes a person, estate, trust, governmental unit, and United States Trustee." A "person" is an "entity," but an "entity" is not necessarily a "person."

Id. (citations omitted). While the Series Trust fits this definition, other courts have imposed various glosses, restrictions, conditions, qualifications, provisos and requirements on the definition of "business trust." Thus, it is necessary to examine the bases for these impositions of judicial gloss on the term "business trust" and determine whether such qualifications hold up under scrutiny and whether they are pertinent to this case.

Most published cases that interpret the term "business trust" do so for the purpose of determining whether the entity is a "person" that may be a debtor in bankruptcy under Section 109 of the Bankruptcy Code. These cases are hardly uniform in isolating the distinctive attributes of a "business trust." See, e.g., Takemi Ueno, Defining a "Business Trust": Proposed Amendment of Section 101(9) of the Bankruptcy Code, 30 HARV. J. ON LEGIS. 449 (1993).

1. Active/passive distinction

One line of cases makes the distinction that "trusts created with the purpose of carrying on some kind of business" are business trusts while trusts designed merely to "protect and preserve the *res*" for beneficiaries generally are not business trusts. Shawmut Bank Connecticut v. First Fidelity Bank (In re Secured Equipment Trust), 38 F.3d 86 (2d Cir. 1994). This is the sole distinction that BOA makes between a business and a non-business trust.

Within this line of cases is In re Heritage North Dunlap Trust, 120 B.R. 252 (Bankr. D. Mass. 1990), in which the court concluded that "nominee trusts" which held real property were "merely a tax device for holding and preserving investment property while limiting liability, simplifying title transfers and preserving anonymity of beneficiaries." Id. at 253-54. In rejecting the debtors' argument that it was a "business trust" entitled to file a bankruptcy petition, the Heritage court relied heavily on the fact that the jurisdiction had a state statute that specified the "necessary requirements

for entities to be considered business trusts" and that the debtors had not complied with the statute. Id. at 254. The Court observed that the state statute

> recognizes the existence of business trusts as voluntary associations and imposes both rights and obligations. There must be a written instrument, transferable shares, recordation with the Secretary of State and with the Clerk in the very city or county where the trust has a place of business. Where the states tell you what you must do to be a business trust, that is what you must do!

Id. See also In re L & V Realty Trust, 61 B.R. 423, 424-25 (Bankr. D. Mass. 1986) (trust that failed to register or otherwise comply with Massachusetts business trust law was not a business trust). Because the Series Trust was established pursuant to the Delaware Business Trust laws (which, in September 2002, were renamed the Delaware *Statutory* Trust laws), BOA cannot take comfort in the "nominee trust" line of cases.[27] See also In re Medallion Realty Trust, 103 B.R. 8, 14 (Bankr. D. Mass. 1989), *aff'd*, 120 B.R. 245 (D. Mass. 1990) (nominee trust was determined to be a partnership rather than a trust).

Another case noting the distinction between active businesses and passive holding vehicles as potentially relevant to a determination of whether an entity is a business trust is In re Constitutional Trust # 2-562, 114 B.R. 627, 631 n.12 (Bankr. D. Minn. 1990). The bizarre facts of Constitutional Trust do not make a clear case for the proposition that a business trust must actively operate a business rather than merely hold and preserve the trust *res*. In that case, the debtor called itself a "revocable domestic trust" which was created by a trust-like entity that itself was purportedly

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[27] A "nominee trust" is a non-taxable entity, which generally is used to hold bare legal title to real estate. Essentially, the nominee trust acts as an agent for individual or entity beneficial owners. The beneficial owner(s) are the owners for income tax purposes and are subject to all income tax consequences arising from the action of the trustees. Roger Ritt & Michael Nathanson, "Choice of Business Entity: Certain Federal Income Tax and Other Considerations," SF 94 ALI-ABA 37, 44 (2001).

created under the Constitution of the Republic of Panama, whose trust document contained "a number of nonsensical and seemingly unrelated clauses concerning so-called Beneficial Interest Certificates, Privileged Recipient Interest, and Equity Credit Accumulation." Id. at 628. The trust document expressly stated that it should not "be deemed 'to be, or create, or evidence the existence of a corporation, de facto or de jure, or a Massachusetts Trust, or any other type of business trust.'" Id. The trustees of the trust were a husband and wife, and the only asset of the trust was the couple's residence. The couple created another trust to operate a machine shop that was located in the garage of the residence and which paid rent to the trust that held the residence. Id. at 629. The Court found that the debtor trust was not a business trust that was eligible for bankruptcy for several reasons, including because the trust document specifically disclaimed its status as a "business trust" and because the trust did not meet the requirements of a business trust under state law. Id. at 631. Further, the Court indicated that the trust did not transact any business and that the trust document itself stated that its purpose was "to hold title in trust property and protect and conserve such property until its sale, liquidation, or transfer." Id. at 632. The Court held that the trust was a tax shelter and "[t]o the extent that the debtor is transacting business, that business appears to be the evasion of the [couple's] taxes." Id.

The Constitutional Trust belongs in the category of trusts that are considered non-business trusts because they are personal estate planning vehicles. The Series Trust, on the other hand, is clearly a commercial rather than personal venture, and it clearly complies with the business trust laws in its state of registration. Thus, the Constitutional Trust case is not helpful to BOA.

Another case in which a court held that a non-operating trust was not a business trust is In re Treasure Island Land Trust, 2 B.R. 332 (Bankr. M.D. Fla. 1980). Again, however, the key element

upon which the Court relied in finding that the trust was not a business trust was the denial in the trust instrument of any intention to create a business trust. The trust document provided –

> The objects and purposes of this Trust shall be to hold title to the trust property and to protect and conserve it until its sale or other disposition or liquidation. The TRUSTEE shall not manage or operate the trust property nor undertake any other activity not strictly necessary to the attainment of the objects and purposes stated herein; nor shall the TRUSTEE transact business of any kind with respect to the trust property within the meaning of [the Florida business trust statutes], or any other law; nor shall this agreement be deemed to be, or create or evidence the existence of a corporation de facto or de jure, or a Massachusetts Trust, or any other type of business trust, or an association in the nature of a corporation, or a co-partnership or joint venture by or between the TRUSTEE and the BENEFICIARIES, or by or between the BENEFICIARIES.

Id. at 334-35. In holding that the trust was not a business trust, and thus not eligible for bankruptcy relief, the Court stated "[t]he Trust sought, at all costs, to avoid the registration requirements of the securities laws. Now that its form has proven inadequate for its intended purposes [because the SEC determined that the entity was required to register], the debtor seeks to abandon it and escape its consequences altogether." Id. at 335. Invoking estoppel, the Court refused to deem the land trust a business trust in light of the trust's contrary arguments to the SEC, the refusal to register as a statutory business trust, and the terms of its own chartering document. "In what might otherwise be a close question, the debtor's course of conduct since its inception causes the Court to refuse to permit the debtor to baldly deny the language of the trust instrument. Treasure Island Land Trust does not qualify as a business trust within the meaning of Section 101(8)(A)(v)." Id. at 336.

Again, this case does not lead to a conclusion that the Series Trust is a non-business trust. The Series Trust was explicitly created as a "business trust" under Delaware law. The Trust Agreement unequivocally states—

> It is the intention of the parties hereto that the Series Note Issuer [previously defined as the Series Trust] constitute a business trust under the Business Trust Statute and that this Agreement constitute the governing instrument of such business trust. . . . Effective as of the date hereof, the Series Owner Trustee shall have all the rights, powers and duties set forth herein and, to the extent not inconsistent herewith, in the Business Trust Statute with respect to accomplishing the purposes of the Series Note Issuer.

GREAT Series Trust 1998-B Trust Agreement, CFS App. A-8 at 5, § 2.6. Further, the Trust Agreement states its purposes and powers as follows—

> Section 2.3 Purposes and Powers. The purpose of the Series Note Issuer [previously defined as the Series Trust] is, and Series Note Issuer shall have the power and authority, to engage in the following activities:
>
> (a) to issue the Notes pursuant to the Series Indenture and to issue the Companion Certificate pursuant to this Agreement, and to sell the Notes and the Companion Certificate, to transfer and exchange the Notes and to pay interest on and principal of the Notes and the Companion Certificate;
>
> (b) to acquire the Trust Certificate, the Series Interest Rate Cap and a security interest in the Series Reserve Account, to make deposits to and withdrawals from the Series Reserve Account and to pay the organizational, start-up and transactional expenses of the Series Note Issuer;
>
> (c) to assign, grant, transfer, pledge, mortgage and convey the Series Indenture Property pursuant to the Series Indenture and to hold, manage and distribute to the Certificate Issuer [the Master Trust] pursuant to the terms of the Series Basic Documents any portion of the Series Indenture Property released from the Lien of, and remitted to the Series Note Issuer pursuant to, the Series Indenture;
>
> (d) to enter into and perform its obligations under the Series Basic Documents to which it is a party;
>
> (e) to establish and maintain Eligible Deposit Accounts in connection with the Series Basic Documents, in its own name or otherwise;

> (f) to engage in those activities, including entering into agreements, that are necessary, suitable or convenient to accomplish the foregoing or are incidental thereto or connected therewith; and
>
> (g) subject to compliance with the Series Basic Documents, to engage in such other activities as may be required in connection with the conservation of the Series Trust Property and the making of distributions to (or on behalf of) the Noteholders and the Certificate Issue as holder of the Companion Certificate.
>
> The Series Note Issuer is hereby authorized to engage in the foregoing activities. The Series Note Issuer shall not engage in any activity other than in connection with the foregoing or other than as required or authorized by the terms of this Agreement or the Series Basic Documents.

Id. at 2-3, § 2.3. Thus, unlike the trust instrument in Treasure Island, the Series Trust Agreement specifically declares itself as a business trust and sets forth business purposes and powers of the trust that extend far beyond mere holding and preserving a *res*.

BOA relies heavily upon Shawmut Bank Connecticut v. First Fidelity Bank (In re Secured Equipment Trust), 38 F.3d 86 (2d Cir. 1994), to support its argument that the relevant inquiry is whether the trust is an operating business or is merely a holding company.[28] Although the Court is not constrained to follow the precedent of the Second Circuit, the Court does find the Shawmut case useful in articulating two conflicting but equally supportable conclusions as to whether a trust put into service as a bankruptcy-remote structured financing vehicle is a "business trust" and therefore a "person" that may be a debtor in bankruptcy.

In Shawmut, a divided panel of the Second Circuit affirmed the dismissal of an involuntary petition filed against the Secured Equipment Trust of Eastern Airlines, which had been created as

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[28]BOA contends that the Shawmut case is the "only federal appellate decision" on this issue and that it supports BOA's position. BOA Response at 37. Since the briefing in this case closed, however, the Sixth Circuit Court of Appeals has decided In re Kenneth Allen Knight Trust (Brady-Morris v. Schilling), 303 F.3d 671 (6th Cir. 2002).

a part of a secured financing to segregate a portion of Eastern's fleet of aircraft as collateral. The trust issued $500 million in trust certificates to investors, purchased the aircraft from Eastern, and leased the aircraft back to Eastern. Id. at 87. The amount of rent paid by Eastern to the trust coincided precisely with the principal, interest and premium promised to the trust investors, and the payments were collected by the Collateral Trustee and passed through a Series Trustee to the investors on a periodic basis. Id. at 87-88. Upon payment of the trust certificates in full, title to the aircraft was to be conveyed to Eastern; upon default by Eastern, the Collateral Trustee could take possession of the aircraft in order to enforce the trust indenture. Id. at 88. The majority of the Second Circuit panel characterized the transaction as a secured financing rather than a true sale and leaseback. Id. at 87. After Eastern filed bankruptcy and defaulted on the lease, it sold some of the collateral for $230 million, which it paid to the trust, and surrendered the remaining aircraft to the trust. Id. at 88. The task of liquidating the returned aircraft fell to the Collateral Trustee, who hired counsel, consultants, and accountants to assist in a liquidation effort that was expected to take several years. Id. Three holders of trust certificates filed an involuntary chapter 11 petition against the trust, and the Collateral Trustee moved to dismiss the petition, arguing that the trust was not an eligible debtor pursuant to Section 109 because it was not a "business trust." Id. In reviewing the extant lower court cases on the issue of what constitutes a "business trust," two judges of the Second Circuit panel concluded that—

> [c]learly, most courts agree that a basic distinction between a business trust and other trusts is that business trusts are created for the purpose of carrying on some kind of business, whereas the purpose of a non-business trust is to protect and preserve the *res*. See, e.g., In re DeHoff Trust, 114 B.R. at 191; In re Faber Trust, 113 B.R. at 601; In re Treasure Island Land Trust, 2 B.R. 332, 334 (Bankr. M.D. Fla. 1980). Furthermore, while a trust must engage in business-like activities to qualify as a business trust, such activity, without more, does not necessarily demonstrate that a

> trust is a business trust. See In re St. Augustine Trust, 109 B.R. 494, 496 (Bankr. M.D. Fla. 1990). Other than these two general points, "[a] uniform body of law has not resulted . . . [and] [t]he decisions are, in fact, 'hopelessly divided.'" Cutler v. The 65 Sec. Plan, 831 F. Supp. 1008, 1014 (E.D.N.Y. 1993). Ultimately, each decision is based on a very fact-specific analysis of the trust at issue.

Id. at 89. The majority did not foreclose the possibility that a trust without a profit motive could be considered a "business trust," but found that profit motive was a factor to be considered nevertheless because "most corporations are established to generate a profit." Id. at 90.[29] The decisive factor, in the majority's opinion, was that the trust indenture made clear that the trustee's sole responsibility was to protect the certificate holders' security interest, and that any post-default business transactions taken by the trustee were merely incidental to the primary purpose of safeguarding the collateral. Id. at 90-91. Thus, the majority concluded that the trust was not a business trust eligible for bankruptcy protection. Id. at 91.

Judge Kearse dissented from the majority opinion, concluding that the trust's original purchase and lease of aircraft, and its later liquidation of aircraft, was a business in which the certificate holders invested, and that the trust met the requirements of a business trust under New York law. Id. at 91-92. Judge Kearse also rejected a restrictive view of what constitutes a business trust, noting that when the Bankruptcy Code was adopted in 1978, Congress intended to *expand* the universe of business trusts eligible for bankruptcy by deleting the Bankruptcy Act's requirement that

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[29]Several courts consider profit motive an elemental aspect of a business trust. See, e.g., Merrill v. Allen (In re Universal Clearing House Co.), 60 B.R. 985, 991 (D. Utah 1986) ("If the purpose [of the trust] is profit oriented, the trust is found to be an eligible trust."). Others reject the profit motive element. See, e.g., In re Affiliated Food Stores, Inc. Group Benefit Trust, 134 B.R. 215 (Bankr. N.D. Tex. 1991) (trust established to merely hold contributions to self-funded employee medical benefit plan and which contracted administration of the plan to a third party was nevertheless a business trust eligible for bankruptcy relief).

beneficial interests be evidenced by a written instrument. Id. at 92. She also disagreed with the majority's view that the formation of the trust was not motivated by the goal of making a profit.

> And though the majority seems to rely most heavily on the fact that any excess profits generated by the purchase-and-leaseback [after payment of the certificateholders] would be payable to Eastern, the Trust plainly was no eleemosynary entity. Its operations were intended to generate a return on certificateholders' investment in the Trust, and while the amount of that return was contractually limited, the certificateholders were still to receive their agreed profit. I fail to see why the agreed profit limitation should remove the Trust from the Code definition of corporation.

Id. at 93. Judge Kearse, therefore, considered the activities of the trust to be sufficiently active to render it a business rather than a passive receptacle for collateral, and thus believed that it was a business trust eligible for bankruptcy relief. Id.[30] The question for this Court is which view, if either, would the Tenth Circuit or United States Supreme Court have adopted if faced with the facts in Shawmut? Or would they reject the active/passive distinction entirely and establish a different test?

This Court notes that other entities that passively hold property for the benefit of investors are "persons" that may be debtors under Section 109. See, e.g., Franklin Savings Corp. v. Office of

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[30]As an interesting bonus, CFS submitted, as CFS App. F, a certified copy of the financing/trust document interpreted in Shawmut. The document is a "Secured Equipment Indenture and Lease Agreement" between the Indenture Trustee and Eastern (the "Indenture and Lease Agreement"). Despite the apparent similarities between the Shawmut case and this case, it is relevant to note that the Indenture and Lease Agreement was not formed or registered as a business trust under state law nor does it refer to the formation of any entity called a business trust, as the Series Trust does.

CFS also points out that in the Shawmut case, the trust certificate holders filed an involuntary bankruptcy against the "trust" embodied in the Indenture and Lease Agreement, but the Indenture and Lease Agreement does not specifically create a separate trust entity. Further, the court in the Shawmut case, like courts in other business trust cases, focuses on attributes that make a trust suitable to be eligible for bankruptcy relief, and does not have occasion to analyze the issue in the context of a subordination argument under Section 510(b).

Thrift Supervision, 213 B.R. 596 (D. Kan. 1997) (corporation that held only bank stock was eligible debtor); In re First Financial Enterprises, Inc., 99 B.R. 751 (Bankr. W.D. Tex. 1989) (corporation that was holding company of stock in insurance companies was an eligible debtor, even though insurance companies are specifically precluded from bankruptcy eligibility); Peoples Bankshares, Ltd. v. Dept. of Banking (In re Peoples Bankshares, Ltd.), 68 B.R. 536 (Bankr. N.D. Iowa 1986) (limited partnership whose only assets were shares of stock in five banks was an eligible debtor, even though banks are not eligible for bankruptcy relief).

Even a *dissolved* corporation, which obviously does not operate a business, is a "person" that may be a debtor under Section 109. See In the Matter of Quad City Minority Broadcasters, Inc., 252 B.R. 773 (Bankr. S.D. Iowa 2000). Cf. In re A Car Rental, Inc., 166 B.R. 869 (Bankr. S.D. Tex. 1993) (corporation that forfeited its corporate charter was not an eligible "person" after the statutory three year period allowed for winding up had expired). Indeed, a liquidating trust established as a successor to a debtor corporation has been recognized as a "business trust" entitled to reorganize under chapter 11. In re Cooper Properties Liquidating Trust, Inc., 61 B.R. 531 (Bankr. W.D. Tenn. 1986) (liquidating trust could be a debtor because it possessed the "powers and privileges of a private corporation" and was exercising the function of "winding up" the affairs of the grantor corporation); In the Matter of Captran Creditors Trust, 53 B.R. 741 (Bankr. M.D. Fla. 1985) (debtor liquidating trust was considered a business trust notwithstanding that the trust agreement stated that its primary purpose was to liquidate assets "with no objective to continue or engage in the conduct of a trade or business"); In re Tru Block Concrete Products, Inc., 27 B.R. 486 (Bankr. S.D. Cal. 1983) (under California law, "liquidating a corporation is considered doing business," thus liquidating trust was business trust).

The Sixth Circuit Court of Appeals recently adopted a "primary purpose" test, which gives lip service to the active/passive distinction, but the result adopted by the Court does not turn on that distinction, and in fact appears to be contrary to it. In summing up its holding, the panel stated—

> We are satisfied that the standard articulated in our prior opinion in this case is reasonably clear and workable, and reflects the intent of Congress. The standard consists in two propositions: first, "trusts created with the primary purpose of transacting business or carrying on commercial activity for the benefit of investors qualify as business trusts, while trusts designed merely to preserve the trust *res* for beneficiaries generally are not business trusts"; and second, "the determination is fact-specific, and it is imperative that bankruptcy courts make thorough and specific findings of fact to support their conclusions"--findings, that is, regarding what was the intention of the parties, and how the trust operated.

In re Kenneth Allen Knight Trust, 303 F.3d 671, 680 (6th Cir. 2002). The appellate court affirmed the bankruptcy court's determination that the primary purpose of the subject trust was to conduct commercial activity for its grantor/investor. The trust was created and managed by the grantor primarily for the benefit of himself and his daughters. The trust's principal assets were the grantor's personal residence and stock in a holding company that in turn held the stock of four subsidiary corporations that owned and operated real estate, fast food franchises and other businesses. The trust was essentially a *holding company* for the grantor's business enterprises; the trust itself did not operate any business, yet it was held to be a business trust.

The relationship between the Kenneth Allen Knight Trust and its operating "subsidiaries" is somewhat similar to the relationships between and among the Series Trust (the entity that makes distributions to investors), the Master Trust (which holds the income producing receivables), and CFS (the operating entity that collects the receivables). In both instances, the operations that generate revenues for the trust beneficiaries are two times removed from the trust being analyzed for

qualities of a business trust.[31] Notwithstanding the Sixth Circuit's articulated standard, this Court is not convinced that the active/passive dichotomy is the dispositive distinction between business trusts and non-business trusts.[32]

2. The Morrissey test

Some courts test an entity for characteristics of a business trust under the rules that were established by the United States Supreme Court in an income tax case, Morrissey v. Commissioner, 296 U.S. 344 (1935). See, e.g., Mosby v. Boatmen's Bank (In re Mosby), 61 B.R. 636, 638 (E.D. Mo. 1985), *aff'd*, 791 F.2d 628 (8th Cir. 1986); In re Star Trust, 237 B.R. 827, 831-32 (Bankr. M.D. Fla. 1999); In re Constitutional Trust # 2-562, 114 B.R. 627, 631 n.12 (Bankr. D. Minn. 1990).

In Morrissey, the Supreme Court held that a trust that was created to purchase and develop land for the benefit of those who had purchased interests in the trust was deemed an "association" that was taxed as a "corporation" under the tax code, rather than as a "trust," because of the trust's similarity in form and function to a "corporation." After rejecting the proposition that the degree of control exercised by the trust beneficiaries over the management of the trust was the decisive factor in differentiating a trust from an association (and thus a corporation), id. at 351-56, the Court examined congressional intent in including "association" in the definition of "corporation" for the purpose of the tax laws.

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[31]Using the Sixth Circuit's reasoning, the Series Trust is arguably an easier case for business trust status than the Kenneth Allen Knight Trust because the Series Trust has a pure business or commercial purpose while the Kenneth Allen Knight Trust possessed some characteristics of a family or estate planning trust.

[32]Even if the active/passive dichotomy survived close scrutiny, the Court concludes that the Series Trust falls within the "active business" category of trusts. See text on page 79-80, infra.

> 'Association' implies associates. It implies the entering into a joint enterprise, and, as the applicable regulation imports, an enterprise for the transaction of business. This is not the characteristic of an ordinary trust– whether created by will, deed, or declaration– by which particular property is conveyed to a trustee or is to be held by the settlor, on specified trusts, *for the benefit of named or described persons*. Such beneficiaries do not ordinarily, and as mere *cestuis que trust*, plan a common effort or enter into a combination for the conduct of a business enterprise. Undoubtedly the terms of an association may make the taking or acquiring of shares or interests sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons. But the nature and purpose of the co-operative undertaking will differentiate it from an ordinary trust. In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type trusts, but to provide a medium for the conduct of a business and sharing its gains. Thus a trust may be created as a convenient method by which persons become associated for dealings in real estate, the development of tracts of land, the construction of improvements, and the purchase, management and sale of properties; or *for dealings in securities or other personal property*; or for the production, or manufacture, and sale of commodities; or for commerce, or *other sorts of business; where those who become beneficially interested, either by joining in the plan at the outset, or by later participation according to the terms of the arrangement, seek to share the advantages of a union of their interests in the common enterprise*.

Id. at 356-57 (emphasis added). Thus, although the Court's description of business trusts gave examples of active businesses, it also found that "dealing with securities" was sufficiently active, and that the true distinction required the beneficiaries to voluntarily join and invest in the enterprise rather than be appointed by a grantor. The Court articulated the "salient features" that would render a trust analogous to a corporation for tax purposes as follows–

> A corporation, as an entity, holds the title to the property embarked in the corproate undertaking. Trustees, as a continuing body with provision for succession, may afford a corresponding advantage during the existence of a trust. Corporate organization furnishes the opportunity for a centralized management through representatives of the members of the corporation. The designation of trustees, who are charged with the conduct of an enterprise, who act 'in much the same manner as directors,' may provide a similar scheme, with corresponding effectiveness. Whether the trustees are named in the trust instrument with power to select successors, so as to constitute a self-perpetuating body, or are selected by, or with the advice of, those beneficially interested in the undertaking, centralization of management analogous

> to that of corporate activities may be achieved. An enterprise carried by means of a trust may be secure from termination or interruption by death of owners of beneficial interests and in this respect their interests are distinguished from those of partners and are akin to the interests of members of a corporation. And the trust type of organization facilitates, as does corporate organization, the transfer of beneficial interest without affecting the continuity of the enterprise, and also the introduction of large numbers of participants. The trust method also permits the limitation of personal liability of participants to the property embarked in the undertaking.

Id. at 359.

The Third Circuit followed Morrissey in finding that an "investment trust" was an "association" closely analogous to a corporation to render it taxable as a corporation. See Pennsylvania Co. for Insurances on Lives and Granting Annuities v. United States, 138 F.2d 869 (3d Cir. 1943), *cert. denied*, 321 U.S. 788 (1944). That Court stated that although the trust did not need to have all the attributes of a corporation in order to be taxed as a corporation, it was clear that "pure trusts, that is, trusts of the traditional pattern where property is conveyed by will, deed, or declaration to a trustee or is to be retained by the settlor on specified trusts for a certain term for the benefit of named or described persons" were not business trusts. Id. at 873.

In another tax case, Commissioner v. City Nat'l Bank and Trust Co., 142 F.2d 771 (10th Cir.), *cert. denied*, 323 U.S. 764 (1944), the Tenth Circuit, in examining the trust instrument of a similar investment trust,[33] held—

> The garment in which this trust is clothed makes it difficult to recognize any resemblance to a traditional trust. The trust clearly was engaged in the business of buying and selling securities for income and profit for its members. Its structure, while not identical to that of a corporation, was measurably akin thereto. Being an association in the nature of a corporation, it falls within the provisions of the act and is taxable accordingly.

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[33]These "investment trusts" differ from the Series Trust in that the investment trusts actively bought and sold securities, reaping profits from "playing the market," while the Series Trust holds securities that profit not from gains and losses on sales, but from interest.

Id. at 776.

The line of tax cases emanating from Morrissey are not particularly pertinent, however, because the peculiarities of tax law and policy are not congruent with bankruptcy law. For instance, whether a trust is actively engaged in a trade or business or is merely a conduit for passing through investment income to the beneficiaries is very relevant for taxation purposes because that distinction has become the benchmark for determining whether a trust is a taxable entity.[34] But for bankruptcy

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[34]For instance, the 1998 tax laws regarding trusts were summarized in a private letter ruling as follows:

> Sections 671 through 678 provide rules for determining when grantors of trusts and others are treated as substantial owners.
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> Section 671 provides that if the grantor or another person is treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust to the extent that such items would be taken into account in computing the taxable income or credits against the tax of an individual.
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> Section 677(a) provides that, in general, the term "trust" as used in the [Internal Revenue] Code refers to an arrangement whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries. In general, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.
>
> Section 301.7701-4(c) provides that an "investment" trust will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. See Commissioner v. North American Bond Trust, 122 F.2d 545 (2d Cir.1941), *cert. denied*, 314 U.S. 701 (1942). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets of the trust, will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders.
>
> A fixed investment trust is an organization in which a trustee holds the legal title to

eligibility purposes, taxability of the entity does not matter. Nor does taxability of an entity make any difference in determining whether the entity's investors, who assert a claim for securities fraud, should advance ahead of general unsecured creditors in the distribution line. Being a taxable entity, as opposed to a conduit, was not a prerequisite to being a business trust in 1926, when business trusts were added to the definition of "corporation" in the Bankruptcy Act. Therefore, although the Morrissey case contains language that clearly sets forth the attributes of a corporate-like entity, its progeny in the tax arena have no direct applicability to bankruptcy matters. See also In re Tru Block Concrete Products, Inc., 27 B.R. 486, 491 and n.8 (Bankr. S.D. Cal. 1983) (although IRC would not recognize the debtor as a business trust, "corporate taxation and bankruptcy do not share the same objectives and policies").

3. Attributes of a business trust

Then what are the essential elements of a business trust? Because "business trust" falls within the Code's definition of "corporation," it seems obvious that possessing corporate powers and attributes, such as the power to issue certificates of ownership[35] and the power as an entity to

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investment assets for the benefit of multiple beneficiaries. The trust is not actively engaged in a trade or business, but is merely a conduit for passing through the investment income to the beneficiaries. There must be no power to vary the trust's investments, because the power would allow the certificate holders to profit from buying and selling investment assets rather than from the investments themselves. See generally, Pennsylvania Co. for Insurances on Lives and Granting Annuities v. United States, 146 F.2d 392 (3rd Cir.1944); Commissioner v. Chase National Bank, 122 F.2d 540 (2d Cir.1941); Commissioner v. Bond Trust, 122 F.2d 545 (2d Cir.1941), *cert. denied*, 314 U.S. 701 (1942).

Private Letter Ruling 9810015 (1998).

[35]Although the Bankruptcy Code eliminated the requirement that a business trust issue transferable certificates, the power to issue transferable certificates is still relevant in assessing whether an entity has attributes of a corporation.

sue and be sued, and the attributes of continuity of existence, liability limited to the assets of the entity, centralization of management, and an existence that is created by authority of state law, are all germane in the determining whether a trust should be considered a species of a "corporation." The inclusion of business trusts in the statutory definition of "corporation" originated in 1926, when the Bankruptcy Act's definition of "corporation" was amended to include a "business conducted by a trustee, or trustees, wherein beneficial interest or ownership is evidenced by certificate or other written instrument." The definition was amended in order to recognize the similarity of statutory or common law business trusts to corporate entities. See Highway & City Freight Drivers, Dockmen and Helpers, Local Union No. 600 v. Gordon Transports, Inc., 576 F.2d 1285, 1290 (8th Cir.), *cert. denied*, 439 U.S. 1002 (1978). From 1926 until 1978 when the Bankruptcy Code was adopted, Bankruptcy Act § 1(6) provided that—

> "corporations" shall mean all bodies having any of the powers and privileges of private corporations not possessed by individuals or partnerships, and shall include limited or other partnership associations organized under laws making the capital subscribed alone responsible for the debts of the association, joint stock companies, unincorporated companies and associations, and *any business conducted by a trustee, or trustees, wherein beneficial interest or ownership is evidenced by certificate or other written instrument.*

City of Lincoln v. Ricketts, 297 U.S. 373, 374 (1936) (quoting 11 U.S.C.A. § 1(6)) (emphasis added). In Gordon Transports, *supra*, the Eighth Circuit reasoned that in enacting the 1926 amendment that added trusts to the definition of "corporation," "Congress meant to create a clear dichotomy between corporations and partnerships." Id., 576 F.2d at 1290.

Some courts have concluded that Congress intended to broaden, rather than restrict, the scope of trusts that may considered "corporations" when it replaced the above-emphasized clause in Section 1(6) with the words "business trust" and eliminated the requirement for certificates when the Bankruptcy Act was repealed and the Bankruptcy Code adopted in 1978. See, e.g., In re

Affiliated Food Stores, Inc. Group Benefit Trust, 134 B.R. 215, 217 (Bankr. N.D. Tex. 1991) ("Under the Act, only those trusts 'conducted by a trustee or trustees wherein beneficial interest or ownership [was] evidenced by certificates or other written instruments,' qualified to be debtors. The Code's deletion of the Act's documentary requirement removed a technical restriction on bankruptcy eligibility."). See also Shawmut v. First Fidelity Bank (In re Secured Equipment Trust of Eastern Air Lines, Inc.), 38 F.3d 86, 92 (2d Cir. 1994) (in dissent); In re Kenneth Allen Knight Trust, 303 F.3d 671, 679-80 (6th Cir. 2002); In re Medallion Realty Trust, 103 B.R. 8, 11 (Bankr. D. Mass. 1989), *aff'd*, 120 B.R. 245 (D. Mass. 1990) ("that [Congress] chose to make such a change [to delete the certificate requirement] is sufficient indication of a purpose to broaden the types of trusts which can qualify [to file bankruptcy]"); In re Gonic Realty Trust, 50 B.R. 710, 713 (Bankr. D. N.H. 1985) ("expanded protection given under the new definition [of business trust by eliminating the certificate requirement] is consistent with the remedial nature of the bankruptcy laws").

It is also self-evident that a "business trust" should have a business or commercial purpose rather than a family support or estate planning purpose. Testamentary trusts and trusts established for the benefit of someone chosen by the grantor are generally not deemed to be "business trusts," even if the trust operates a business. See, e.g., Mosby v. Boatmen's Bank (In re Mosby), 61 B.R. 636, 638 (E.D. Mo. 1985), *aff'd*, 791 F.2d 628 (8th Cir. 1986) (trust established by father for benefit of son which held property used for hog and poultry operations was not a business trust because its purpose was to preserve and protect assets for the benefit of the grantor's family); In re L & V Realty Trust, 61 B.R. 423 (Bankr. D. Mass. 1986) (trust established by two men for benefit of their wives was not a business trust in part because the wives did not contribute capital to the trust and thus were non-investing family member beneficiaries); In re Armstead and Margaret Wayson Trust, 29 B.R. 58, 59 (Bankr. D. Md. 1982) (although the trustees of a testamentary trust operated a business for

the benefit of beneficiaries, the trust was held to be a non-business trust because it was not created by a voluntary pooling of capital by investors holding transferable interests).[36] Cf. In re Kenneth Allen Knight Trust, 303 F.3d 671 (6th Cir. 2002) (trust established by grantor for the benefit of himself and his daughters was a business trust; grantor/beneficiary had contributed the trust assets and conducted the business activities and thus the beneficiary was in fact an investor in the trust).

In these cases, the distinguishing feature of a business trust, as compared to a family or estate-planning trust, lies in the identity and contribution of the beneficiary. The beneficiary of a business trust has a commercial relationship with the trust, and has invested capital in the trust in exchange for an undivided beneficial interest in the whole. The beneficiary of a family support or estate planning trust generally has not made a contribution to the trust, but is chosen by the grantor to receive the bounty of the grantor's generosity. A family trust can actively engage in business for the benefit of beneficiaries or it may merely hold and protect property— the level of its involvement in generating income is not relevant to its exclusion from the "business trust" category of entities.

In In re Medallion Realty Trust, 103 B.R. 8 (Bankr. D. Mass. 1989), *aff'd*, 120 B.R. 245 (D. Mass. 1990), Judge Queenan indicated that he would extend the definition of business trust to any trust that has a business purpose (as opposed to an estate planning purpose) in which its beneficiaries have invested. Placing the distinction between a business trust and a non-business trust in a historical context, Judge Queenan explained that –

> The bankruptcy law of this country, unlike that of England, has always barred estates from relief in bankruptcy. Under both the Bankruptcy Act of 1867 . . . and the Bankruptcy Act of 1898 . . . the courts construed the word "person" in the eligibility provision to exclude to estates. As explained in Adams v. Terrell, a principal reason

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[36]The Court in the Wayson Trust case reasoned that non-business trusts are not "persons" eligible for relief in bankruptcy court because such "trusts do not have a separate legal existence from the trustee." Wayson Trust, 29 B.R. at 59.

> for doing so was the view that state probate law provides an adequate framework for the administration of insolvent estates. The continued use by Congress of the word "person" in the law's eligibility provision indicates Congressional agreement with this reasoning. In denying general eligibility to trusts, Congress presumably viewed trusts, even those of the intervivos variety, as being much like estates in that they are typically enmeshed in an estate plan and are under the control of state probate courts.
>
> A trust which is not part of a settlor's estate plan presents different considerations. A probate court is not its traditional forum. Its beneficiaries are investors in a business enterprise rather than recipients of a settlor's largess. Congress obviously recognized these differences when in 1926 it amended what was then § 1(8) of the prior act to allow bankruptcy relief for "any business conducted by a trustee or trustees wherein beneficial interest or ownership is evidenced by certificate or other written instrument." This opened the door to the traditional Massachusetts business trust. Because of the restrictive language, eligibility continued to be denied to a trust whose creating instrument was the only document evidencing beneficial ownership. . . .
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> *****
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> One court has stated that the distinction should be between trusts "created for the purpose of carrying on some kind of business or commercial activity for profit and those created to preserve the trust *res*." In re Treasure Island Land Trust, 2 B.R. at 334. That dichotomy points in the right direction, but the test should be simpler–whether the trust was created to transact business for the benefit of investors. The latter test is certain to deny bankruptcy relief to the traditional donative trust created for the benefit of family members, a result which is consistent with both the history of estate ineligibility and what appears to be the core reasoning of most of the decisions. A distinction between the conduct of a business and the preservation of trust principal through investment, moreover, seems too fine for practical application, particularly where the trust invests in real estate.
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> I conclude, therefore, that Congress intended to permit bankruptcy relief for all trusts which are created for the purpose of transacting business and whose beneficiaries make a contribution in money or money's worth to the enterprise, without regard to whether the trust has characteristics of a corporation such as separate certificates of ownership.

Medallion Realty Trust, 103 B.R. at 11 (citations omitted). The trust in Medallion was found to be not a trust at all, but a partnership, because the so-called trustee was allowed to act only upon the direction of the majority of the beneficiaries, which created an agency relationship rather than a trust

relationship. Id. at 12. But, said the Court, "to the extent that the Debtor may be regarded as a trust, it is an eligible business trust." Id. at 14.

This Court finds Judge Queenan's analysis compelling. Insolvent trusts that can be administered by a probate court, such as estate-planning, family and testamentary trusts, have no need for bankruptcy protection. There is no principled reason that trusts that are created to accommodate the needs (tax and otherwise) of commercial investors, but that otherwise have attributes similar to corporate entities, should not be treated as such corporations in bankruptcy. And while it is obviously necessary to have an operating business in order to reorganize under Chapter 11 of the Bankruptcy Code, what purpose does it serve to limit the type of commercial trust that may be entitled to an orderly liquidation that Chapter 7 provides?

Thus, the Court concludes that, at a minimum, the essential characteristics that make a trust a species of corporation, and thus a "business trust" under bankruptcy law, are that (1) the trust possesses some of the attributes of a corporation; and (2) its beneficiaries have invested in or contributed capital to the trust. Other recurring themes in the catalog of "business trust" cases that may weigh in one direction or the other are: (1) whether the trust is in compliance with a state business trust law, (2) whether the purpose stated in the trust document precludes the trust from being a business trust (*i.e.*, through estoppel), and (3) the business or commercial purpose of the trust.

4. The Series Trust is a business trust.

The Series Trust was formed under and in compliance with the Delaware business trust statutes.[37] Series Trust Agreement, CFS App. Exh. A-8 at 5, § 2.6.[38] As a Delaware business trust,

[37]While it is undisputed that the Series Trust is a Delaware business trust, its designation as such and its organization under the Delaware domestic business trust law is not dispositive. As of

September 1, 2002, the Delaware legislature replaced all references to "business trust" in the Delaware Code with "statutory trust" and declared that any entity previously organized under the Delaware business trust statutes would now be referred to as a "statutory trust." See Del. Code tit. 12 § 3801 (2002). This revision was made for the specific "purpose of avoiding any implication that a trust formed under Chapter 38, Title 12 of the Delaware Code constitutes a 'business trust' within the meaning of Title 11 of the United States Code. Such amendments are not intended to result in any substantive change in Delaware law." Del. Laws, S.B. No. 412, ch. 329, synopsis (2002).

Accordingly, the "Definitions" article of the former Domestic Business Trust chapter of title 12 of the Delaware Code (now the "Domestic Statutory Trusts" chapter) states–

> The term "statutory trust" shall be deemed to include each trust formed under this chapter prior to September 1, 2002, as a "business trust" (as such term was then defined in this subsection). Neither use of the designation "business trust" nor a statement in a certificate of trust or governing instrument executed prior to September 1, 2002, to the effect that the trust formed thereby is or will qualify as a Delaware business trust within the meaning of or pursuant to this chapter, shall create a presumption or an inference that the trust so formed is a "business trust" for the purposes of Title 11 of the United States Code.

Del. Code Ann. tit. 12, § 3801 (2002). The revisions to the Delaware Code appear to reiterate what should be obvious: that the conclusion that an entity is a "business trust" for the purposes of determining an entity's right to seek bankruptcy protection cannot be dictated by state law, but rather is an issue of federal law. See Kenneth Allen Knight Trust, 303 F.3d at 678-79; In re Gurney's Inn Corp. Liquidating Trust, 215 B.R. 659, 661-62 (Bankr. E.D.N.Y. 1997) (whether an entity is a business trust, and thus eligible for bankruptcy relief is a question of federal law; "states have no right to open or close the door to federal bankruptcy relief").

In any event, even if the fact that the Series Trust is designated a Delaware business trust creates no presumption or inference that it is a "business trust" under the Bankruptcy Code, the fact that the parties chose the business trust form and complied with the Delaware business trust statutes remains relevant to the interpretation of the Series Trust Agreement, and in determining the intended purpose and function of the Series Trust. The Delaware business trust law in effect in 1998 was itself incorporated into the Series Trust Agreement. See Koval v. Peoples, 431 A.2d 1284, 1285 (Del. Super. Ct. 1981).

[38]Section 2.6 states, in relevant part–

> It is the intention of the parties hereto that the Series Note Issuer [the Series Trust] constitute a business trust under the Business Trust Statute and that this Agreement constitute the governing instrument of such business trust. . . . Effective as of the date hereof, the Series Owner Trustee [Wilmington] shall have all rights, powers and duties set forth herein and, to the extent not inconsistent herewith, in the Business Trust Statute with respect to accomplishing the purposes of the Series Note Issuer [Series Trust]. The Series Owner Trustee shall file the Certificate of Trust

the Series Trust possesses limited liability, one attribute of a corporation. See Del. Code Ann. tit. 12, § 3803 ("beneficial owners shall be entitled to the same limitation of personal liability extended to stockholders of private corporations for profit"); see also Series Trust Agreement at 5, § 2.7(b) (Noteholders have no personal liability for trust liabilities). Subject to the Basic Documents providing otherwise, the Series Trust Agreement provides for a Series Owner Trustee to provide central management of the trust, id. at 10, § 6.2, and for perpetual existence until its purpose is served (full payment of the Series Notes) or it is terminated consistent with the terms of the trust agreement, id. at 16-17, § 9.1. The Series Trust's beneficiaries (originally Kitty Hawk and Enterprise and others, but currently only BOA) contributed approximately $189 million in capital to the Series Trust in exchange for a Series Note, which evidences in writing the beneficiaries' investment in the Series Trust. Finally, unlike the trust agreement in the Treasure Island Land Trust case that emphatically denied that it was or should be deemed to be a business trust, the Series Trust Agreement specifically provides that "[i]t is the intention of the parties hereto that the Series Note Issuer constitute a business trust under the Business Trust Statute and that this Agreement constitute the governing instrument of such business trust." Id. at 5, § 2.6.

And again, the purposes and powers of the Series Trust are not limited to merely "preserving and protecting the *res*" as BOA claims. Section 2.3 of the Series Trust Agreement provides—

> Section 2.3 Purposes and Powers. The purpose of the Series Note Issuer [the Series Trust] is, and Series Note Issuer shall have the power and authority, to engage in the following activities:
>
> (a) to issue the Notes pursuant to the Series Indenture and to issue the Companion Certificate pursuant to this Agreement, and to

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substantially in the form of Exhibit B hereto with the Secretary of State of Delaware.

Series Trust Agreement, CFS App. Exh. A-8 at 5, § 2.6.

> sell the Notes and the Companion Certificate, to transfer and exchange the Notes and to pay interest on and principal of the Notes and the Companion Certificate;
>
> (b) to acquire the Trust Certificate, the Series Interest Rate Cap and a security interest in the Series Reserve Account, to make deposits to and withdrawals from the Series Reserve Account and to pay the organizational, start-up and transactional expenses of the Series Note Issuer;
>
> (c) to assign, grant, transfer, pledge, mortgage and convey the Series Indenture Property pursuant to the Series Indenture and to hold, manage and distribute to the Certificate Issuer [the Master Trust] pursuant to the terms of the Series Basic Documents any portion of the Series Indenture Property released from the Lien of, and remitted to the Series Note Issuer pursuant to, the Series Indenture;
>
> (d) to enter into and perform its obligations under the Series Basic Documents to which it is a party;
>
> (e) to establish and maintain Eligible Deposit Accounts in connection with the Series Basic Documents, in its own name or otherwise;
>
> (f) to engage in those activities, including entering into agreements, that are necessary, suitable or convenient to accomplish the foregoing or are incidental thereto or connected therewith; and
>
> (g) subject to compliance with the Series Basic Documents, to engage in such other activities as may be required in connection with the conservation of the Series Trust Property and the making of distributions to (or on behalf of) the Noteholders and the Certificate Issue as holder of the Companion Certificate.
>
> The Series Note Issuer is hereby authorized to engage in the foregoing activities. The Series Note Issuer shall not engage in any activity other than in connection with the foregoing or other than as required or authorized by the terms of this Agreement or the Series Basic Documents.

Id. at 2-3, § 2.3.

The Court finds that the Series Trust meets all the criteria of a "business trust," as those criteria have been established by various courts, including the requirement that some active business

be transacted. The Series Trust has a business purpose and a profit-motive (to earn and distribute interest to Noteholders); payments to investors constituting return of capital and interest were contemplated. Thus, the Court concludes that the Series Trust is a "corporation" under Section 101(9) of the Bankruptcy Code.[39] As a "corporation," the Series Trust is a "person" that may be an "affiliate" under Section 101(2)(C). Thus, the next inquiry is whether CFS in fact "operated" the business or "substantially all . . . property" of the Series Trust under the terms of an "operating agreement." 11 U.S.C. § 101(2)(C).

5. The Series Trust is an "affiliate" of CFS.

Although the Court finds that the Series Trust was a commercial enterprise that was sufficiently engaged in business, the definition of "affiliate" does not require the "person" to be actively engaged in business. Under Section 101(2)(C) of the Bankruptcy Code, a person is an affiliate either if its "business" is operated by the debtor *or* its "property" is operated by the debtor. Thus, the affiliate itself need not be an operating business; it may merely own and hold *property* which is "operated" by someone else. Subsection (C) presupposes that someone other than the affiliate, *i.e.*, the debtor, operates the business or the property.[40]

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[39]Even if the Series Trust was not a "business trust" as historically defined, it clearly complies with the elements of the first definition of "corporation" in Section 101(9)(A) of the Bankruptcy Code, which states that a "corporation" is an "association having a power or privilege that a private corporation, but not an individual or partnership, possesses." 11 U.S.C. § 101(9)(A)(i). The Series Trust possesses limited liability, transferable shares and centralized management—all attributes of a corporation that are not possessed by a partnership or an individual.

[40]It could be argued that the "business activity" prong of the test for a business trust should be even more relaxed when determining whether a trust should be classified as a business trust for the purpose of meeting the test of a corporation, thus person, thus affiliate under Section 510(b). In this case, the focus is on whether BOA's claim for rescission of the purchase of securities should be subordinated under Section 510(b), the intent of that statute being that investors in securities, rather than unsecured creditors, should bear the risk of fraud in the issuance of the securities. Because Section 510(b) was enacted to close a technical loophole in the bankruptcy law that allowed

In this case, the "property" of the Series Trust is a certificate representing an equity interest in a pool of Loans held by the Master Trust, among other property, and the "operation" that generates income for the holders of the Series Note (*i.e.*, interest) is the collection of the Loans, accounting operations that allocate the collections among various lockbox accounts for the ultimate benefit of the Series Note holders, and distribution of the collected funds, all of which are delegated to CFS (*i.e.*, the Servicer), albeit in obfuscating language. The Basic Documents appear to be designed to lead a casual observer to believe that the Series Trust is operated by a Series Owner Trustee who is entirely independent of CFS, when in fact CFS was contractually obligated to perform not only all duties of the Servicer, but also the obligations of the Master Trust and the Series Trust. The Series Owner Trustee, Wilmington Trust, held the Certificate. Virtually all other activities contemplated by the Series Trust were performed by CFS.

The GREAT Servicing Agreement (CFS App. Exh. A-7), as supplemented by 1998-B Supplement (CFS App. Exh. A-3), which was an integral part of the "Series Basic Documents" governing the relationship between and among CFS, the Master Trust and the Series Trust (see 1998-B Supplement at 8 (list of "Series Basic Documents")), disclosed CFS's role in the operation of the property of the Master Trust and by extension, the Series Trust. The GREAT Servicing Agreement

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defrauded investors to unfairly elevate the priority of their claims over creditors who did not assume the risk of fraud, it is a remedial statute that must be construed broadly in order to give effect to its purpose–that is, to close the loophole. See In re Permian Producers Drilling, Inc., 263 B.R. 510, 520 (W.D. Tex. 2000); In re Granite Partners, L.P., 208 B.R. 332, 341 (Bankr. S.D.N.Y. 1997).

The most relevant characteristics for the purpose of determining whether an entity is an affiliate of the debtor for the purpose of determining application of Section 510(b) are whether the trust issued securities, whether the trust had a business or commercial purpose rather than an estate planning or support purpose, and whether the beneficiaries are investors who voluntarily entered into a contractual relationship with the trust rather than beneficiaries chosen by a grantor with a donative intent. The level of business activity undertaken by the issuer of a security, however, is not relevant to implementing the policy of subordinating rescission claims of securities holders to avoid an unfair elevation of such rescission claims.

provided that CFS, through its affiliate SPC, transferred the Loans to the Master Trust and the Master Trust issued a security (a Trust Certificate) representing an undivided interest those Loans to the Series Trust, (GREAT Servicing Agreement at 2, § 2.3); the Master Trust appointed CFS to *operate its property*, that is, service all the Loans and "manage the Assets" of the Master Trust, including collecting on the Loans (id. at 9-10, § 3.1(a) and (b)), giving CFS "the full power and authority . . . to do or cause to be done all things in connection with" servicing, without consulting with or obtaining the approval of the Master Trust or any Trustee (id. at 10, § 2.3(c)); "to execute, deliver and file, in the name and on behalf of the [Master Trust]" instruments, documents or pleadings necessary to collect, settle, release or litigate with respect to the Loans (id. at 10, § 2.3(d)-(e); and then to perform all the accounting and banking functions necessary to properly allocate the moneys collected among various lockbox accounts to insure that collections of the Loans backing the Trust Certificate, which backed the Series Note purchased by BOA, were ultimately directed to the payment of the principal and interest due on the Series Note (id. at 11, § 2.3(g), and at 45, § 11.1). CFS also performed the monthly and annual reporting functions for the Master Trust (id. at 18, §§ 4.5, 4.7, and 30, § 6.6) and calculated, for each collection account, the total amount collected and all fees payable from each account to CFS for servicing and performing duties on behalf of the trusts, and to the Series Owner Trustee and the Series Indenture Trustee (id. at 30, § 6.6). CFS was to advise the Master Trustee and the Paying Agent of the amount to pay the Series Noteholders. Id. CFS also was responsible for calculating, preparing and delivering to the Noteholders a detailed monthly statement of collections and fees. Id. at 30, § 6.7. The Series Trust Agreement also provided that the Series Owner Trustee, that is, Wilmington Trust, specifically had "no obligation to administer, service or collect the Assets or to maintain, monitor or otherwise supervise the administration, servicing or collection of the Assets." Series Trust Agreement, CFS App. Exh. A-8

at 10, § 6.2. These were generally the duties of CFS as Servicer, operating the "property" of the Master Trust and Series Trust[41] in order to generate revenues that would ultimately result in a profit to the Series Noteholders. The Court concludes that because CFS "operated" substantially all of the property of the Series Trust "under an operating agreement," that being the GREAT Servicing Agreement and the Series Trust Agreement collectively, the Series Trust is an affiliate of CFS. 11 U.S.C. § 101(2)(C).

The Court also concludes that CFS was also obligated under the GREAT Servicing Agreement to operate the "business" of the Master Trust and Series Trust. Section 11.1 of the GREAT Servicing Agreement stated—

> Servicer shall perform all its duties and the duties of Certificate Issuer [Master Trust] under the Master Trust Agreement and each Series Note Issuer [Series Trust] under each Series Trust Agreement and shall consult with the Master Trustee and each Series Owner Trustee as Servicer deems appropriate regarding the duties of Certificate Issuer under the Master Trust Agreement and the duties of each Series Note Issuer under each Series Trust Agreement. Servicer [CFS] shall monitor the performance of Certificate Issuer and each Series Note Issuer and shall advise the Master Trustee and each Series Owner Trustee when action is necessary to comply with Certificate Issuer's duties under the Master Trust Agreement or each Series Note Issuer's duties under the applicable Series Trust Agreement. Servicer [CFS] shall prepare for execution by Certificate Issuer and each Series Note Issuer or shall cause the preparation by other appropriate Persons of all such documents, reports, filings,

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[41]The assets of the Master Trust and the Series Trust were consolidated for tax purposes and the Series Note was treated as a debt of the Master Trust rather than the Series Trust. The Series Trust Agreement states—

> It is the intention of the parties hereto that, for federal, state and local income and franchise tax purposes, the Series Note Issuer [Series Trust] will be disregarded as an entity separate from the Certificate Issuer [Master Trust] and the Notes will be treated as debt. The parties agree that unless otherwise required by appropriate tax authorities, the Series Note Issuer [Series Trust] will not file or cause to be filed, annual or other necessary returns, reports and other forms required for partnerships.

Id. at 5, § 2.6.

> instruments, certificates and opinions as it shall be the duty of Certificate Issuer or such Series Note Issuer to prepare, file, or deliver pursuant to the Master Trust Agreement or Series Trust Agreement. In furtherance of the foregoing, Servicer [CFS] shall take all appropriate action that is the duty of Certificate Issuer to take pursuant to the Master Trust Agreement or any Series Note Issuer to take pursuant to the applicable Series Trust Agreement.

Id. at 45, § 11.1(a). These duties included engaging in all activities set forth in the "Purposes and Powers" provision of the Series Trust Agreement (Series Trust Agreement at 2-3, § 2.3). The duties of the Series Owner Trustee included the execution of instruments, and oversight and approval if and when CFS notified the Trustee that CFS intended to perform a "non-ministerial" matter, that is – amend trust documents, initiate or compromise any litigation by or against the Series Trust, amend the Servicing Agreement, or change or remove any trustee or paying agents. GREAT Servicing Agreement at 45-46, § 11.1(b); Series Trust Agreement at 9, § 6.1. The Series Owner Trustee also maintained the Delaware office of the Series Trust in order to qualify as a Delaware business trust. Series Trust Agreement, §§ 2.1, 2.1, 2.4, 2.9, 3.8. But, the Series Owner Trustee was authorized, *but not obligated*, to take all actions required of the Series Trust, and was authorized to take action recommended by the Servicer, CFS, with respect to the Basic Documents. Id. at 9, § 6.1. The Series Owner Trustee was not obligated to perform the "actions required of the Series Trust" because those actions were the responsibility of CFS by virtue of Section 11.1 of the Servicing Agreement. Thus, the Court concludes that the Series Trust was a "person whose business [was] operated under . . . [an] operating agreement by the debtor" and therefore the Series Trust is an affiliate of CFS. 11 U.S.C. § 101(2)(C).

6. Application of Section 510(b).

> For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, . . . shall

> be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security . . . .

11 U.S.C. § 510(b). As set forth above, the undisputed facts show that BOA's Constructive Trust Claim is a claim arising from the rescission of its purchase of the Series Note, that the Series Note is a security of the Series Trust, and that the Series Trust is an affiliate of CFS. Subordination of the Constructive Trust Claim is therefore mandatory.

VII. Conclusion

For the reasons stated above, summary judgment is granted in favor of CFS and against BOA on CFS's Section 510(b) subordination defense. The Constructive Trust Claim is therefore subordinated below Class 5 claims and is determined to be a Class 6 Claim.

SO ORDERED this 11th day of July, 2003.

Dana L. Rasure

DANA L. RASURE
UNITED STATES BANKRUPTCY JUDGE

Exhibit 12

John J. Slain & Homer Kripke,
***The Interface Between Securities Regulation and Bankruptcy – Allocating the Risk of Illegal Securities Issuance Between Securityholders and the Issuer's Creditors*,**
48 N.Y.U. L. Rev. 261 (1973)